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Durban Investment Promotion Agency

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Durban's Super 7 are the seven key reasons Durban is attractive to Business and Leisure visitors. The acronym, 'ALL HITS' has been coined for easy recall.

1. **A**ward-winning Municipality. We have the best run and financially strongest local government on the continent. Awards are bestowed through the likes of the Vuna awards – recognising Durban as being the best-run city in South Africa, with 18 500 employees. International credit rating agencies have given us investment grade credit ratings of AA+ off a budget of over R23Bn ($2,5Bn) per annum. We have a huge, expanding fibre-optic system to really make Durban *THE* Smart City. We also have one of the lower cost/higher benefit baskets of rates and services levies across the major centres in South Africa.

2. **L**ifestyle of business, sports and event pleasure ***together.*** This is a place to live, work and play. You might have other centres that are dominated by business, but perhaps not as blessed as we are with a sustainable lifestyle, sporting events and sense of pleasure. You might have other places that dominate on lifestyle and pleasure, but don't have a huge business side to them in terms of manufacturing or infrastructure profile. The emphasis for us is on the word 'together', it's the two complementary halves, the business or career half and the social, sporting and lifestyle-family side.

3. **L**argest Human Resources base. At the heart of one of SA's most populace Provinces (KwaZulu-Natal), we have large pools of skilled, semi-skilled and unskilled labour, plus some of the best and fastest Skills Development taking place amongst our 3,5 million cosmopolitan population. We have Africa's second largest direct contact University based in Durban, the University of KwaZulu-Natal, with more than 45 000 direct contact tertiary students of Black African, Asian and European descent.

4. **H**ighest growth rates. Our economic growth rates are higher than the country's average, and that of the other major centres, historically being in the region of +/-6%. We're targeting in the range of 7,5% - 9%. This impacts positively on business confidence levels, fixed capital formation, etc. As most analysts would observe, "the trend is our friend" in Durban.

5. **I**nfrastructure Leader. We have the continent's leading infrastructure base. This includes virtual infrastructure like globalised financial services, plus the physical infrastructure base. We have the best electricity distribution on the continent, a vast roads network, the best and biggest water treatment and supply base, telecommunications via expanding City fibre-optics, and land. We have reasonable amounts of available vacant land at realistic prices across our 2 300 square kilometre city. At our infrastructure heart, Durban leads the continent in terms of port infrastructure, with Africa's busiest harbour, plus the massive new international airport nearing completion for 2010.

6. **T**ourism Crown. Durban is the largest domestic tourism destination in South Africa, plus we have concrete projects in place to become one of the largest international tourism destinations. This is done through an 'event-led' tourism drive across both business and pleasure tourism. Our International Convention Centre has been rated by the global association as Africa's best convention centre for the past seven years running. We have recently spent nearly half a billion Rand in terms of further expanding its footprint. On the leisure front, we have recently hosted high profile events such as the A1 Grand Prix where the global organisers and competitors rated Durban as the best host City. This event-led tourism build-up is clearly focusing on our 2010 FIFA World Cup event, with the associated infrastructure upgrades (R15Bn+), the build-up events such as FIFA Beach Soccer World Cup and life after 2010, with our eyes on the Commonwealth Games and 2020 Olympics.

7. **S**ubstantial, successful, sustainable business base already in place across the primary, secondary and tertiary sectors. It's a case of functional magnetism – companies like to be located synergistically, with more than 65% of the Province's GGP produced in Durban, along with the Durban Chamber of Commerce being the largest Metro Chamber nationally. Business is clustered around the manufacturing, tourism, services, maritime, logistics and agricultural industries. Having the second largest business and industrial base in SA provides many options for suppliers, support services, customers and employees, which are all important factors of production.

These are the 'ALL HITS' Super 7 key reasons that make Durban attractive to both residents and visitors alike.

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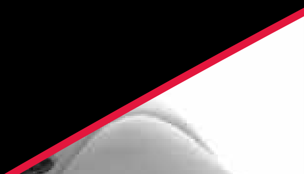

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The Season for Financial Summitry Is Upon Us

The season for financial summitry is upon us. There will be promises to prevent a crisis ever happening again and talking up of the nascent recovery in the global economy. We can look forward to the G20 summit at the end of September and the IMF-World Bank annual meetings in October. The leaders will take stock of the progress made and discuss further actions to assure a sound recovery from the global economic and financial crisis. Their piety will seem genuine.

There will be talk about the global origins of the crisis – "not in my back yard" – and about the "social" function of finance, and the Tobin tax on financial transactions. They will insist on further regulation on the banking industry and not remind themselves of their own regulatory failures. Economists will explain how the crisis is over, forgetting their previous predictions (in July a letter was sent to the Queen, apologising for "...the failure to foresee the timing, the extent and severity of the crisis and to head it off, while it had many causes, was principally a failure of the collective imagination of many bright people, both in this country and internationally, to understand the risks to the system as a whole").

Here we need to pause. The financial crisis should teach us not to have blind faith in economic and financial models ("Lies, damned lies, and statistics") that entrench a populist view, whether it is in finance or on climate change. Computer models make predictions that are determined by the information and assumptions that are fed in. If the maths is wrong, the answers will be wrong and the policy based on the answer will be wrong. If something, for example toxic mortgages turned into risk-free investments, is too good to be true, common sense says that it is too good to be true. There was, and never will be, market perfection.

There are plenty more short-term challenges facing the G20 leaders and this autumn's summiteers. One is sustaining the recovery, and making sure it doesn't get killed by every government withdrawing their stimulus all at once. Have the rescue measures deployed by governments around the world in the last year created new problems for the future, whether by creating a new crisis or by leaving lasting distortions in economies?

Central bankers and finance ministers have been deferring action on tighter regulation or bigger capital requirements for fear of discouraging banks from lending money at the time the economies need it. This will not and should not last. Reform of public spending and increased taxes are inevitable. Growth inevitably will be curtailed.

Another issue to consider is transparency of the financial system. Regulators were lax in spotting banks hiding the securities they traded in off balance sheet investment vehicles. They didn't know the risks the banks were incurring (to be fair, neither did the management of the banks). Some of this problem has been dealt with, but how much? Without international agreement on transparency the problem shall remain.

The autumn summits hopefully will provide solutions. Otherwise, the recent rush of confidence will prove a short revival. As Keynes famously observed, monetary policy can be as ineffective as pushing on a string when an economy has been drained of all its confidence. ■

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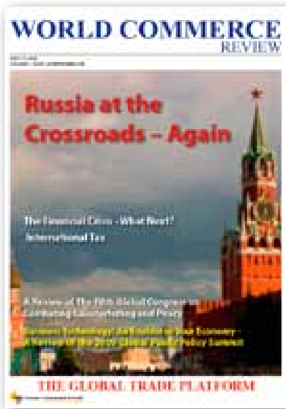

WORLD COMMERCE REVIEW
Russia at the Crossroads – Again
THE GLOBAL TRADE PLATFORM

Russia at the Crossroads – Again

Dr Fraser Cameron is the Director of the EU-Russia Centre, an independent information and expertise resource for anyone interested in the relationship between the EU and modern Russia

"Russia has to make some very difficult decisions. They have a shrinking population base, they have a withering economy, they have a banking sector and structure that is not likely to be able to withstand the next 15 years, they're in a situation where the world is changing before them and they're clinging to something in the past that is not sustainable."

These remarks by US Vice President Joe Biden in an interview with *The Wall Street Journal* in late July touched a raw nerve in Russia. But to his credit, President Dmitry Medvedev, admitted that Russia could not continue as it had in the past. He told a party meeting that the Russian economy had 'crumbled' as the global crisis hit. *'We cannot develop like this any further. It is a dead end. We will have to make decisions on changing the structure of the economy. Otherwise, our economy has no future.'*

There is little doubt that for the 'dream team' of President Medvedev and Prime Minister Vladimir Putin crunch time is fast approaching. Despite official optimism, economic growth is sharply down, unemployment is rising fast and reserves are falling steadily as the Kremlin tries to defend the rouble and prop up both private and state-controlled industries and banks. The Kremlin's war chest is vanishing fast as the budget deficit rises to nearly 10% this year. Major infrastructure projects are being delayed and there is evidence of mounting social unrest. To many, last month's catastrophic accident at the water power plant Sajano-Sushenskaja is symbolic for the lamentable state of the Russian power industry. Western capital is pulling out, often citing the absence of the rule of law in Russia as a principal reason. The danger of growing protectionism is clear, as evidenced by the wavering over Russia's WTO membership bid.

Normally when things go bad in Russia the President fires the Prime Minister, but one does not have to be a Kremlin specialist to understand that this is not an option for Dmitry Medvedev. There is zero chance of Vladimir Putin being sacked, even though he must shoulder much of the blame for the parlous state of the Russian economy. At the end of his eight years in the Kremlin, Russia was as much dependent on oil and gas revenues as in 2000. Russia's share of global GDP is a static 2.5%, almost a tenth of the EU. Apart from energy, there is little that the world wants to buy from Russia.

Despite the image of strong leadership, Putin was actually a weak leader in terms of setting and achieving goals for Russia as a modern state closely integrated into the world economy. Buoyed by high oil prices, (over $140 a barrel towards the end of his presidential term) Putin took the easy way out. Instead of confronting the bloated bureaucracy and other vested interests, he sought popularity by distributing some of the largesse from the sale of hydrocarbons. Wages of officials and employees of huge state corporations increased, but there was no increase in productivity and no attempt to tackle enormous social problems ranging from a crumbling healthcare system (and one of the highest HIV/Aids rates in the world), widespread alcoholism, a growing rich-poor divide, a derisory pension system and a lack of modern infrastructure. The demography statistics are also worrying. The Russians are literally dying out with the average male failing to live until sixty. As Putin himself has admitted, Russia suffers from low productivity, poor energy efficiency and widespread corruption. But all these problems worsened during his watch. Furthermore, nothing was done to promote the rule of law. Indeed the Yukos case revealed only too clearly that the judiciary serves the Kremlin's political and economic interests, and opened the way to dozens of similar, though less public, cases.

Recent years have also seen a reversal to state control of all major sectors of the Russian economy. It is difficult to see how such moves can help increase productivity. As Medvedev admitted: *'The state system is weighed down by bureaucracy and corruption and does not have the motivation for positive change, much less dynamic development.'* Last month, Medvedev ordered a probe into the activities of some of the major state-controlled companies, many of which were set up in the last year of Vladimir Putin's presidency, and which have swallowed up tens of billions of roubles of state funds. The president's move followed demonstrations by workers from the country's biggest car plant, AvtoVAZ, part of one of the biggest state corporations, Russian Technologies. The president also fired the boss of the conglomerate, Sergei Chemezov, from his role as an advisor in the commission to oversee the modernisation of the Russian economy.

One of the most worrying statistics is that in 1991 there were 300,000 bureaucrats in Russia. Today there are four times as many. Another trend of concern is the monopoly of political power and the absence of any checks and balances. The political scene is far less open and democratic than it was in the 1990s. When Medvedev took over in May 2008 there were hopes that he could bring about change. In particular, the new president had emphasised the need to tackle 'legal nihilism' and involve civil society more. But apart from a few conciliatory gestures such as giving an interview to *Novaya Gazeta*, the newspaper that employed the campaigning journalist, Anna Politskaya who was brutally murdered two years ago, there have been no noteworthy changes. In nearly all international assessments of transparency and governance, Russia comes out poorly. If one judges a state by its ability to serve the people and protect them from the powerful, including itself, then Russia is ineffective. Putin may have increased the power of the Kremlin, but he has not helped create a modern responsive state apparatus.

So where does Russia go from here? Analysts point to the two camps fighting for control of policy. The first camp, including the siloviki (the military-security complex) argues that as Russia is facing many threats, it must continue down an authoritarian and protectionist path. They contend that there is no need for Russia to join the WTO and that restrictions on foreign investment in Russia should remain. The second camp argues that if Russia is to become a competitive economy, it has no choice but to open up to the world, join the WTO, and become a more liberal society with strong institutions providing for checks and balances. At present the first camp looks stronger than the second, reflecting entrenched interests in key economic sectors and a bloated bureaucracy. While Medvedev is believed to favour the second camp, Putin has kept his options open. He remains the decisive figure in Russian politics and plays the role of mediator.

The EU could play a key role in assisting the modernisation of the Russian economy. With its nearly 500 million consumers, the EU has the largest and most attractive internal market in the world – and Russian companies want a slice of this cake. Europe pays top rates for Russian energy and Gazprom gets 70% of its profits from sales to the EU. The EU takes nearly 60% of total Russian exports (the US only 5%). The EU is the most important player in the WTO and can facilitate Russian accession. Despite the recent mixed messages from Moscow on the WTO, there is little doubt that Russia's accession would encourage a stronger, rules-based, international trading system. This would be to Russia's long-term advantage, for example, in facing up to the Chinese economic threat, something that is viewed with increasing concern in Moscow. At present, the negotiations between the EU and Russia for a new strategic agreement are proceeding steadily at the technical level. There have been five rounds so far, both sides have a better understanding of each other's aims and a number of chapters have

been provisionally closed. But difficult issues such as energy and visas remain to be resolved.

On energy, there are very different views on pipelines, pricing and access to markets. The constant disputes between Russia and Ukraine that have affected millions of EU consumers has dented Russia's image as a reliable energy supplier. Russia is also unwilling to be bound by international rules in this sector. Although it signed the Energy Charter, it has not ratified it, and Putin recently announced that Moscow intends to withdraw from the Charter. The bottom line, however, is that the EU and Russia have a shared interest in a reliable framework that regulates supply and demand. It should not be impossible to negotiate a deal that satisfies the interests of both parties.

What are the prospects for Russia now? According to Elvira Nabiullina, economy minister, there are signs that the pace of economic decline is slowing. The economy ministry forecasts overall gross domestic product contraction of 8.5 per cent this year, with growth resuming in 2010 but at only one per cent. The economy ministry's revised forecast for annual inflation is still high, at 12.5%, but down from 13.3% last year. Increased revenues owing to higher oil prices are yet to find their way into the rest of the economy as the banking system remains paralysed by fear over the growth in bad loans. Overall lending has fallen each month this year. Profits at Sberbank, the state-controlled savings bank, plummeted 98% in the first quarter. The central bank predicts that bad loans might reach 12%, a level that would wipe out bank profits. But bankers say they could reach as high as 20% of credit portfolios. Russia is still debating how to fund growing budget deficits. The government is expected to rack up a budget deficit of 7.4% of GDP, and 7.5% next year, above the 5% it originally planned for 2010.

Against this background, the liberal camp argues that the way forward lies in the establishment and effective application of a legal framework which would guarantee the protection of private property, apply strict antitrust policies, allow free competition and promote global integration. As Russia's economy is increasingly dominated by a small group of powerful companies with ties to the Kremlin, efforts to achieve these goals will not be easy. In addition, financial sector reforms are needed to ensure that the banking system serves the entire economy and not just the major players. In July, the IMF highlighted serious concerns about the financial system, warning that the central bank should be more willing to compel bank closures and consolidation. Structural problems and labour mobility also need to be tackled. The reliance on hydrocarbons has shown how dangerous it is to set so much store in one sector. More effort is needed to reduce employment in the public sector by helping people find work elsewhere in the economy. Incentives to promote labour mobility will be best served by higher investment in the transport infrastructure and education. Russia also needs to tackle its social problems that could impact negatively on economic development. If Medvedev and Putin can achieve even half this agenda then maybe they can call on Joe Biden to eat his words. ■

From One Crisis to Another? The Importance of Continuing Investment in Energy

Hanni Rosenbaum and Jonny Greenhill work at BIAC, the Business and Industry Advisory Committee to the OECD

For many companies around the world, the current financial and economic crisis signifies a time to save, not to invest. Companies are forced to make cutbacks and survive long enough until the economy begins to recover. However, while investment cutbacks are often necessary as a survival mechanism, reducing investment in the energy sector could seriously undermine broader economic recovery in the longer term, particularly in the context of rising energy demand and the growing importance of addressing climate change. On the contrary, the current crisis should be seen as an opportunity to reinvigorate investment. We therefore argue that investment in the energy sector must be helped back on track, and that will require major and urgent efforts from both the public and private sectors.

Investment urgently needed to cope with rising demand

The financial and economic crisis has hit the energy sector at a time when the sector is already facing other major worries. Two deep-rooted and long-lasting trends that will cast a long shadow on the sector's future are rising energy demand and rising energy-related carbon dioxide emissions.

The International Energy Agency (IEA) has estimated that, based on current government policies, global demand for primary energy will grow by 45% between 2006 and 2030, requiring US $26 trillion of cumulative investment[1]. This is particularly important for countries where many existing oil and gas basins are drying up, necessitating further exploration and infrastructure development. Meanwhile, global energy-related carbon dioxide emissions are set to also grow by 45% in this timeframe unless new policies are put in place.

Major inflows of investment in the energy sector were therefore already desperately needed before the current financial and economic crisis gripped the global economy. The crisis, however, has made things even worse. It has led to serious investment cuts in the energy sector, which does not bode well for governments' efforts to tackle rising energy demand and carbon dioxide emissions.

The consequences of the crisis for energy investment

Since the crisis began to weigh on the global economy, investments in the energy sector have been drying up. The IEA estimates that global upstream oil and gas investment budgets for 2009 have been slashed by over 20% compared with 2008, signifying a reduction of almost USD 100 billion[2]. And despite countries' efforts to switch to "greener" energy sources, investment in renewable energies is estimated to fall by as much as 38% in 2009.

All of this spells major problems for addressing the general trends of rising energy demand and carbon dioxide emissions. The crisis is resulting in delays or blocks on new fossil fuel extraction projects, refineries, pipelines, grid expansions and power plants, as well as delayed deployment of more energy-efficient equipment. Several planned major upstream oil and gas projects have been recently postponed or cancelled due to fewer funds for exploration.

As for renewable energies (such as solar, wind, biofuels, etc.), most have been rendered less competitive due to the lower costs of fossil fuels, thus deterring investment in these areas. Meanwhile, less investment into the research and development of cleaner, emerging energy technologies will delay their entry onto the market. Furthermore, energy consumers are reportedly delaying paying for new energy-efficient equipments, buildings and appliances, as lower incomes and lower energy prices act as counter-incentives.

On the other hand, however, the crisis is expected to have reduced energy demand for 2009, the first annual decline since the end of the Second World War. At a time when companies are cutting back, this drop may come as a slight reprieve, putting less strain on existing capacity in order to meet demand. But this calmer period should be exploited to invest in future production and infrastructure that will be much-needed when the economy (and energy demand) rebounds, particularly as some resource-rich countries may now feel more in need of foreign investors. Failure to invest could lead to another episode of escalating energy prices in a few years time, which could impede the overall recovery of the global economy.

Barriers to investment in energy need to be urgently addressed

If countries are to reverse the downward fall in energy investment and seize new opportunities, they must identify and remove the barriers to investment.


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One of the obvious barriers is the lack of available credit. Financially-stretched projects and companies have had to scale-back. This predominantly impacts small- and medium-sized enterprises, which often experience more difficulty in gaining access to credit and many of which have had to sell out to more established enterprises. Many banks have also shortened the period for loan payments (some only allow five years or less), making long-term financing for infrastructures particularly difficult.

Meanwhile, the turbulent and unpredictable energy markets have led many venture capitalists and private equity investors to pull out from projects. Falling energy prices (particularly oil) have made new investments in production facilities less profitable, while investment costs have generally remained high. This creates an unattractive investment environment.

In addition, lack of policy predictability in some countries acts to significantly deter investors, particularly as energy projects are often long-term in their nature. Choosing winners and losers and engaging in a "subsidy race" between countries or sectors is also detrimental to investment and the diversification of energy sources. Similarly, continued discrimination by some countries towards foreign investing companies is reportedly deterring much-needed investment in energy infrastructure. Other barriers include administrative hurdles, poor grid planning, lack of information, and social acceptance issues, concerning, for example, nuclear energy, carbon capture and storage, biofuels, and so on.

Build the right policies to boost energy investment

In the short-term, governments can play an important role by boosting investment in the energy sector, as the private sector is still reeling from the impacts of the crisis. However, in addition to allocating public funds to "kick-start" investment in the energy sector, the main role of governments should be to remove investment barriers and create a policy framework that encourages private sector investment in the energy sector.

Achieving the right balance of public funding is not an easy task. Public sector investment should follow market principles and help create the necessary enabling environment for private investment which will follow once economic recovery begins to pick up or once investment barriers are removed.

However, public sector investment should not distort market competiveness. Long-term public subsidies for certain types of energy production need to be carefully evaluated and eventually removed where market distortions occur. Similarly, public subsidies for the use of energy by consumers in some countries are often not consistent with the goal of achieving energy efficiency or achieving effective energy pricing systems.

The idea for the public sector to invest in the energy sector during the crisis is not new – many government stimulus packages have already included funds directed at clean energy and energy-efficiency, totalling USD 100 billion to date[3]. Yet much more will need to be done in order to meet energy supply and climate change objectives.

Governments' resources, however, are also limited, and their public funding will only go so far. The key to improving investment in the energy sector will eventually come from enabling the private sector. The role of governments should thus be to introduce policies that tackle the barriers to investment and offer incentives for the private sector to pursue certain projects. Governments should improve the access to credit, particularly for small- and medium-sized enterprises, and in the context of the current crisis should consider the use of loan guarantees, clean energy bonds, and tax incentives.

An enabling policy framework should also include the following: a system of government whereby a reliable and transparent framework of laws provides a common and stable foundation to promote law and order and justice via due process; an economic system promoting individual business/property rights and freedom of entry; markets where barriers to entry are few and primarily defined by an enterprise's competitive/financial capabilities; and a free market approach to determine solutions and prices to consumer, supplier, investor or government objectives.

Policies should look to the long-term with a view to providing more stability and predictability for private sector investors. They should also consider the full range of possible energy options, including fossil fuels, renewables, nuclear energy, etc. in order to maximise energy security. Public-private partnerships will be crucial for boosting energy investment, and business as well as other key stakeholders should be thoroughly consulted when forming national energy policies.

Addressing climate change must remain a key objective

While it will be essential to boost investment in the energy sector to meet demand, it is crucial that new investment also functions to address climate change. The crisis has had a worrying impact on investment in the "cleaner" energy and energy-efficiency technologies, undermining some efforts to reduce carbon-dioxide emissions. Projects dependent on these technologies are currently receiving less investment, as their markets are less proven and as financial resources are scarce. In addition, falling fossil fuel energy prices have meant that renewable energies are becoming less competitive vis-à-vis fossil fuel alternatives. In such an environment, investors are often less keen to invest in the energy efficiency market if it is perceived as too risky. However, in view of the immense challenges we are facing in trying to tackle climate change, such investments are crucially needed.

In light of the crisis, it is therefore more important than ever to carefully target investments and to seek ways to enhance efficiencies. In view of rising emissions, there is a need for breakthrough technologies, which require global cooperation and support for research and development. Public-private partnerships for technology cooperation and capacity building should be encouraged. At the same time and as illustrated by a number of IEA studies, investment in energy efficiency holds major potential for reducing carbon-dioxide emissions and should remain a top priority for policy makers and the private sector.

Despite the negative impacts of the crisis on the world's efforts to address climate change, and in view of the upcoming Climate Change Conference in Copenhagen, policy makers and business need to remain committed to addressing climate change as a top priority. This should be reflected in their long-term investment decisions.

From one crisis to another?

The impacts of the current financial and economic crisis on the energy sector have been profound. Investment in the energy sector is suffering, further intensifying the already-existing problems of rising energy demand and carbon dioxide emissions. Yet new investment opportunities should be sought. Short-term crisis-related funds will be necessary and will help, but they will only go so far. Governments and business must also work together to revitalise investment with a post-crisis vision. These efforts will only work if they are built on a bedrock of enabling policies that mobilise and encourage private sector investment. If not, there could be yet another crisis on the horizon. ■

1. International Energy Agency (IEA) 2008 World Energy Outlook.
2. IEA (2009) "Launching an Energy Revolution in a Time of Economic Crisis: the case for a low-carbon energy technology platform".
3. IEA Press Release "IEA says that G8 call for increased investment in energy supply, energy efficiency and low-carbon technology is timely and urgent". July 9, 2009.

Restoring Confidence and Creating Resilience in the Global Financial System

Charles Dallara is the Managing Director of the Institute of International Finance

Today, as the global financial crisis enters its third year, there is evidence of a restoration of financial stability. At the same time, there is a need for far-reaching regulatory reforms to reinforce the financial services industry's efforts to strengthen the global financial system. The key is to restore confidence in and stability of the financial system. This is imperative, above all, to secure well functioning financial markets that are essential for sustaining global economic growth.

In the wide-ranging debates in many countries over regulatory reform of the financial system, there has largely been insufficient attention to efforts that firms themselves have made to take the lessons learned from the crisis and implement operational and governance reforms that, as I believe is already becoming increasingly apparent, are contributing to healthier institutions. Before discussing the public sector's approaches to regulatory reform, therefore, I believe it is useful to look at what the industry has been doing.

As the crisis started in the second half of 2007, leaders of the world's largest financial services firms agreed to establish a special committee on market best practices in the Institute of International Finance (IIF) to understand the weaknesses that the crisis was exposing and to formulate principles and recommendations to guide reforms within banks and other financial services firms. Senior executives from more than 60 firms participated in this undertaking which resulted in July, 2008, in the publication of the *"Final Report of the IIF Committee on Market Best Practices: Principles of Conduct and Best Practice Recommendations. Financial Services Industry Response to the Market Turmoil of 2007-2008."*

This IIF report has become a blueprint for action, the subject of many management seminars in many countries and an important influence on the many changes that we are now seeing in firms. To be sure, much remains to be done to strengthen practices in many firms, but significant advances have already been seen, including the following:

- **Materially improved risk management,** including more robust risk governance, strengthened capabilities in risk aggregation, improved stress testing, improvement of market-risk management and significant investment in risk systems and data;
- **Increased and better quality capital** compared to the position prior to the crisis, in response to market and official demand;
- **Better liquidity risk management,** including more robust analysis of funding needs and sources, wide application of stress-testing techniques, and substantial liquidity buffers;
- **Substantial reduction of leverage,** both on a systemic and individual-firm basis, based on the clear recognition of the negative effects of excessive leverage;
- **Reducing procyclicality** by analyzing its causes, refining provisioning practices and making more extensive use of "through-the-cycle" approaches to capital;
- **Material improvement on disclosure and transparency** through Pillar 3, together with **industry initiatives to reform securitization,** working toward more transparent, liquid, and standardized markets, and clarifying firms' **off-balance-sheet exposures;**
- Development with the official sector of a **better understanding of systemic risk,** using this understanding in risk management, and working with the official sector on macroprudential means through which it can be identified, addressed, and mitigated;
- Significantly enhanced risk management, processing, transparency, and systems and procedures for carrying on **Credit Default Swaps (CDS) and other Over-the-Counter (OTC) derivatives** business.

> **"We believe that the crisis affords a unique opportunity to build a more efficient global financial system"**

In addition on compensation, significant reforms of firms' compensation practices are taking place to align incentives with long-term shareholders' interests and firm-wide profitability, taking account of overall risk and cost of capital. The IIF's members are committed to implementation of the principles on compensation set out in the *Market Practices Report* and we welcome the new Financial Stability Board's *Principles for Sound Compensation Practices* published in April.

Given the progress being made within firms, and the extensive developments completed or underway in the official sector, we see reform of the financial system onto a more stable and sustainable path as very much a shared responsibility between the industry and the public sector. Our determination to contribute to public understanding and to provide the perspectives of the financial services industry to many of the proposals for reform that have been published in recent months, has led our IIF Special Committee on Effective Regulation to recently publish a new report, *Restoring Confidence, Creating Resilience: An Industry Perspective on the Future of International Financial Regulation and the Search for Stability.*

The IIF is the global association of more than 375 member institutions and the new report reflects the views of a very wide spectrum of the industry's leaders. The IIF Special Committee is co-chaired by William T Winters, Co-Chief JP Morgan's Investment Bank and Member of the JP Morgan Chase's Operating Committee, and Walter B Kielholz, Chairman of the Board of Directors, Swiss Reinsurance Company Ltd (as of May 2009), former Chairman of the Board of Directors of Credit Suisse Group (2003-2009). The report stresses that financial regulatory reforms must better align incentives for sound risk management, improve transparency, and enhance resilience over the business cycle. It notes the overarching need to build a strong international financial system reinforced by well-coordinated international regulation and credible market discipline. Regulatory measures need to be designed with strong international cooperation to achieve regulatory goals on an effective but also efficient basis.

We believe that the crisis affords a unique opportunity to build a more efficient global financial system. To achieve this, the new regulatory framework of the system needs to be well coordinated across borders with an emphasis on consistency and harmonization. It will need to avoid inward-looking measures that may seem to make sense from a national perspective, but can damage the overall system if taken without adequate coordination across national jurisdictions.

The fact is that in recent months we have seen how an array of national authorities have responded to the crisis by taking measures with a distinctly domestic orientation without adequate consistency and coordination with other countries. There is reason to be concerned that should this trend continue, it risks the fragmentation of the system of international regulation. Regulatory coordination is absolutely crucial for sustaining an open global system of finance,

investment and trade. We suggest in our report, for example, that the Financial Stability Board's (FSB) mandate and resources could be expanded to help avoid regulatory fragmentation.

It is important to understand that the financial services industry fully supports the need for regulation to be enhanced in scope, impact, and quality to minimize systemic risks and as best as possible, prevent future crises. For example, we accept that levels of capital in many parts of the system leading up to the crisis were insufficient and that overall levels in the system may need to be increased within the framework of a revised Basel II risk-based approach. In this connection we strongly supports measures to counter cyclicality by building resources in good times that can be drawn down in bad times.

Moreover, we do believe that leverage in the system has been too high and needs to be kept under control in the future. This requires a regulatory response to reinforce industry efforts and market incentives. Rather than hard-wired ratios, which do not take into account actual portfolio composition and basic risk issues, we are recommending a less rigid approach. We suggest an approach where supervisors can react to individual situations and adopt appropriately sharp remedial actions, avoiding arbitrary and anomalous results that distort prudent lending patterns.

But, as authorities consider remedies to past weaknesses and new regulatory approaches, so we underscore the need to avoid duplicative or inefficiently burdensome solutions, which inevitably would be at the expense of consumers. For example, one could see some authorities increasing capital and liquidity requirements at the group level, and then others doing so again at the individual country level. All reforms should be framed around risk-based principles, decided through strengthened international coordination.

What we emphasize is that regulatory reform should be implemented with an integrated global perspective and an assessment of the cumulative impact of all of the different changes that are being devised – in home country and host country regulations, in intensity of supervision, in conduct-of-business regulation, and in accounting – that are in the works. We are concerned that multiple official institutions doing hard, often technical work via different workstreams may not have the time to make an integrated judgment of all the changes that have been or will be imposed, especially on an international level. Yet that impact assessment is absolutely essential to devising a new system that is efficiently functional as well as safe and sound.

An issue that is discussed in detail in our new report and that is very much on the stage of public debate today relates to how best to make changes in the architecture, objectives, and framework of financial regulation, domestic and international, to reduce systemic risks. We agree that all market participants whose activities could materially impact systemic stability should fall within the framework of macroprudential oversight regardless of form or license. So also should all financial markets and products with similar potential for systemic impact.

At the same time, our report underscores that it would be counter-productive to create formal categories of highly systemically relevant firms that should be subject to separate or additional regulation. To do so would invite adverse consequences and could add to instability at a time of market volatility. The report does stress, however, that large and complex institutions may need to be subject to more intense supervision, depending on the risks inherent in their business. The report stated, *"It is essential that all parties recognize that systemic risk may emerge from the complex interaction of institutions, markets and products, and that focusing solely on a list of institutions is unlikely to help detect or manage systemic risks more effectively. It would give rise to a mistaken sense that systemic risk had been corralled and controlled within such a category of firms; it would incentivize risk migration and opacity; it would give rise to undue reliance on an entity-based prism for viewing systemic risk; and it would create distortion moral hazard."*

As we point out in our report, systemic events can be triggered by firms of many different shapes and sizes or by market developments. More importantly, such risks do not reside in single entities but in the interconnectedness of global markets, players and products. Large institutions play an important role in supporting the global economy. Artificial restrictions on size could produce materially distorting effects and unmanageable risk patterns within the system.

Noting that successful regulation needs to operate in tandem with well-disciplined markets, we have emphasized that there needs to be meaningful market discipline over firms. This means that investors and creditors (other than ordinary depositors or policy-holders) need to face a possibility of loss and so it needs to be made feasible for even the largest financial firms to fail. And, in this regard, we suggest that it should be a priority to implement the infrastructural, legal, and process reforms necessary to ensure that all firms can exit the market in an orderly fashion and without causing a systemic crisis regardless of their size, nature, or range of activities.

At the same time, while government interventions to secure stability have been welcome and important, it is necessary now to develop strategies for governments to exit their holdings in financial firms and end debt guarantee programs and extraordinary support for markets and liquidity. We stress that well-formulated, well-coordinated, and well-executed exit plans are essential to avoid competitive distortions and ensure a level playing field both within and across countries and to restore an effectively functioning market place.

The substantial progress being made within firms today to adopt practices that guard against vulnerabilities and that offer strong prospects for stable and sustainable corporate development are likely to join with important reforms of the regulation and supervision of the financial system. We are hopeful that the opportunity indeed will be seized to create a more effective and efficient international system. And, we look forward to a continued and deepened dialogue with the official sector, at national and international levels, as a reformed framework takes shape. The combined efforts of the industry and the official community can, if properly coordinated, have enormous potential to assist in the reestablishment of financial stability and create a more resilient system for the future. ■

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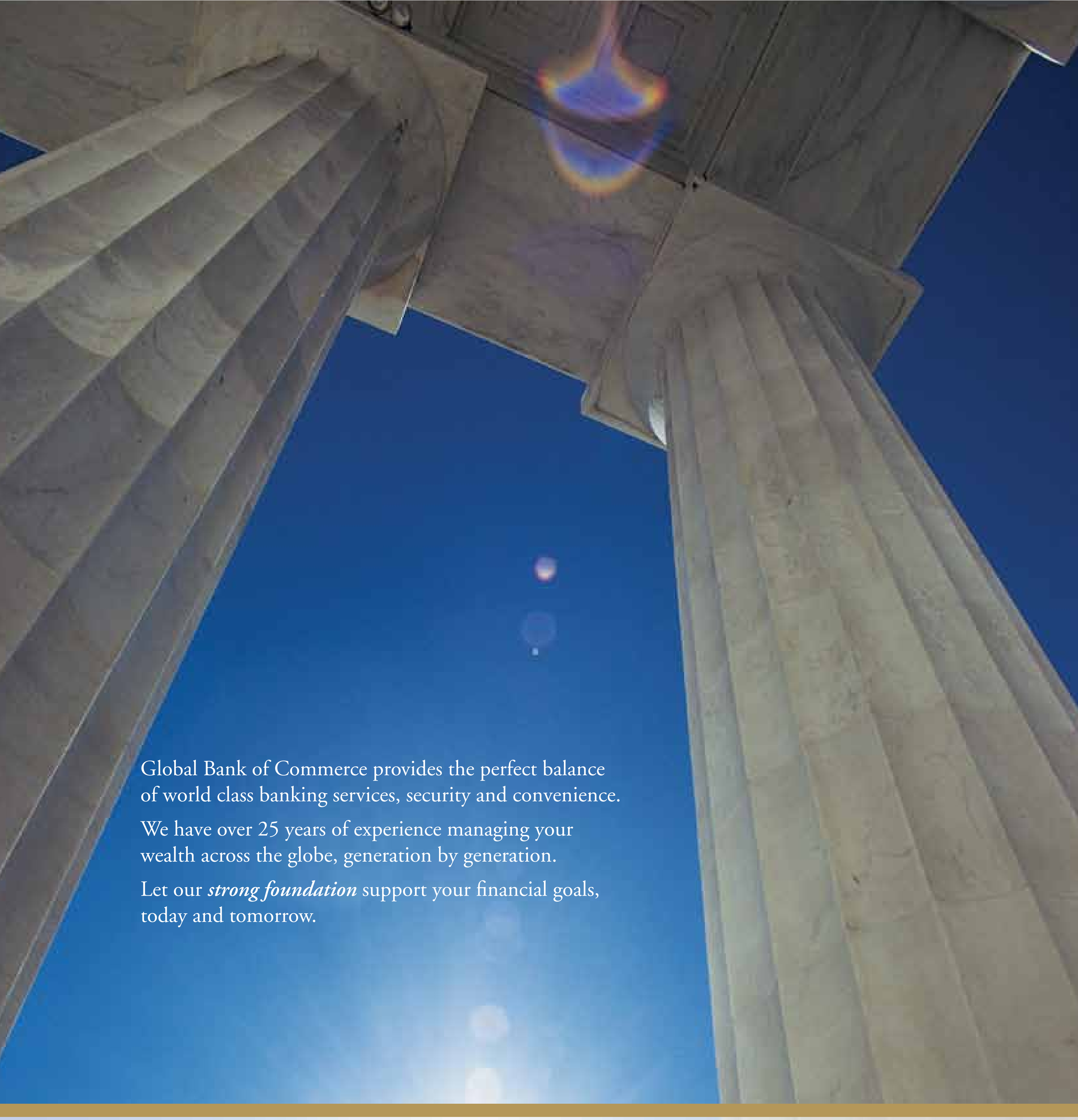
The Institute of International Finance (IIF) is the global association of financial institutions. Members include most of the world's largest financial services firms, including leading commercial and investment banks, insurance companies with global operations, and investment management firms. The Institute, established 25 years ago with its offices in Washington DC, has more than 375 members headquartered in more than 65 countries, including Australia. www.iif.com



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Government Policy and the Financial Sector: Dealing With Moral Hazard and "Too-Big-To-Fail"

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Terms such as too-big-to-fail (TBTF), lender-of-last-resort (LoLR) and moral hazard are closely related. They are all connected with the overall objective of safeguarding the public's deposit money should a financial institution collapse. In essence they refer to how the government, or more specifically its central bank, would come to the rescue of a bank in financial crisis, because a bank on the brink of bankruptcy would have a destabilising effect on the entire financial system. Spill-over effects are closely related to systemic risk. Hence this kind of protection afforded to a bank may make it TBTF for the system.

In this article we consider the new reality of the role of government in the financial system in the post-credit crunch era. We describe how moral hazard will remain in the system, and provide recommendations for how to mitigate this risk exposure, as well as dealing with the issue of the TBTF bank.

Living with moral hazard

One result of the 2007-08 financial crisis is that governments and central banks are now playing a pivotal role in maintaining moral hazard. A reaffirmation of their position as LoLR creates a dual principle. First of all it gives a strong signal to deposit holders not to withdraw their money from banks, as they should expect that the central bank will place unlimited resources at the disposal of private banks to keep the credit process going. Secondly it encourages deposit holders to place their money at the bank with the highest deposit interest rate.

Banks in turn compete against each other to attract deposits. The bank that is able to pay the highest deposit rate will, all else being equal, attract most deposits. This is only sustainable from a bottom-line viewpoint by taking on more risk on the asset side of the balance sheet.

This happened with the UK bank Northern Rock plc. In part due to its more aggressive credit portfolio, the bank was able to pay out a higher rate on its clients deposit accounts compared to that paid by the big "high street" banks (Cooper 2008). At the US Federal Reserve, this moral hazard principle was emphasised by a number of unfortunate comments from Alan Greenspan. On occasion he gave the market the impression that the Federal Reserve would put a floor under financial markets in general. During a speech at the Economic Club of NY in December 2002, he stated: *"Asset bubbles cannot be detected and monetary policy ought not to be in any case used to offset them. The collapse of bubbles can be detected, however, and monetary policy ought to be used to offset the fallout."* This and other similar utterances became known as the "Greenspan Put."

Figure 2. Overview of bank bailouts

Date	Event
16/03/2008	Bear Stearns bailed out by a joint effort from JP Morgan and the US Federal Reserve, which provides a credit line of USD 30 bln
07/09/2008	Fannie Mae and Freddie Mac are bailed out by the US government for an amount of USD 200 bln in preferred stock and credit lines
15/09/2008	Lehman Brothers: allowed to fail by US Treasury Secretary, creates bank liquidity crisis
16/09/2008	AIG receives a rescue package of USD 85 bln from the US government
25/09/2008	Washington Mutual comes under control of the US government, the majority of its assets are sold to JP Morgan
29/09/2008	Glitnir Bank is nationalised by the Icelandic government
	Mortgage lender Bradford & Bingley is nationalised by the UK government
30/09/2008	Dexia Bank receives support from the Belgian government via a capital injection
	Irish government guarantees all deposits, and the senior and subordinated debt of all six Irish banks
03/10/2008	Fortis Bank is split into in three parts by the Benelux governements
	US Congress approves TARP plan for USD 750 bln to buy toxic assets from banks
06/10/2008	Hypo Real Estate receives a government facilitated credit line from the Federal German government
13/10/2008	RBS, HBOS and Lloyds receive USD 64 bln from UK government
	EU commits EUR 1.3 trillion to support banks
16/10/2008	Hungary receives a EUR 5 billion credit line from the ECB
28/10/2008	IMF offers a USD 25 billion support package to Hungary
16/01/2009	BoA receives suport package from US government under the form of preferred equity injection
19/01/2009	UK government raises its stake in RBS to 70%
10/02/2009	US government announces the Public-Private Investment Programme of up to $ 1 trillion to purchase troubled assets

Source: BIS 2009, www.creditwritedowns.com

Figure 1. Global Bailout Bill

Global Overview	
Country	$ bln
US*	14,499.00
EU**	1,972.80
Japan	375
UK***	2,888.20
IMF	140.20
Total	19,875.20
* excluding Fannie Mae and Freddie Mac	
** EURUSD rate 1.40	
*** GBPUSD rate 1.60	

Source: US Treasury, Federal Reserve, FDIC, IMF

The latter has come under severe criticism as this safety net gives the impression that profits within the banking industry will remain privatised, but any losses will be socialised at taxpayers' expense. Protecting the public's money is a noble objective, however bailing out banks comes with a cost that the taxpayer has to pay for. The cost post-credit crunch is now in the trillions. The total bill, for bailing out the banking sector and injecting stimulus packages into the global economy, has risen to just below $20 trillion, the majority in the US (see Figure 1). These numbers are unprecedented, even compared to inflation-adjusted levels seen during the 1930s.

Figure 2 gives a (non-exhaustive) overview of the bailouts undertaken since the start of the crisis. This excludes the coordinated measures taken by central banks, such as the establishment of USD swap lines, to ease short term pressures in the money market. Figure 2 gives an idea of the extent of the moral hazard.

There is no doubt that the existence of a safety net creates an unconscious reflex in bank senior management to take on more

risk. Perhaps not currently, because in the immediate post-crisis environment investors remain risk averse; but as the economy recovers the issue will become more problematic. Due to competitive pressures in banking a higher risk-reward profile becomes a self-fulfilling prophecy, as banks seek to generate more customer business and attract deposits.

This appears to be what happened when Goldman Sachs (along with Morgan Stanley) converted into a commercial bank in September 2008. It forced to make this change because of the interbank market implosion created by the Lehman Brothers collapse. It was a blunt acknowledgment that its "investment bank" model of finance had become unsustainable, and that it needed the cushion of bank deposits, as well as the LoLR backing, to stay afloat amidst the market turmoil.

Goldmans received a rescue package of $10 billion from the US government Troubled Asset Relief Program (TARP). With this explicit guarantee, it proceeded to take on even bigger risks during Q1 2009, a period when other financial market participants were scaling back their risk exposures. During Q1 and Q2 of 2009 Goldmans extended its value-at-risk (VaR) limits to record highs, on risks led by equity trading (see Figure 3).

Figure 3. Goldman Sachs VaR exposure (USD mm)

Quarter End	Value-at Risk (daily average)
Jun-09	$ 245
Mar-09	$ 240
Nov-08	$ 197
Aug-08	$ 181
May-08	$ 184
Feb-08	$ 157
Nov-07	$ 151
Aug-07	$ 139
May-07	$ 133
Feb-07	$ 127

Source: Bloomberg LP

If one takes a closer look at the results it is striking that the revenues are pure investment banking and trading related (see Figure 4). In other words, the revenues are unrelated to any form of commercial banking business. This is despite the fact that the firm applied for a banking license in September 2008, in order to be able to access TARP funds. In other words, Goldmans is a licensed commercial bank, with all the implicit LoLR backing that this implies, but which carries out very little conventional commercial banking business.

Figure 4. Goldman Sachs net revenue, Q2 2009

Division	Net Revenue	Change (YOY)
Equity underwriting	$ 736 mio	19%
Debt underwriting	$ 336 mio	25%
Fixed Income, Currency and Commodities	$ 6.8 bio	186%
Investment Banking Advisory, mergers and acquisitions	$ 368 mio	-54%
Total Trading and Principle Investments	$ 10.8 bio	93%

Source: Bloomberg LP

The question remains then whether the US government was justified in offering Goldman Sachs this lifeline. Once it received government assistance, Goldmans had access to cheap credit lines from the Federal Reserve, and proceeded to increase its risk exposure and further distance itself from competitors.

Continuing moral hazard is an issue that needs to be solved sooner rather than later if we are to avoid a re-occurrence of the crisis. However this is not an easy task. The principle of LoLR has merit. The Great Depression in the 1930s could have been more contained if the central bank had played a more dominant role. In essence we have a conundrum that is not easily solved.

For the foreseeable future the LoLR concept will not disappear. It is necessary for the safe operation of the financial system. We observed during the Lehman collapse the effects when a government and central bank lets market forces act freely: at one stage in October 2008 it appeared as if the entire Western banking system might collapse, with disastrous consequences for the entire economy, if governments had not stepped in to guarantee liabilities. It is an economic law that in this case the fall in asset prices relative to current output prices would have been greater but for state intervention. Furthermore the drop in investments and consumption would be substantial and the decline in income and employment would be larger as well. So the public sector must step in for the "greater good", in a way that does not apply to other industrial sectors.

Mitigating moral hazard risk

Thus, moral hazard has seemingly become an inescapable fact of life. The ultimate solution to the problem may be no more ambitious than reducing (rather than attempting to eliminate) moral hazard, without curtailing risk taking. To that end, we require new regulations. Three major issues around moral hazard and the TBTF issue need to be addressed:

- Transparent communication by central banks about moral hazard;
- The interconnection of financial markets and the systemic risk related to it;
- Consolidation trends and the risks of "too-big-to-fail".

We discuss each of these points individually.

Transparent communication by central banks about moral hazard

As we noted above the crisis was underpinned by a false perception that unsecured institutions, for example those that do not fall under US FDIC protection, would nevertheless be regarded as TBTF by the US government. This perception was first created by frequent interventions by central banks during the past four decades, and exacerbated by the dubious rhetoric of Fed Chairman Alan Greenspan. Current Fed Chairman Ben Bernanke recognises this issue however, stating "market discipline may erode further if market participants believe that, to avoid the risk of a financial crisis, the government will step in to prevent the failure of any very large institution – the 'too-big-to-fail problem"(Bernanke 2007).

As a first step, the Federal Reserve and other central banks need to modify their rhetoric and start informing the market that there is no absolute floor under the markets, and that their expectations of being rescued must be diminished. If not, market discipline, as we have seen from Goldman Sachs, will not change. Of course this is not a short-term solution, but something that can only take place over time. Perceptions built up over 20 years do not evaporate overnight. It is important however that governments act now, rather than wait until the next crisis. The opportunity should be taken on a regular basis when communicating monetary policy, for example during the press conference after Bank of England, ECB or Federal Open Market Committee meetings, and at the Humphrey Hawkins testimonies.

In addition to the frequency of communication, its quality needs to be raised as well. General comments along the lines of "banks are at risk of losses due to excessive risk taking" are not going to change market mentality. Central banks and other institutions such as the FDIC must disclose more information on the research they are conducting on how to maintain financial stability. For example, the FDIC is doing research on procedures and methodologies in identifying which depositors it must protect and which it can impose losses on. This type of research needs a wide readership.

The most important aspect of increased communication towards the market should be in explaining how central banks undertake market stabilisation efforts, and estimate future losses that have to be taken by creditors.

MAZOVIA'S Great potential

About Mazovia

Mazovia is the best known Polish district which popularity is based first of all on being the biggest and centrally situated region in the country hence it has easily become an economic leader. Due to its central location, large and absorbent market (more than 5 million inhabitants) which constantly improves as well as its educated and qualified population, Mazovia tends to perform as the most frequently picked up region by overseas investors. Almost 30% of the largest foreign investments are settled exactly here and one of the main reasons of that is the central localization at the crossroads of trade routes, thanks to which Mazovia nowdays is a promising district and has the greatest chances to become an important and equal region in the entire European Union.

Mazovia is the fastest growing voivodeship in Poland that exploits the changes most effectively and is the place where all the economic dynamic transformations of the last decade are visibly seen. Promptly taking an intended advantage of these transformations led Mazovia to position of the economic and change leader among Polish regions. In no other region in the whole country changes went so instantly and so successfully. Mazovia's high in various ways attractiveness beats other regions of Poland and at the same time it draws numerous foreign tourists what makes this region the most visited in Poland. This fact is highly significant to Mazovia's economy (about 5 million people annually, almost 30% of the total number of visitors to Poland).

Mazovia is the voivodeship with a commonly known great history, stunning monuments and of course the immense economic potential and above all – it permanently gets more and more well-prepared to play a significant role among European regions.

Poland, the country situated in the very heart of Europe, is the main beneficiary of foreign direct investments (FDI) in Central Europe: in years 2006, 2007 and 2008 an average FDI worth around EUR 14,4 billion. According to the Polish Agency for Foreign Investments (PAIZ) the most important factors which incline investors to choose Poland as an investment location are the size and absorbency of the market (nearly 40 million inhabitants - the largest country in central Europe), the low labour costs (one of the lowest on the continent), favourable business environment, growing integration with the worldwide economy and the success of Polish privatization. Over 70% of the capital invested in Poland comes from European companies.

Why investors choose Mazovia?

- **Geographic location**
- **Infrastructure**
- **Market's absorptivity**
- **Labour market availability**
- **Development huge potential**
- **Accessibility of investment incentives and attractive plots as well!**

ARMSA
Agency for Development of Mazovia Plc

Investor assistance

- Investment offers presentation
- Assistance at location selecting proccess
- Study tours organisation

Support for Polish entrepreneurs

- Promoting export
- Assistance in commercial and trading missions
- Tracing contacts with potential investors

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The interconnection of financial markets and systemic risk

We accept that more transparent communication on its own will not solve the problem. Stronger measures are needed to reduce the frequency with which central banks and governments bail out banks.

The reason why a LoLR facility is put in place is to avoid spill-over effects towards other banks and ultimately prevent a bank run. Banking is ultimately a business based on confidence. The instant that customers start withdrawing their deposits on a large scale, banks are in trouble and will need to be bailed out (either by takeover or merger with another bank or buy outright support from the LoLR). The basic bank business model relies on leverage, with only a small fraction of a bank's liabilities held in reserve at the central bank. As bank funding is based on borrowing in the interbank market, systemic risk is inherent in the model.

Therefore the authorities must place more focus on the following:

- Setting strict liquidity ratio limits, imposed by the regulator, as well as requirements to diversify funding sources, reduce reliance on single funding sources, and increase the average tenor of liabilities; the UK's FSA has already started the process to implement a much stricter liquidity regime for banks (FSA 2008);

- The establishment of a global central clearing agency for OTC derivatives; efforts are already underway to set this up for credit derivatives, and such a system would help to reduce bilateral counterparty risk. An alternative is for regional clearing centres based on currency;

- The establishment of a clearing house for the money markets, a so-called "International Money Exchange" for the interbank market that would work similarly to an exchange clearing house (Choudhry 2009); such a facility would serve to make the interbank market more robust during times of crisis or illiquidity, because it is at these times that banks withdraw credit lines with other banks. A central clearing mechanism that eliminated bilateral counterparty risk would make it less likely that banks would withdraw lines;

- Reducing leverage, if necessary by regulatory fiat, through the imposition of leverage limits on banks;

- Imposing higher capital ratios than currently in place under Basel II, tailored according to the bank's size, its extent of risk exposure and the amount if systemic risk it represents;

- Developing new capital instruments which absorb losses in distressed situations. Our recommendation is that banks promote a product which has similar features to a classic reverse convertible bond. Banks would issue so-called reverse convertible debentures, which would automatically convert into equity once the minimum capital ratio level of a bank is breached.

The above measures once implemented would reduce the likelihood that a central bank or government would have to bail out the banks during the next economic downturn.

Consolidation trends and the risk of "too-big-to-fail"

The current debate on TBTF raises the issue that such banks should be made smaller. This does appear at first sight to be a reasonable idea.

The case for this is strong when considering the Icelandic banks, which could not be rescued by their government since they had outgrown their own country's GDP. In this decade these banks grew from being domestic lenders to major international players. During the expansion they acquired foreign assets of almost ten times the country's GDP (this from almost two times GDP in 2003). Furthermore almost 80% of these assets were in foreign currency, making them extremely vulnerable to foreign exchange volatility. When the bubble burst the government had to ask the IMF for an emergency loan or risk the total collapse of the banking system and thereby the economy.

However, these banks were not a major threat to the international banking system. European banks did make writedowns on the collapse of Kaupthing, Glitnir and Landsbanki; nevertheless the impact was not on the scale of the Lehman collapse.

The case of Ireland, which is a member of the euro-zone, provides stronger backing for advocates of making banks smaller. Unlike the Icelandic banks, who decided to become international players, the Irish banks focused mainly on their home market and the UK. The Irish banking industry grew hand-in-hand with the domestic real estate boom. Between 1998 and 2007 house prices in real terms quadrupled on a national level. When the housing bubble burst, Irish banks were heavily exposed and as Figure 5 shows their capital ratios were not robust enough to survive the shock. The Irish government was forced to provide explicit backing for its banks; one impact of this was that the Ireland sovereign rating was cut from AAA, on fears that the public sector debt liability created by the guarantees would become unsustainable. Ultimately the majority of Irish banks were effectively nationalised. The Irish situation was not that dramatic compared to the Icelandic one for a simple reason: Ireland had the safety net of the euro-zone. This in itself exposed euro-zone taxpayers to potential losses if the government itself had needed to be bailed out.

Figure 6. GDP per country

Country	GDP $ millions
US	14,264,600
Japan	4,923,761
Germany	3,667,513
France	2,865,737
UK	2,674,085
Italy	2,313,893
Spain	1,611,767
Netherlands	868,940
Belgium	506,392
Switzerland	492,595
Ireland	273,248

Source: IMF

Despite the deleveraging process that has been going on since the start of the crisis, some major international banks are still bigger than their own country's GDP. This is certainly the case for the Swiss banks UBS and Credit Suisse. At the end of 2008 Credit Suisse balance sheet was 2.72 times and UBS's 4.18 times the GDP of Switzerland (see Figures 5 and 6).

Figure 5 also proves that (contrary to popular belief) European banks were and still are more leveraged than American banks, and that no UK or German bank outgrew its country's GDP.

However in countries such as the Netherlands and Belgium one can notice a similar pattern to that in Switzerland. The Dutch bank ING clearly became TBTF for the government as its total assets were 1.53 times the GDP of the Netherlands. This was also the reason why, in the case of Fortis Bank, the Benelux countries implemented a joint rescue plan to save it.

While in principle we agree with the idea of breaking up banks that are too large, there are practical difficulties with so doing. First, what metric would be used to determine whether a bank is too big? A simplistic measure of looking at the total size of assets on the balance sheet is not the answer.

It is perfectly plausible that a bank's total assets increase via organic growth. In this case it would be unfair to penalise this development, certainly where the quality of assets are perfectly matched with outstanding liabilities. To make a comparison, one would not necessarily break up the US retail distributor Wallmart or the UK supermarket chain Tesco simply because either had a dominant market position. That said, neither of these corporate institutions is

Figure 5. Bank overview of leverage and total assets

Bank	2000	2001	2002	2003	2004	2005	2006	2007	2008
JPMorgan Chase & Co									
Total Assets	715,345	693,575	758,800	770,912	1,157,248	1,198,942	1,351,520	1,562,147	2,175,052
Financial Leverage	18.62	17.41	17.85	17.7	12.82	11.09	11.44	12.19	14.48
Tier 1 / Core	8.50	8.29	8.24	8.50	8.70	8.50	8.70	8.40	10.90
Bank of America Corp									
Total Assets	642,191	621,764	660,951	719,483	1,110,432	1,291,803	1,459,737	1,715,746	1,817,943
Financial Leverage	13.87	13.16	12.99	14.06	12.37	11.94	11.77	11.55	12.54
Tier 1 / Core	7.50	8.30	8.22	7.85	8.20	8.25	8.64	6.87	9.15
Citigroup									
Total Assets	902,210	1,051,450	1,097,190	1,264,032	1,484,101	1,494,037	1,884,318	2,187,480	1,938,470
Financial Leverage	14.05	13.55	13.02	12.96	13.4	13.56	14.68	17.53	22.37
Tier 1 / Core	8.38	8.42	8.47	8.91	8.74	8.79	8.59	7.12	11.92
Royal Bank of Scotland									
Total Assets	320,004	368,859	412,000	454,428	588,122	776,827	871,432	1,840,829	2,401,652
Financial Leverage	18.64	16.65	17.04	18.55	18.26	19.68	21.78	29.08	37.91
Tier 1 / Core	6.90	7.10	7.30	7.40	7.00	7.60	7.50	7.30	10.00
HSBC Holdings									
Total Assets	674,129.90	696,079.60	758,605	1,034,216	1,279,974	1,501,970	1,860,758	2,354,266	2,527,465
Financial Leverage	15.69	14.9	14.82	14.2	14.46	15.63	16.75	17.82	22.01
Tier 1 / Core	9.00	9.00	9.00	8.90	8.90	9.00	9.40	9.30	8.30
Wells Fargo & Co									
Total Assets	272,426	307,569	349,197	387,798	427,849	481,741	481,996	575,442	1,309,639
Financial Leverage	10.31	10.87	11.44	11.38	11.27	11.63	11.23	11.41	16.4
Tier 1 / Core	7.29	6.99	7.70	8.42	8.41	8.26	8.95	7.59	7.84
Mitsubishi UFJ Fin Group									
Total Assets	No data	No data	99,489.26	99,175.32	106,615.50	110,285.50	187,046.80	187,281	192,993.20
Financial Leverage	No data	No data	No data	No data	31.07	25.74	26.62	25.05	24.18
Tier 1 / Core	No data	No data	5.27	5.68	7.15	7.62	6.80	7.59	7.60
Santander Central Hispano									
Total Assets	348,871.90	358,116.20	324,193.30	351,780.40	664,486.30	809,106.90	833,872.70	912,915	1,049,632
Financial Leverage	19.43	16.51	14.86	13.8	17.09	19.86	19.41	17.46	17.4
Tier 1 / Core	7.64	8.44	8.01	8.26	7.16	7.88	7.42	7.71	9.10
Goldman Sachs									
Total Assets	289,760	312,218	355,574	403,799	531,379	706,804	838,201	1,119,796	884,547
Financial Leverage	20.25	17.32	17.94	18.69	20.02	24.12	26.21	27.05	22.88
Tier 1 / Core	No data	No data	No data	No data	No data	No data	No data	No data	15.60
BNP Paribas									
Total Assets	693,315	825,288	710,305	782,996	1,002,503	1,258,079	1,440,343	1,694,454	2,075,551
Financial Leverage	33.62	32.86	30.09	27.31	29.49	30.95	31.46	34.03	42
Tier 1 / Core	7.10	7.30	8.10	9.40	7.50	7.60	7.40	7.30	7.80
Barclays Bank									
Total Assets	316,190	356,612	403,062	443,262	538,181	924,357	996,787	1,227,361	2,052,980
Financial Leverage	26.35	24.31	25.59	26.8	30.44	43.93	51.61	51.62	54.76
Tier 1 / Core	7.20	7.80	8.20	7.90	7.60	6.90	7.70	7.80	8.60
Mizuho Financial Group									
Total Assets	N/A	N/A	N/A	134,007.20	137,750.10	143,076.20	149,612.80	149,880	154,412.10
Financial Leverage	N/A	N/A	N/A	N/A	503.63	129.51	62.49	36.81	38.85
Tier 1 / Core	No data	No data	No data	4.87	5.76	6.20	5.89	6.96	7.40
Morgan Stanley									
Total Assets	426,794	482,628	529,499	602,843	747,334	898,523	1,121,192	1,045,409	658,812
Financial Leverage	22.6	23.26	23.95	24.22	25.44	28.68	31.83	33.63	27.56
Tier 1 / Core	No data	No data	No data	No data	No data	No data	No data	No data	17.90
Uncredit									
Total Assets	202,655.50	208,388.10	213,349.30	238,255.60	265,406.20	787,000.30	823,284.20	1,021,835	1,045,612
Financial Leverage	23.45	22.77	19.53	18.06	18.81	21.44	21.86	19.19	18.35
Tier 1 / Core	6.37	6.79	7.21	6.96	7.94	6.89	5.82	6.55	6.66
Sumitomo Mitsui Fin Group									
Total Assets	N/A	N/A	N/A	104,586.80	102,215.20	99,731.86	107,010.60	100,858.30	111,955.90
Financial Leverage	N/A	N/A	N/A	N/A	108.7	89.01	51.84	31.7	31.38
Tier 1 / Core	No data	No data	No data	5.50	6.03	5.39	7.11	6.44	65.73

Bank	2000	2001	2002	2003	2004	2005	2006	2007	2008
ING Bank									
Total Assets	650,172	705,119	716,370	778,771	876,391	1,158,639	1,226,307	1,312,510	1,331,663
Financial Leverage	19.1	28.97	35.74	37.77	36.46	33.47	31.8	33.64	40.97
Tier 1 / Core	No data	7.03	7.31	7.59	7.30	7.32	7.63	7.39	9.32
Deutsche Bank									
Total Assets	928,994	918,222	758,355	803,614	840,068	992,161	1,584,493	2,020,349	2,202,423
Financial Leverage	26.29	22.02	23.89	26.84	30.38	32.81	41.1	51.64	62.33
Tier 1 / Core	7.80	8.10	9.60	10.00	8.60	8.70	8.50	8.60	10.10
Societe Generale									
Total Assets	455,881	512,499	501,265	539,224	601,355	835,134	956,841	1,071,762	1,130,003
Financial Leverage	33.7	32.9	32.2	32.07	32.46	34.64	34.4	36.04	34.77
Tier 1 / Core	8.91	8.36	8.14	8.66	7.69	7.57	7.82	6.62	7.88
Credit Suisse Group									
Total Assets	979,121	1,016,078	1,027,158	1,004,308	1,089,485	1,339,052	1,255,956	1,360,680	1,170,350
Financial Leverage	31.01	33.66	32.8	29.8	29.8	30.98	30.28	30.15	33.52
Tier 1 / Core	11.30	9.50	No data	11.70	12.30	11.30	13.90	11.10	13.30
UBS									
Total Assets	1,087,552	1,253,297	1,181,118	1,386,000	1,737,118	2,058,348	2,396,511	2,274,891	2,014,815
Financial Leverage	27.49	26.49	29.5	34.49	45.01	48.69	47.54	53.97	61.81
Tier 1 / Core	No data	11.60	11.30	11.80	11.90	12.80	11.90	9.10	11.00
Commerzbank									
Total Assets	454,904	501,312	422,134	381,585	424,877	444,861	608,278	616,474	625,196
Financial Leverage	34.85	39.38	44.9	44.9	42.79	38.73	39.09	41.7	36.11
Tier 1 / Core	6.50	6.20	7.30	7.30	7.50	8.10	6.70	7.00	10.10
Fortis Bank									
Total Assets	438,082.70	482,875.10	485,668	523,364.20	614,085.30	728,994.50	775,229	871,179	92,870
Financial Leverage	29.41	31.82	39.49	44.68	41.9	39.2	38.01	30.66	24.2
Tier 1 / Core	7.30	8.50	8.20	7.90	8.30	7.40	7.10	No data	No data
HBOS									
Total Assets	N/A	312,071	355,030	408,413	448,165	540,873	591,813	666,947	689,917
Financial Leverage	N/A	N/A	27.42	26.99	26.91	28.92	29.94	29.87	40.08
Tier 1 / Core	No data	7.90	7.90	7.60	7.90	8.10	8.10	7.70	6.00
Dexia									
Total Assets	257,726	351,250	350,692	349,463	388,787	508,761	566,743	604,564	651,006
Financial Leverage	42.6	41.28	40.82	38.42	33.46	32.98	37.15	40.29	67.66
Tier 1 / Core	9.30	9.30	9.30	9.90	10.00	10.30	9.80	9.10	10.60
Lloyds TSB Group									
Total Assets	219,113	235,793	252,561	252,012	284,422	309,754	343,598	353,346	436,033
Financial Leverage	21.24	22.32	26.69	28.72	25.95	27.97	30.6	29.92	36.66
Tier 1 / Core	8.20	8.40	7.70	9.50	8.20	7.90	8.20	8.10	8.00
KBC Group									
Total Assets	187,658	227,759.20	221,730.50	225,586.80	285,163	325,801	325,400	355,597	355,317
Financial Leverage	34.42	31.21	28.16	25.45	23.78	21.76	19.86	19.81	22.53
Tier 1 / Core	9.50	8.80	8.83	9.54	10.07	9.40	8.70	7.40	7.20
Allied Irish Bank									
Total Assets	80,250	89,359	85,821	80,960	101,109	133,214	158,526	177,862	182,143
Financial Leverage	17.14	17.27	19.34	18.28	17.04	18.87	19.74	19.29	20.26
Tier 1 / Core	6.30	6.50	6.90	7.10	8.20	7.20	8.20	7.50	7.40
Anglo Irish Bank									
Total Assets	11,047.30	15,776	19,417.80	25,520.10	34,339.80	48,413	73,290	96,652	101,321
Financial Leverage	32.27	32.75	29.29	27.73	21.32	20.56	25.29	25.23	24.21
Tier 1 / Core	32.27	32.75	29.29	27.73	21.32	20.56	25.29	25.23	24.21
Bank Of Ireland									
Total Assets	68,017	78,875	87,298	89,303	106,431	127,780	162,212	188,813	197,434
Financial Leverage	20.09	20.79	20.84	21.56	23.58	27.41	30.67	29.47	29.24
Tier 1 / Core	7.40	7.80	7.60	8.00	7.20	7.90	7.50	8.20	8.10
Irish Nationwide Building Soc									
Total Assets	No data	No data	5,574.75	5,953.20	8,554.10	10,994.50	14,629	16,099.10	14,429.30
Financial Leverage	No data	No data	12.29	11.01	10.97	11.60	11.61	11.18	11.31
Tier 1 / Core	No data	No data	11.00	11.59	10.07	13.71	No data	8.60	7.40

Source: Bloomberg LP

relying on the LoLR, and neither represents any kind of "systemic" risk to the economy.

But where regulators have a stronger case is in the area of growth through mergers and/or acquisition. When this takes place, regulators must look closely at how the transaction is funded. It is now obvious that Royal Bank of Scotland and Fortis suffered as a result of taking over ABN Amro without having a waterproof funding strategy in place behind the transaction.

Even a smaller bank is no guarantee that systemic risk would diminish. Some banks are small in assets but still impose a huge risk for a potential run on the banking system. Northern Rock and Bear Stearns were very good examples of that. So it becomes important that a range of quantitative and qualitative assessments need to be made before one can decide that a bank has become too big. Central banks, which have a considerable amount of private information at hand, are in a position to make that judgement call. However a policymaker who needs to streamline this into a simple metric legal framework is less capable of doing this.

There is also the issue of what to do with banks that are already too big. This would mean that they have to be broken up. The question then is who will buy the assets? At what price are they going to be sold? These are not insurmountable problems, they simply need careful consideration. We recommend that as far as possible, viable business lines are hived off into stand-alone operations under existing management. This would be perfectly feasible in the case of most multinational banking groups, which often take over overseas banking chains as a complete whole.

When governments succeed in breaking up big banks, they will face substantial pressure not to allow these companies to grow too large again. There is precedent for this in other industries; for example the break-up of AT&T in the US. This triggered subsequent mergers among other telecommunication firms, which subsequently became large organisations. In the US there is legislation in place to block a merger or acquisition if the bank is left with more than 10% of the total deposit base of the market. We recommend a similar cap in other countries.

It is evident that certain banks became too big during the last 10 years, to the extent that the prosperity of a country and its citizens was placed in jeopardy. The best examples were Citigroup and RBOS. There was a side negative impact as well, as big banks lost focus on the relationship side. The banking sector is in theory still synonymous with being a financial service industry; however it appears that over the years the people in the business neglected "service" in their business model. Putting the clients' needs first should become a priority again, and to do this we will need a change in approach and emphasis among bank senior management.

Keeping the size of banks in check should be first achieved by keeping quantitative measures, such as liquidity and leverage ratios, under strict limits as we suggested above. However if regulators do not succeed in keeping banks in line using these restrictions, then downsizing the total asset size of a bank below a certain percentage of the GDP of its own country must become the solution of last resort.

Conclusions

The events of 2007-2008 have resulted in an unavoidable state of affairs that combines government guarantees of virtually the entire Western banking system alongside potentially significant moral hazard. This arrangement became necessary to prevent complete collapse in the global economy following the Lehman's default, when it appeared that many large Western banks were about to go bankrupt. Therefore in the foreseeable future we do not expect that the current market structure will change.

Given the risks that such moral hazard implies, which essentially allows banks to take as much risk exposure as they wish to maximise profit in the knowledge that should they incur large losses they will be bailed out, it becomes important for governments and regulators to act decisively to mitigate these risks. We have proposed three areas in which policy makers should implement strict rules as part of a new bank business model, which will reduce the likelihood that the LoLR has to intervene during the next economic downturn. ■

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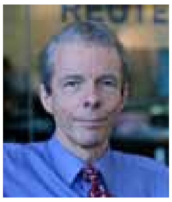

Nudging the Bankers – Does the Walker Review Nudge Enough In the Area of Induction, Training and Development?

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How do we get bankers to behave well? Do we pass new laws, create new regulations, make existing regulations more stringent, increase the amount of supervision, increase the level of enforcement? Or understand the psychology of board room interaction and investor interaction with bank boards and try to make changes which nudge bankers and institutional investors towards making decisions and taking actions that are better for society as a whole?

The Prime Minister must think this last approach is one which has merit (along with all the toughening up of capital and liquidity regulation that is in train) since he commissioned David Walker to undertake a study with a remit to:

> *"examine corporate governance in the UK banking industry and make recommendations, including in the following areas: the effectiveness of risk management at board level, including the incentives in remuneration policy to manage risk effectively; the balance of skills, experience and independence required on the boards of UK banking institutions; the effectiveness of board practices….; the role of institutional shareholders in engaging effectively with companies and monitoring of boards…."*

But before looking at Walker, it makes sense to review the Turner Report since that Report analysed the possible causes of the crisis. The remit for the Turner Report, commissioned by the Chancellor of the Exchequer and published only a few months before Walker was to:

> *"review the causes of the current crisis and to make recommendations*

on the changes in regulation and supervisory approach needed to create a more robust banking system for the future".

One of the first things the report notes under the heading 'Fundamental Theoretical Issues' is that the crisis 'raises important questions about the intellectual assumptions on which previous regulatory approaches have been largely built'. That is quite a challenge to what FSA and other regulators have been doing all these years. One of these assumptions is that:

"market discipline can be used as an effective tool in constraining harmful risk taking".

This assumption, along with others, is now subject to extensive challenge on both theoretical and empirical grounds, with the potential implications for the appropriate design of regulation and for the role of regulatory authorities.

What we are probably seeing in both the Turner Report and the Walker Report is an indication of a possible 'paradigm shift' in understanding of markets – a shift from the pure classical Chicago School approach to a much more subtle approach based on human nature not being rational at all times but swinging from optimism to pessimism with the consequence, in the case of bankers, of mis-valuation of assets and financial crises.

The problem is partly a technical one of the failure of the mathematics and underlying assumptions of the Value at Risk concept used by banks and regulators to measure risk. This resulted in an underestimate of risk (an issue covered by Turner) and hence a failure of risk management. But equally, it was a failure of risk management in the managerial sense, ie. how risk was dealt with in the board room and all the way down the line to those on the coal face who were rewarded for taking risks with large potential payoffs but also large potential losses (part of Walker's remit). These failures happened as a result of a range of behaviours, including irrational group behaviour, which are commonly understood by psychologists.

"...we need a different approach to regulation to encourage people to make the decisions that are wanted for public policy reasons"

Walker has enough experience of board rooms to know that group decisions are not necessarily the ones that any particular individual might take and that 'group think' is a problem in boards as elsewhere As a result of the failure of the challenge function in this area as in many others, the first of the four criteria to which Walker has given priority has been to develop proposals:

"with the principal emphasis on behaviour and culture, and the avoidance of proposals that risk attracting box-ticking conformity as a distraction from and alternative to much more important (though often much more difficult) substantive behavioural change".

Changing behaviour is also the 'new Chicago School' approach of Thaler and Sunstein in their recently published book *'Nudge'*. Libertarian paternalism as it is called, would recommend that since people, including bankers, don't always act in the rational way that the classical Chicago School suggests, we need a different approach to regulation to encourage people to make the decisions that are wanted for public policy reasons. If people behaved as classical economic theory predicts then, for example, market discipline might have been an effective tool in constraining harmful risk taking in banks. At the level of decision making in boardrooms, market discipline would have suggested that bankers would not 'carry on lending while the music was still playing' even while they might have believed it could lead to bankruptcy or at the level of the owners of the banks, the institutional investors, they would have stopped the music and taken away the punchbowl before the party got out of hand. In fact, of course, neither happened and in some cases the institutional investors were the cheerleaders.

Nudging is generally thought of as a way for the state to act non-coercively to get us all to do things which are for the greater good. But it can apply also to the regulatory framework for banking since just promulgating new laws is no guarantee that they will have the desired outcome. Indeed, the 'law of unintended consequences' almost always follows on from new regulation hastily created in response to perceived abuses but without trying to understand the limitations of models of the economy or of markets. The Tory embrace of *'Nudge'* shows how far that party, as well as the government, has moved in its approach to free markets.

We need them to lend, but not over-lend. We need them to make markets, but not make excessive profit. We need them to take risks but not ask us, the taxpayers, to take the downside of risk when things go wrong. We need them to run our payment systems but not fleece us with charges. We need a system of checks and balances which have the best chance of achieving these and other objectives. And most of all we need a system of bank regulation which is based on human psychology as well as appropriate mathematics and statistics.

Some will see what is proposed by Walker as being soft on bankers. But if it is behavioural change which is sought, then head-on conflict through legislation which is 'tough on bankers and on the causes of banker misbehaviour' may be as ineffective as decades of being 'tough on crime and on the causes of crime' has been. Understanding the psychology of bankers, bank competition and board room psychology is more likely to lead to a solution that reduces the risks that the essential process of maturity transformation in banks creates for society.

We do, however, take issue with Walker when he says that the shortage of talent with banking experience who also meet the 'independence criterion' of the Combined Code, means that we must accept as non-executives those who were recently senior executives in the same bank or those who would be caught by the so-called 'nine-year rule' (9 years on the same board). That seems to us a guaranteed route to group-think – something which Walker is very keen to avoid as it would seem to have been a major cause of the crisis. Challenge would seem unlikely in someone who has been on the board for that length of time. Today there are many senior ex-bankers with experience. To suggest as he does that 'they would understandably be unwilling to serve on boards of entities with which they were in keen competition in their former executive roles' is surely not founded on any research but on his prejudice. Given the rate at which senior executives jump ship between major employers on the basis of an offer of even higher remuneration or a more senior position, we find this contention impossible to accept.

We also find his recommendations on 'Induction, training and development' very weak. To say that 'Precisely how to organize induction, training and mentoring will be for individual boards to determine' is sensible. But in terms of guidance, just to say that 'the responsibility should be taken very seriously' is hardly giving an adequate nudge. At the Henley Business School, we take the creation of 'induction, training and development programmes' very seriously indeed and hope that our combination of technical skills in banking risk management combined with our skills in management development and boardroom practice can contribute to re-structuring the way in which decisions are made in boardrooms.

For example, a programme on 'issues in the boardroom' might include questions such as "So you have a complex innovation from which other firms seem to be profiting, do you introduce it or not? How do you interpret the competitive pressures to imitate? Are dissenting voices given a fair hearing? How do you identify and test the underlying assumptions? How far do you go with your line of enquiry if you are a non-executive?" How do you avoid being stage-managed during board meetings? Can you sense corporate-spin when presented with it?

We would have hoped that Walker might have been more explicit in this area of his Report and tried to ensure that programmes were developed by business schools in consultation with banks, which ensured his reforms achieved their objectives. ■

Austria - Dealing with the Financial Crisis

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Recapitulating the known facts of the "financial crisis", it can be said that, at least in the public perception, it started with the turbulences of the "sub-prime" markets in the United States of America almost two years ago, in the summer of 2007. It continued with Fannie Mae and Freddy Mac being nationalized in September 2008 and peaked with Lehman Brothers filing insolvency mid September 2008. These turbulences in the financial markets, amongst other factors, have led to a recession in many areas of what is referred to as the real economy.

As of mid-2008 several national governments as well as pan-national actors, such as the European Union, took measures in order to stabilize the financial markets and prevent a collapse of the monetized and credit economy. So far these measures seem to have proved successful. Even though several banks, like the Belgian-Dutch-Luxembourgian FORTIS-Group and the German Hypo Real Estate AG, faced grave financial difficulties, a crisis engulfing the banking sector as a whole has not taken place so far.

"...confidence is growing that Austria will secure and expand its financial operations in Central Europe"

The purpose of this article is to briefly outline the legislative measures taken by the Austrian government in response to international developments which did not leave Austrian banks entirely unscathed.

At the core of these measures, one finds the Interbankmarktstärkungsgesetz (Interbank Market Consolidation Act, IBSG) and the Finanzmarktstabilitätsgesetz (Financial Market Stability Act, FinStaG), both enacted in October 2008. Both Acts aim at saving and stabilizing the Austrian national economy and in particular at re-establishing the public trust in the Austrian monetary and credit market.

Interbank Market Consolidation Act (IBSG)

To fulfil this aim, the Act provides for a couple of measures which enable the Republic of Austria to lend the necessary support, quickly and effectively, to credit institutions or insurance companies facing liquidity problems or other problems in the interest of saving the Austrian national economy. For this purpose, a clearing-platform is established. This clearing-platform is the Oesterreichische Clearingbank AG (OeCAG), newly founded according to this Act.

The OeCAG is tasked with accepting, in its own name and for own account, money market deposits from credit institutions and insurance companies by means of the interbank market and lending those deposits to other credit institutions and insurance companies by means of the interbank market, again in its own name and for own account.

To ensure the borrowing and lending institutions' trust in the liquidity and creditworthiness of the OeCAG, the Austrian Minister of Finance is entitled to accept a liability, for a limited period of time, for certain receivables from such transactions as well as issue guarantees and bonds for such receivables. The Act further enables the Minister of Finance to underwrite commercial papers issued by other financial institutions.

The OeCA is owned by Austria's major credit institutions, such as the Raiffeisenzentralbank Österreich AG, the Erste Group Bank AG, the UniCredit Bank Austria AG, the Hypobanken Holding GmbH, the Österreichische Volksbanken AG as well as smaller institutions as minor stake holders.

According to the Act, the volume of the transactions may not exceed €75 billion. This sum thus is the amount up to which the Republic of Austria, through the Minister of Finance, is entitled to take over liabilities.

The Act shall go out of force by December 31, 2009. The reasoning behind this is that it is intended to only be a temporary measure to tackle a transient crisis on the financial market. This means that thereafter, the Republic of Austria will not take over further liabilities. However, OeCAG will continue to exist to settle existing liabilities.

Financial Market Stability Act (FinStaG)

According to the Act, the Federal Minister of Finance may, for the recapitalization of credit institutions and insurance companies, take over liabilities of such companies or issue guarantees covering their receivables, grant loans, as well as equity, acquire shares or convertibles in case of an increase in capital, or acquire shares by contractual means. Credit institutions or insurance firms affected by the financial crisis may also be nationalized.

In order to implement these measures, the Minister of Finance may avail himself of the Österreichische Industrieholding Aktiengesellschaft (Austrian Industrial Holding Corporation, ÖIAG) or a subsidiary of it especially established for such purposes. ÖIAG is a share company, wholly owned by the Republic of Austria, which manages participations of the Republic of Austria still existing in some commercial sectors not yet entirely privatized.

The Financial Market Stability Act does not have a time limit.

Further legislative measures

Contemporaneously with the passing of these Acts, other codes and statutes were amended to fit the present situation, eg. the Austrian Banking Act as well as the Stock Exchange Act. In the Banking Act, in particular, the provision according to which personal savings were guaranteed up to the amount of €20,000 has been amended and now has an unlimited guarantee. As of January 1, 2010, this guarantee will be limited to €100,000 again. By virtue of this means Austrian population's trust in the stability of the financial markets is to be re-established. The Stock Exchange Act enables the Austrian Financial Market Supervisory Agency to restrict or prohibit short selling of certain financial instruments.

Aspects of European law

The Interbank Market Consolidation Act as well as the Financial Markets Stability Act have been approved by the European Commission according to the rules and regulations governing state aid.

Summary and future prospects

Considering the macroeconomic development so far, it can be said that the legislative measures have had an outward positive effect with regard to the Austrian national economy. So far, neither have any major disruptions of the Austrian monetary and credit markets occurred, nor has a severe recession taken place. Therefore, confidence is growing that Austria will secure and expand its financial operations in Central Europe in the future. ■

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The Cyprus Economy and Its Economic Role in Europe

Charilaos Stavrakis is the Minister of Finance of the Republic of Cyprus

Joining the European Union in May 2004 was a landmark for the Cyprus economy, as the process of harmonization to the European rules and regulations has brought forward many significant reforms. Though these changes have posed significant challenges for the public and the private sector, they have also set the stage for sustained economic growth. Moreover, Cyprus adopted the euro as from 1st of January 2008 and thus has been able to enjoy the benefits of the single currency and the benefits of being a member of a strong group of countries, such as the euro area.

The economy of Cyprus can be generally characterised as small, open and dynamic, with services constituting its engine power. The tertiary sector is the fastest growing area and accounted for about 80% of GDP in 2008.This development reflects the gradual restructuring of the Cypriot economy, from an exporter of minerals and agricultural products in the period 1961-73 and an exporter of manufactured goods in the latter part of the 1970s and the early part of the 80s, to an international tourist, business and services centre during the 1980s, 1990s and the 2000s. The secondary sector (manufacturing) accounted for around 17.5% of GDP in 2008.The primary sector (agriculture and fishing) is continuously shrinking and only reached 2.5% of GDP in 2008.

It`s important to also note that, like most island economies, Cyprus is dependent on imports. The main product categories imported are road vehicles, fuel and lubricants, iron and steel products, power-generating equipment, machinery, medicines and pharmaceutical products, clothing, foodstuffs and drink and cigarettes. Traditionally the UK has been the single most important trading partner for Cyprus. The two countries have a longstanding and wide ranging bilateral relationship which has been further strengthened by Cyprus' EU membership. Indicatively, in 2008, UK exports to Cyprus totaled €640.5 million, whereas the UK imported from Cyprus, goods worth €119.2 million.

Regarding the production process, the private sector, which is dominated by small and medium-sized enterprises, has a significant role. The Government's role is, mainly, to support the private sector and regulate the markets, in order to maintain conditions of macroeconomic stability and a favourable business climate (through the creation of the necessary legal and institutional framework) and secure conditions of fair competition. For relatively big government projects, public and private sector co-operate via public-private partnerships.

Key sectors of the Cyprus economy are financial services, shipping and tourism. Financial services is an increasingly important area of the economy. There are several local banks as well as foreign banks operating both in retail as well as in specialised banking services. The cooperative credit sector is an important player in the banking system of Cyprus, especially in the retail sector. It consists of 118 Cooperative Credit Institutions (CCIs) with branches all over Cyprus, both in urban and rural areas. The Cyprus insurance sector is considered to be competitive and sophisticated, due to the large number of insurance suppliers operating on the island in relation to the size of the population. An official stock market was established in 1997. The Cyprus Stock Exchange (CSE) is an associate member of the Federation of the European Stock Exchanges (FESE). In 2006 the CSE launched a common platform with the Athens Stock Exchange.

As early as 1963, Cyprus has recognised the significant contribution that shipping could make to the island´s economic development. Since then, successive governments have implemented appropriate policies and have succeeded in attracting shipping entrepreneurs and in developing the island into a fully-fledged shipping centre, which combines both a sovereign flag and a resident shipping industry, renowned for the high quality of its services and standards of safety. Cyprus ranks tenth in the world, with a merchant fleet exceeding 950 ocean going vessels of 19 million gross tonnage, and has the third largest fleet within the European Union, with 12.2% of the total fleet of the EU. Cyprus also appears to be among the top five countries and territories in the world with the largest number of third party ship management companies on its territory.

Since the 1980s, the tourism industry has been the main driver of economic growth. Cyprus is actually considered to be among the world's best holiday and retirement destinations. There are more than 2.4 million tourist visits per year, generating revenue of more than €1.7 billion and making a contribution to the GDP of about 11%. Around half of the numbers visiting the island come from the UK. Although traditionally focusing on the sun and sea sector, the Cyprus Tourism Organizations' new Tourism Strategy, which was implemented in 2003 and will run until 2010, aims at also developing special-interest tourism and creating a high quality tourist experience. This strategy creates numerous investment opportunities in the tourism sector such as the development of theme parks, museums, parks exploiting the history of the island, conferences and exhibitions, sports tourism, medical and wellbeing tourism, nautical and rural tourism.

Regarding the recent performance of the Cyprus economy, rising living standards have been exhibited, as shown by the high level of real convergence with the EU. The per capita GDP was standing at around 94.6% of the average for the EU27 in 2008, driven by the real GDP growth of 3.7%. Labour market conditions in Cyprus generally have been conducive, with the unemployment rate being around to 4% of the labour force and employment rate rising close to 71% in 2008. Employment growth has continued to expand strongly, sustained, to a considerable extent, by a continued inward immigration and the employment of Turkish Cypriots. Public finances have been substantially improved, reaching a surplus of 1% of GDP in 2008. The public debt, as a percentage of GDP, entered a downward course and is estimated at around 49.3% in 2008, from 69.1% of GDP in 2003.

Main economic indicators

	2006	2007	2008
Rate of growth of GDP (%)	4.4	4.1	3.7
Per capita GDP in PPS, (EU-27 = 100)	90.3	90.7	94.6
Rate of Inflation HICP (%)	2.2	2.2	4.4
Unemployment Rate (%)	4.5	3.9	4.0
Employment Growth (%)	2.7	3.1	1.9
Fiscal Position (% GDP)	-1.2	3.4	1.0
Public Debt (% GDP)	64.6	59.4	49.3

However, the unfolding international economic crisis, which has deepened appreciably since September 2008, has had a major impact on world growth and on EU. Cyprus has so far weathered the storm reasonably well and is relatively less affected from the crisis, compared with the other European economies. This can be partly explained by the strong and healthy banking system of Cyprus, which had very limited exposure to toxic products and hence has exhibited strong capital adequacy and liquidity ratios.

Given the global economic crisis, the prospects for the Cyprus economy in 2009 naturally appear to be more challenging than

2008. The crisis primarily affects the construction, real estate and tourism sectors in Cyprus. Given the deceleration of the economy, the Government of the Republic of Cyprus has adopted a number of fiscal measures to support the real economy, which are in line with the wider European effort for economic recovery. The measures target the tourism and construction sector, which are the areas hit the hardest.

In the medium term perspective, the adoption of the euro is expected to strengthen economic growth, through the improvement of the overall business environment and the strengthening of confidence that international markets and investors place in the Cyprus economy. Moreover, the eurozone constitutes Cyprus' largest trading partner and trade relationships are expected to be enhanced even further. Indeed, Cyprus has already enjoyed some benefits, through reduced interest rates and increased foreign direct investment and other capital inflows.

Regarding the issue of Cyprus as an attractive investment destination, it is worth mentioning the comparative advantages Cyprus offers as an international business centre.

First of all, Cyprus' geographical location in the eastern Mediterranean Sea places it close to the busy shipping and air routes that link Europe with the Arab world and the Far East. This strategic position has played a major role in the development of the island, as the base for many of the world's leading multinational companies. The strategic location combined with tax incentives and modern infrastructure have made Cyprus a hub for companies seeking to conduct operations with the Middle East, Eastern Europe, Russia and other former Soviet Union Republics, the EU and North Africa. The island is today the European Union's south-easternmost outpost, and therefore, it is not surprising that Cyprus is considered as "the gateway" of Europe.

Cyprus also has a favourable investment policy for both EU and non-EU nationals. Since October 2004, most restrictions concerning non-EU residents have been lifted, signalling the completion of earlier reforms concerning EU investors. The Government of the Republic of Cyprus has recently established the Cyprus Investment Promotion Agency, in order to promote Cyprus more effectively in overseas markets, as an attractive foreign investment destination and a centre for international business operations. Furthermore, in order to facilitate and expedite the whole process of establishing operations in Cyprus, the Government has set up "One-Stop-Shop" under the auspices of the Ministry of Commerce, Industry and Tourism, for both local and foreign-based companies.

In addition, the accession in the EU implies an overall improvement of the conditions of security and the consolidation of macroeconomic stability. It also creates additional opportunities for the Cypriot services sector in the internal market of the EU. At the same time, Cyprus boasts a workforce with high educational level, a satisfactory state and continuous upgrading of its infrastructure in transport, energy and telecommunications, high quality consultancy services such as legal, accounting, auditing and a modern legal, financial and accounting system, identical to that of Britain.

I would like to give special attention to the current tax regime in Cyprus given its importance for foreign investments. First of all, the tax reform that took place in 2002 is in compliance with the EU Code of Conduct for Business Taxation and the commitment to the Organization for Economic Co-Operation and Development (OECD) for the elimination of harmful tax practices. It is a simple and modern tax system, which applies comparatively low tax rates for corporations and physical persons. The uniform corporate tax rate of 10% is one of the lowest corporate tax rates in Europe. The taxation system is also friendly to non-residents and businesses, since, for example, it abolished withholding taxes on interest and dividends. Moreover, the Government of the Republic of Cyprus intends to expand its current network of bilateral treaties for the avoidance of double taxation. Cyprus already disposes a wide network of agreements for double taxation avoidance with more than 40 countries.

To conclude, I would like to reiterate the ability of the Cyprus economy to successfully confront major challenges. I would also like to highlight Cyprus` establishment as an important business centre, which offers great opportunities for business and commercial activities. Last but not least, we have set the foundations for enhancing our trade and economic relations with the EU countries and we are certain that the existing opportunities will be further explored. ■

Operating Impact and Insurance Implications Resulting From Production Fluctuations in the Process Industry

The following Swiss Re experts contributed to this article: Stanley Cochrane, Ernst Zirngast, Peter Buetikofer, Georges Galey, Ulrich Straub, Michael Kuhn and Nicholas West

Assessing exposures and calculating an adequate premium is an essential part of single risk underwriting. Most of the currently available underwriting tools assume that such exposures depend primarily on industry type with corresponding premium rates based on fire loads, processes, protection level and covered perils. Even during economically stable times, industries that produce or process commodities – including oil, gas, petrochemicals, steel, mining, pulp & paper – are not among the risks that are easily managed – neither by plant operators nor insurance underwriters. In times of economic downturn when the additional risk from cyclic operation is added, it is of even greater importance to monitor these occupancies and take appropriate action to address the risk changes.

Fluctuating economic conditions pose many challenges for industrial operations and their insurers. Areas of concern include shutdown and re-start operations, increased technical and moral risks in connection with the workforce (ie. skills, motivation, external influences), as well as valuation questions.

Insurance underwriters can no longer assume that long term parameters will adequately reflect this volatility and the underlying exposures. Changes in risk affect all lines of business, particularly Material Damage and Business Interruption (BI) insurance. This article focuses on the mitigation possibilities available to risk managers and how underwriters can manage the additional exposures resulting from cyclic operation of continuous processes.

Managing fluctuating demand

A German chemical company announces shutdown of more than 80 plants worldwide. A large US-based multinational chemical company reports that the utilisation rate of their plants falls from 67% in December 2008, to 44% in February 2009. A large Middle Eastern-based chemical company reports a 95% drop in quarterly profits due to erosion of gross margins and reduced demand. A US-based chemical company reduced the working hours of employees.

These recent news headlines highlight examples of the operating impact on the processing industry when demand fluctuates. Due to reduced demand, petrochemical and chemical plant operators, as well as some refiners, have decided not to operate plants on a continuous basis. Instead, they start and stop sections of continuous processes as needed.

Sizeable reductions in production pose two main issues. First, the mode of continuous operation is replaced by a cyclic operation. Shutdown and start-up up, rare in steady state operation, now become the norm. Second, reduced income and lower margins lead to organisational changes such as downsizing and business process

re-engineering.

While most plants can be operated at a partial load without any significant impact on process safety, many others are unable to adapt to cyclic operations. In the particular case of a chemical plant with batch processes, the time between batches can be increased to reduce throughput. Line production may also be reduced by closing some of the production lines or by stopping the production for an extended period of time such as long weekends. However, the more continuous the processes are, the more challenging it is to operate them at reduced throughput. As a general rule, processes work on the basis that one tonne of feedstock must, in real-time, produce approximately one tonne of product. All the plant processes must then be operative to reach that steady state condition. While throughput can generally, but not always, be reduced by 20 to 30% without significant disruption to the given operating envelope, further reductions can cause instabilities in the operation of equipment.

Additionally, most continuous processes are no longer built in double or multiple production trains. While single train operation has become the norm, multiple train production is more flexible and accommodating to varied demand.

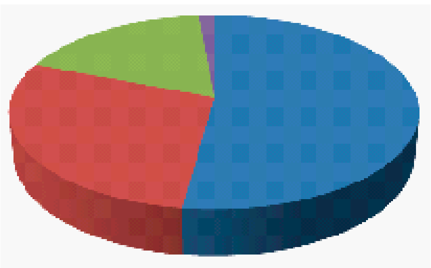
Cyclic operation harbours risks

Damages in the processing industry are likely to occur more often during start-up and shutdown phases rather than at continuous operation. Moreover, cyclic operations are significantly more demanding than continuous operations as they require better trained operators and more detailed procedures. Should the more experienced workforce be downsized, the operational hazard during cyclic operation is amplified.

The process industry has already experienced a number of major losses in recent years during start-up and shutdown phases. For instance, a lightning strike at a plant in Wales led to process instability and subsequent efforts to shut down the plant failed causing a major Vapour Cloud Explosion (VCE) and fire. An attempt to start up the isomerisation (ISOM) unit at a location in Texas led to large hydrocarbon release, followed by a VCE and ensuing fire in 2005. An ethylene oxide plant in Texas had a severe explosion during start-up due to the fact that oxygen analysers were bypassed leading to a runaway reaction. A gas plant in Mexico suffered a large loss due to a VCE during a start-up of a section of the gas processing unit. The operator opened a valve to a pump before the pump flange was firmly connected to the pipe work. Corrosion characteristics during the transient condition of shutdown are different to those of continuous operation. A case in point was the corrosion of the pipe in a refinery loss in Kuwait which happened as a result of the shutdown during the war period. The experience in the process industry is analogous to the aviation industry where nearly 80% of all accidents occur during the phase of starting and stopping flight activity.

Loss statistics in the process industry are not widely available. However, a provisional look into the Oil and Petrochemical Loss Information System (OPLIS) database documents 1,322 incidents regarding their operational status. Of these incidents, 689 occurred during shutdown, start-up, commissioning, filling, loading, testing, transient condition, trip-out or process upset, 234 occurred during repair or welding and 399 took place during normal operation and production times. Thus approximately 52% of incidents occurred during the phases of change of throughput, 18% during repair activity and 30% during normal operation.

Incidents and operational status



Source: OPLIS

Organisational changes also harbour risks

Safety is potentially also influenced by organisational changes in companies, including downsize of operations, business process re-engineering, and outsourcing programs. There are correlations between job insecurity, job satisfaction, workload changes and the human tendency to bend the rules and to cut corners during working hours.

When a company's gross margins are low, or during mergers and acquisitions, there is pressure for manning levels to be reduced. The subsequent downsizing not only causes shortfalls in the performance of certain tasks, but also triggers corporate memory loss which, in turn, increases the frequency of errors. Not all companies are affected in the same way. If the manning level is high, for instance, the hazard rating tends to be low. However, when the fluctuation rate is high through attrition or downsizing, then the risk is likely to skyrocket, regardless of the manning level.

Hazard rating of manning level in function of fluctuation/downsizing rate

Manning level	Fluctuation in operations- and maintenance department		
	Low (0- 5% pa)	Medium (5 to 10% pa)	High (> 10% pa)
Low	Medium	Medium–High	High
Medium	Low–Medium	Medium	Medium–High
High	Low	Medium	Medium–High

Source: SwissRe, Risk Engineering Services

Losing know-how

Retiring specialists who take their knowledge with them pose an additional threat to the processing industry. Many of these employees were involved in the initial start-up of plants and gained a great deal of experience in operating these units over their years of service. Their knowledge of start and stop processes is often not shared with other colleagues verbally or through procedures manuals. Some plants have begun to capture their know-how in detailed Pre-Start-Up Safety Reviews (PSSR) and in start-up procedures for both whole units and equipment. These manuals should cover step-by-step descriptions of start-up procedures, followed by a combination of tick boxes and numerical input requests. Up to a few years ago, plants were shut down on a yearly basis, giving operators sufficient time to get acquainted with this process. Today, however, the time between turnarounds has increased to six years in certain areas. This deprives operators of the valuable "learning-by-doing" experience.

Mitigating risk

Many of the issues facing plant operators can be addressed with common sense solutions. For example, companies should keep their key know-how carriers onboard during the downturn phase and store the experience of more senior workers in procedural descriptions and guidelines. Step-by-step descriptions of start-up and shutdown procedures and PSSRs are also highly recommended. These should not be limited to unit/plant start-up, but should also cover specific items of equipment such as compressors, blowers, heaters, furnaces, reactors and large pumps. Additionally, to minimise risk and stress levels for employees, plant operators should fix the minimum number of people required to be present for a safe shutdown/start-up and limit night shifts per employee to about four. Keeping the control room well-lit (more than 500 Lux) is another important point. Installing a dynamic process simulator to train start-ups and shutdowns under stressed conditions is also a valuable investment.

Recommendations for underwriters

In dealing with the processing industry, underwriters must gather detailed information on the operations and processes and strengthen their technical exchange with both brokers and insureds.

Underwriters are also well-advised to monitor the insured's safety and security standards, especially with respect to plants operating in start and stop mode rather than continuous operation, particularly if they are near the end or even beyond their intended lifespan. Further due diligence should include, among other things, checking the accuracy of the sums insured, adjusting them if necessary, and re-evaluating

items such as limits, deductibles and BI waiting periods.

Underwriters should always be scanning policy terms and conditions looking for possible flaws, such as the omission of average clauses and similar soft market conditions. The introduction of policy warranties to prevent operational increases in risk from going unnoticed is also highly advisable. Finally, the increased exposure should be reflected in premium charged. Underwriters should stay away from risks which do not appear to fulfil necessary underwriting standards. ■

Discovering Malta's Business Incentives

Dr Olga Finkel, of WH Law Group Malta, provides a useful summary to incentives and benefits Malta has to offer to international businesses in various sectors

Malta, a member of the EU, is fast becoming a destination of choice for European businesses looking not only to have an efficient base in Europe but also to finding a gateway, due to its geographic location in the centre of the Mediterranean, into Middle East and African markets.

Businesses are always on the lookout for new opportunities and for ways to reduce costs and thus improve competitiveness. As part of this drive, it is worth considering establishing beneficial corporate structures or relocating part of the business to a cost-effective jurisdiction, especially if such jurisdiction also provides a highly qualified and multilingual work force, sophisticated regulatory environment with efficient and very approachable regulators, highly developed telecommunications infrastructure, as well as fiscal incentives. Any such move should not, of course, impair in any way the European business' rights and benefits emanating from the freedoms of the single market and credibility of European regulation.

This article provides a summary of the main incentives available to businesses seeking to establish themselves in Malta.

Corporate taxation

Malta offers an effective tax rate of 5% to non-resident shareholders. By means of the tax imputation system and the system of tax refunds, shareholders are refunded 6/7ths (30%) of the 35% tax paid by the company on distribution on dividends. No further withholding taxes on dividends or royalties are charged with respect to non-resident shareholders.

Non-resident shareholders are in most cases exempt from capital gains arising from disposal of shares in Maltese companies and from capital gains arising from foreign investments. This makes establishing holding structures in Malta to hold assets overseas very beneficial. There is also an exemption in like cases from stamp duty on acquisition of shares in Maltese companies.

As Malta is a member of the European Union, dividends arising from Maltese subsidiaries are subject to the EU Parent-Subsidiary Directive. Moreover, Malta has a wide network of double taxation treaties (45 and growing).

Human resources

Compared to Western Europe, Malta's skilful and multi-lingual workforce presents an average of 25% to 30% savings on labour costs. The only additional cost of employment to the employer is the employer's part of the social security contribution being either 10% of the gross salary or €1,661 a year (which figure increases slightly every year), whichever is the higher.

ICT, R&D and outsourcing industries

A number of fiscal incentives are applicable to 'qualifying activities' carried out in Malta such as software development and other research and development, as well as the operation of call centres, just to mention a few. The main incentives include tax credits on capital expenditure and human resources costs, cash grants for training and employment aid. Malta offers a state-of-the-art telecom infrastructure which, coupled with the above incentives and the availability of trained personnel, has resulted in more and more international companies establishing its R&D arms, international call centres and high-tech operations in Malta. Being 'near-shore' in Europe is an added advantage for call centres and support operations servicing European business.

The SmartCity@Malta, a foreign direct investment project that will result in a purpose-built city providing a one-stop-shop business park to high-tech companies on the lines similar to Dubai's Internet City, will open its doors in the near future.

There are some additional incentives for small and medium enterprises in line with EU policies.

Funds management

The net asset value of funds domiciled in Malta today is over €7 billion. A rapid regulatory process and lower costs are some of the main advantages of moving funds to Malta. One can find other possibilities rarely found in other EU jurisdictions, such as the registration of self-managed funds, to which the EU's Markets in Financial Instruments Directive (MiFid) may not apply.

After revision of its regulatory framework, Malta is presenting benefits not only to retail funds, but also to professional investment funds (PIFs), which include hedge funds and private equity funds. A fund registered in Malta is required to appoint one resident director, but does not require a local administrator, thus adding to the flexibility of the setup. The licensing process is in fact very efficient - a promise to license 'in principle' can be obtained within a week and a full licence within six weeks. In most circumstances, investment funds are exempt from tax.

Insurance

Being the only jurisdiction within the European Union that have enacted legislation for recognising and regulating protected cell companies (PCC), Malta has already experienced a number of European insurance companies establishing themselves locally to benefit from this regime. Under the PCC legislation, the revenue streams, assets and liabilities of each cell are kept separate from all other cells and the core of the PCC. The assets of each cell are segregated from the assets of other cells, which means that a claim on assets belonging to one cell does not effect in any way the assets of other cells.

The single passporting rights within the EU allow an insurance company established in Malta to directly write third party business throughout the EU from Malta, thus benefitting from the advanced and pro-business regulatory approach and reduced cost of running the business.

Malta is often considered as an efficient base for non-EU insurance companies seeking a base in the EU, especially in view of the Reinsurance Directive.

Shipping and yachts

In addition to widely known advantages of ship registration under the Malta flag (such as the availability of bareboat charter registration and tax exemptions) there are certain incentives for pleasure vessels

registered in Malta. Under rules introduced in 2006, for yachts 10 meters and longer, under certain conditions, VAT payment for a new boat can be cut to as low as 5%. Moreover, there are advantageous rules for financial leasing of yachts bringing substantial savings to boat owners.

As before, ship financiers benefit from Malta's regime of affording ship mortgage an executive title, allowing a swift and efficient enforcement of lender's rights over the mortgaged ship.

Pharmaceuticals

The patent legislation in Malta allows companies to experiment and develop generic drugs in advance of patent expiry, thus allowing companies in the generics' business to start sales of their products immediately upon the expiry of the relevant patent.

Remote gaming

Malta is a first tier jurisdiction within the EU for regulating remote gaming activities. All types of games may be licensed and the operation must run from Malta. Companies licensed in Malta benefit from the Malta's EU membership and thus the freedom to provide their services cross border in the EU, so that other EU countries may not prohibit this services, unless on the ground of coherent, necessary and non-discriminatory policy. Moreover, Malta has been included in the white list of regulated jurisdiction in the UK, so companies licensed in Malta can advertise to customers in the UK.

WH Law Group

Consisting of a Law Firm and associated companies and partners, WH Law Group assists corporate clients in establishing and running their operations from Malta, particularly in the sectors outlined above. Please contact our interdisciplinary team of specialists for further information and assistance on info@whlaw.eu or visit www.whlaw.eu ■

NBAA Convention: Serving All of Business Aviation in Challenging Times

Dan Hubbard is Vice President of Communications at the National Business Aviation Association

This year's National Business Aviation Association (NBAA) Annual Meeting & Convention promises to be yet another highly valuable event for the many companies involved in business aviation in the United States and around the world.

Long recognized as the must-attend event for the industry, the 62nd annual convention is set for October 20-22, and once again will be in Orlando, FL, at the Orange County Convention Center. The Static Display of more than 100 aircraft will again be at nearby Orlando Executive Airport.

Although the show comes together in the midst of stiff economic headwinds, the convention is on track to live up to its reputation for being the most productive and efficient opportunity for business aviation buyers and sellers to connect.

Association President and CEO Ed Bolen said the association has been aggressively reaching out in a variety of ways to attract existing operators and first-time customers to the meeting. "NBAA has been involved in a number of innovative programs and outreach efforts, all designed to attract potential customers from across the country and around the world."

Bolen added that NBAA is particularly sensitive to the economic conditions currently facing the industry, and that NBAA has taken a number of steps to make the show as accessible as possible for all participants.

"We fully realize the state of the economy and its effect on our industry," Bolen said, "so we are taking a number of steps to make this year's convention as cost-effective for exhibitors and attendees as possible." As one example, Bolen pointed to NBAA's decision to freeze rates for exhibiting or attending this year's convention at the same level as last year's show.

Bolen added: "The convention will also provide an important opportunity for the industry to put forward a positive image and promote the many benefits of business aviation.

Demonstrating the value of business aviation

The theme for this year's convention – "Demonstrating the Value of Business Aviation" – aligns precisely with NBAA's ongoing mission to highlight the many benefits business aviation provides for citizens, companies and communities across the US.

The continuing work to carry out this mission is illustrated most vividly through No Plane No Gain, an advocacy initiative cosponsored by NBAA and the General Aviation Manufacturers Association (GAMA).

NBAA2008 Static Display Breaks Records With Cutting-Edge Aircraft

The campaign makes clear that business aviation generates over a million jobs in the US alone (and many more around the world), provides a transportation lifeline to communities without airline service, helps companies be more efficient and productive, and supports humanitarian and philanthropic endeavors.

Throughout the year, the No Plane No Gain campaign has been educating policymakers and opinion leaders about the importance of business aviation through paid advertising in public affairs programming, national television, print and radio news stories, use of the internet and direct outreach to lawmakers on Capitol Hill.

The convention provides an ideal forum to build upon the two associations' advocacy efforts, and amplify the campaign's message about business aviation's important role in the nation's economy and transportation system. As just one example, the gathering of the business aviation community in host city Orlando is estimated to result in about $37 million in economic activity for Orlando.

Providing value for exhibitors and participants

Of course, NBAA's Convention won't just be focused on articulating the industry's value to policymakers and opinion leaders. The show will also focus on providing tools to help the people in business aviation navigate the challenging economy, and survive and thrive in a turbulent marketplace.

The show features a packed agenda that includes speakers with valuable insights to help companies of all sizes understand and confront their economic challenges, including sessions to help attendees quantify and communicate the value of their business aircraft. Sessions will also focus on practical tools to help NBAA members operate their aircraft as efficiently, safely and cost-effectively as possible.

Featured speakers will discuss what global economic trends mean for attendees, including an opening general session speech by *Forbes* magazine publisher and business airplane owner and pilot Rich Karlgaard.

Equally important, the convention will provide briefings and updates on the host of regulatory and legislative challenges facing the industry, and the potential impact of new policies on NBAA member companies. Sessions will focus on security, global emissions control issues, and US air transportation system modernization efforts.

NBAA2009 to include light business airplane focus

NBAA2009 will also feature a Light Business Airplane (LBA) conference at the three-day gathering – a conference within the convention specifically designed to address the needs and interests of light business airplane owners, pilots and entrepreneurs who want to maximize the value a general aviation airplane can provide to their business. There will even be special seminars for businesspeople who are considering a general aviation aircraft for their operations.

Highlights of the special LBA offerings for owner-operators, or anyone contemplating using a light airplane for business, include:

- Education on the tax benefits of using a general aviation airplane for business
- Ideas for entrepreneurs thinking about upgrading their airplane
- Exploration of free online flight and fuel planning resources
- Overview of key technologies available to owners wanting to lower costs and make the most effective use of their airplanes

In addition, John and Martha King, the renowned aviation instructors and jet owners and operators, will be featured speakers at a special LBA session geared for pilots of piston aircraft who are interested in learning more about transitioning to turbojet aircraft. The Kings will share what they wish they had known before they bought and operated their first jet.

NBAA President and CEO Ed Bolen said the focus on light airplane needs is consistent with NBAA's mission to serve companies of all sizes that rely on an airplane as part of doing business.

"A lot of companies are relying on airplanes that care capable of being flown single pilot," Bolen said. "Companies are using everything from the Cirrus SR22 to the Pilatus and the light jets. The LBA program at this year's convention underscores NBAA's commitment to serving businesses large and small, operating out of big cities, small towns and rural areas, creating jobs and taking part in a global economy."

As part of NBAA's long-standing role in disseminating best practices for the safety of flight, a new Single Pilot Safety Standdown will be sponsored by the Cessna Aircraft Company. The standdown will cover explore accident case studies, ground-safety guidelines and other resources to support the safety of single-pilot operations.

NBAA2009: a must-attend event, especially in a challenging economy

Clearly, more than ever, NBAA's Annual Meeting & Convention is the one event that will remain on the calendar for the business aviation community.

"Even in tough times – maybe especially in tough times – NBAA's convention will remain a critical event for promoting a positive image of business aviation, conveying valuable operational information and providing an outstanding forum for the hundreds of companies that depend on the show to market their products and communicate with their customers," Bolen concluded. "It is clear that for everyone who cares about business aviation, Orlando will be the place to be from October 20 to 22." ■

Mary Matalin and James Carville speaking at the Opening General Session of the 61st Annual Meeting & Convention (NBAA2008).

NBAA 2009

62ND ANNUAL MEETING & CONVENTION

ORLANDO, FLORIDA › OCTOBER 20, 21, 22




NBAA2009: A CRITICAL PART OF YOUR BUSINESS STRATEGY

This year more than ever, NBAA2009 will focus on helping Attendees and Exhibitors survive and thrive in these uncertain times.

Attendees will get the information, products and services they need to help their Companies stay as efficient and productive as possible.

Exhibitors will have the unparalleled opportunity to put their products and services in front of thousands of customers – all in one place, at one time.

For all, NBAA2009 presents unrivaled networking opportunities for industry peers and will show the strength and resilience of the many diverse companies that make up the business aviation industry.

WWW.NBAA.ORG

Dagmar Grossmann has more than 25 years experience in the aviation industry, and Grossmann Jet Service spol. s r.o. today ranks among the leading airline operators in central Europe. Grossmann Jet Service was nominated in the 2008 CZECH TOP 100 competition of most significant companies in the Czech Republic. Mrs Grossmann is an active speaker at business seminars and forums. She will be a speaker at "Very Light Jets - Europe 2009 Conference", which will be held in Oxford on 24 - 25 September 2009. The topic of the speech will be "Acceptance of the VLJ in Central Europe."

Cleared for Takeoff

Dagmar Grossmann, CEO of Czech private jet operator Grossmann Jet Service spol. s r.o. introduces her company and comments on the current climate of the private jet market in an interview with Tom Page

How did you get your start in the aviation business?
I literally started from scratch and had no idea that it would become my passion and career. I simply applied for fun one day for a position as a flight attendant, mainly to finance my studies, and then everything fell into place after that. I met my husband, who was a pilot and business aviation manager at the time, and in 1983 he came up with the idea to start out own business. At the time I wasn't too keen on the idea, I was worried we didn't have enough capital to really start it properly. But we made it work, he was the visionary and I was worker. We had 15 planes and by 1995 we were the biggest operator in Austria. I was in charge of the management and operations and learned on the job, which certainly wasn't easy. We ended our cooperation over the decision to buy a large aircraft outright and I decided to shift my focus to the open market in the Czech Republic and open my own business there. Today, Grossmann jet operates 3 planes, and the Jet Set Up Center, a consulting business. Our company ranks among the top 15 best operators in Europe, according to a recent analysis by a well-known bank.

What sort of expertise does Grossmann Jet Service provide its business clients?
We take care of the clients on an individual basis and make them feel like they're our only client. We stress the details and focus on their specific needs. On the ownership side, we also pay careful attention to our fleet, as aircraft maintenance maximizes the owner's profit in the event of a sale. The quality of our maintenance and standards is always reflected in the selling price.

My team maintains a constant level of focus in order to guarantee our clients the highest standard of quality. We are available 24 hours a day for any request, no matter how small. That availability is a challenge for our company's operations, but it's necessary, and we always provide it. My team works very hard, but the experience they gain means they are in high demand and it maximizes their career options, should they ever want a job change. When employees leave the company they are in high demand, and employers appreciate their quality of work and training, I believe that's a testament to the quality of operations at Grossmann Jets.

How can corporate jet services provide a competitive advantage to businesses during an economic downturn?
That question can be answered by simply looking at the news coming out of the aviation industry. Commercial airlines are cutting their services drastically in an effort to save money. Every service they take away, we are continuing to provide to our clients, which only strengthens our position and competitiveness. Look at luggage limitations, passenger volume, restrictions on liquids and everything else. Sometimes I just can't believe these corporate boards are agreeing to these drastic steps, which will only lead to less passengers. Personally I would have found other ways to cut costs before I cut services to passengers and lowered the quality of flights for clients. For example, sacrificing first class is a huge mistake.

We are very flexible, which is of the utmost importance for our clients. We can react immediately to any need and our strategy is always open to changes in demand or market conditions. Our team has an all-hands 9am meeting every day in which we discuss absolutely everything. Even if I'm abroad, I participate via conference call to stay on top of everything. But it also provides a forum for feedback from every single employee, who are all out on the frontlines of the business.

How do you anticipate the sector developing in the future, and what plans does Grossmann Jet Service have?
The market for chartered jets is growing, which also means the competition for mid-size jets is getting tougher. Like any market, if you are flexible and service-oriented, you will succeed and be able to grow your business. Grossmann Jets Service is constantly planning new projects. Many of my ideas come to me when I'm driving my car or travelling. I spend about 15 percent of my day in cars, planes or elevators, so my mind is always thinking about creative strategies. This year in particular we have two big projects, for example we're entering a new market in the Czech Republic and we'll be cooperating on projects in Austria and Slovakia. Another project we're working on will give a stronger voice to the chartered jet industry within the European Union, we're entering a new field in the Czech Republic, but I can't say just yet what it will be.

How are newer markets, such as Russia, evolving?
At one point Russia had one of the fastest growing markets, it was absolutely booming. I was a bit suspicious, however, as I've always had success as a more conservative investor. Business that grows too fast and has volatile turnovers has never appealed to me. That appeared to be the case in Russia, and I was cautious of a market that can often attract investors and operators that are blinded by the expectation of wild success and as a result ignore the difficulties of a local market. Now, Russia has ranked near the bottom in the aviation industry for nearly a decade, the market is saturated with planes for sale and client demand is abysmal. I think the Russian market will continue to perform poorly for at least another five years, so we're not focusing there at the moment.

Please, describe the operations of the travel consultancy side of the company
I had dinner last year with a successful and experienced aviation expert from Canada. Over a nice bottle of wine, we agreed that travel consultancy is really the future of the market. Travel agencies people are our best sales teams, and they're becoming a very attractive alternative to commercial airlines, especially since they offer smaller, charter jets. We're working on the market to connect with peers, monitoring developments and offering better commissions to the travel agencies, and it's working. The work there is to convince the

agents to use charter jets as an alternative to commercial lines. After that is done, the business can run itself, and I believe it's a huge market with very strong potential.

Are there particular markets in Europe that are performing better than others?

Clearly, regions where the local economy is stronger are more interesting to us. We think globally, so booming markets like India or Asia are very important to us, and we try to cover all areas in our service portfolio. The fact that the economic downturn hit a lot of operators means that there are less of us on the market. Adam Smith said it long ago in "The Invisible Hand," and it's still relevant today—that the equilibrium is always present. Fewer providers means there is more business for those that are left. It may come from different areas, but there is a constant market. I will say the EU market is in general doing much better than the US.

What are the biggest differences between the European and US corporate aviation industries?

The US market was huge, and hiring a private jet was becoming quite common. That availability meant there was no focus on the level of service, which has become a disadvantage now for that market.

It was a domino effect; the banking collapse tightened financing conditions which hurt the companies. If you understand the American culture, you know there is a strong tendency to try to set an example, so companies were either selling or trying to sell planes in order to demonstrate they were cutting costs. When you suddenly sell your planes during a recession, it makes the banks nervous because they think there could be a problem in the company. My personal opinion is that half the reason the whole market collapsed was because of rash decisions made in a panicked mindset. Europe is developing more slowly and cautiously, we don't even have one big union, countries like Germany and France strongly compete on EU aviation market. European market is relatively new and has had to overcome a bigger set of challenges, so the whole market has developed with greater flexibility.

What sort of fleet does Grossmann Jet Service have?

We currently operate three aircraft, the Legacy 600, the Hawker 900XP and a Citation Mustang. We have a great portfolio that covers every possible price segment and range. We get offers every week to take on new aircraft under our license, but I am very careful to make sure both the client and the plane fits into our fleet. It has to fit perfectly in order for it to be a win-win situation for both our company and the client.

What advice would you give a company that's considering purchase of a corporate jet?

I've dealt with this situation many times. The first thing I do is make sure I have a very clear picture of the company from an objective standpoint, who they are, what they reflect, how often they travel and for what reasons. I have lengthy conversations with the top management in order to get their different opinions and I check their figures and balance sheets to see how they use travel. That gives me a very good idea about what sort of plane would be appropriate. It's not always cost-effective — sometimes companies need a jet as a marketing tool to give them a certain image they want. All this information together gives me a picture, and it's much like creating a tailor-made dress. I propose the plane, new or used, based on my opinion and experience. In nearly every case I have been right, the only changes come when companies who begin with a cost-effective plane at my suggestion sometimes change to a larger jet within a year. ■

Transfer Pricing and Treaties in a Changing World

Caroline Silberztein is the Head of the Transfer Pricing Unit at the OECD Centre for Tax Policy and Administration[1]

On 21-22 September 2009 the OECD will hold a major conference "Transfer Pricing and Treaties in a Changing World". Transfer pricing and treaty experts from over 100 governments (OECD and non-OECD), from the private sector, academia and international organisations will gather in Paris for the event. This conference is part of the OECD's Global Forum on Tax Treaties and Transfer Pricing, which plays an important role in the OECD Committee on Fiscal Affairs' programme to bring together international tax experts from OECD and non-OECD countries to discuss international tax issues. For the second consecutive year, the conference will be open to participants from the private sector and universities.

A similar event was organised in 2008 for the 50th anniversary of the OECD Model Tax Convention. Participants in the 2008 event overwhelmingly voted the adoption of the OECD's Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations in 1995 as the most important tax treaty development (besides the OECD Model Tax Convention itself) of the past 50 years. Accordingly, this year's conference has a strong focus on transfer pricing, although a number of related treaty topics will be also discussed.

Transfer pricing is an increasingly sophisticated technical matter for lawyers and economists. On the conceptual framework, an inherent difficulty is to allocate profits to various parts of multinational enterprises (MNEs) as if they were independent parties, while recognising that MNEs are more than ever behaving globally. On the more technical side, increasingly sophisticated economic analysis of risks, comparability adjustments, intangible valuation, etc. is developing. This creates challenges for tax administrations and taxpayers alike, as compliance and controls are increasingly complex and resource-intensive.

In a downturn economy, the location of profits and losses within an MNE group is very sensitive as it can greatly affect its effective tax rate, especially where tax losses reported in one country cannot be offset against tax profits made in other countries. Governments also are carefully monitoring the allocation of profits and losses to their jurisdiction, in a context where many of them are striving for a balance between business friendly, pro-growth tax measures and measures to maintain the needed level of tax revenues to support public spending.

These considerations are high in the mind of governments and private sector representatives engaged in the OECD work on transfer pricing and are reflected in the conference programme. Below is a short description of the main topics on the conference agenda.

- **Adjustments and corresponding adjustments: the role of articles 7, 9 and 25 of the Model Tax Convention.** Transfer pricing disputes can arise with respect to the determination of an arm's length remuneration for transactions between associated enterprises (Article 9 of the OECD Model Tax Convention) or to the attribution of profits to a permanent establishment that one enterprise of a State has in the other State (Article 7). Lacking an agreement between the States concerned to resolve the dispute, economic double taxation can arise in the first case if the same profits are taxed in the hands of the two associated enterprises and juridical double taxation can arise in the second case if the same profits are taxed twice in the hands of the same legal entity (once in the country of residence and once in the country of the permanent establishment). Panellists from the OECD Secretariat, from governments and from the private sector will discuss the treaty limitations related to possible adjustments by a tax administration to the profits of a subsidiary and to those of a branch of a foreign company and will examine to what extent the State of residence of the foreign company is obliged to make a corresponding downward adjustment to eliminate economic or juridical double taxation.

- **Information powers and transfer pricing: documentation requirements, exchange of information and burden of proof issues.** In order to effectively enforce transfer pricing legislation, tax administrations need access to information that goes beyond that generally required in non-transfer pricing tax audits. Government and private sector representatives will discuss the implementation of transfer pricing documentation requirements and the use of exchange of information clauses in transfer pricing audits, as well as related burden of proof and penalty issues. The ultimate objective is to find the right balance between, on the one hand, enabling effective enforcement of transfer pricing legislation by tax authorities and, on the other hand, keeping the compliance burden reasonable and providing reasonable certainty to taxpayers who make documentation efforts.

- **Deductibility of interest in related party situations.** The funding of parts of MNEs, whether subsidiaries or permanent establishments, in the form of interest-bearing debt or "free capital" can trigger complex tax issues, in particular with respect to the limitation on the amount of interest charges that is tax deductible in each country. Panellists from the government and private sectors will discuss the treaty aspects of recent changes to thin capitalisation rules; issues related to the allocation of "free capital" for tax purposes to a permanent establishment in the context of the allocation of profits to that permanent establishment; the use of tax treaties to facilitate double dip financing arrangements and cross-border arbitrage with respect to the interest deduction.

- **Transfer pricing in a downturn economy.** The recent economic downturn creates more than one challenge for transfer pricing practitioners from the government and private sectors alike. The question arises of the extent to which loss-making situations are to be regarded as "arm's length", depending in particular on the functional and risk profile of each of the entities of the MNE group to which losses are allocated. Disputes can also arise as to the determination of which entities within an MNE group should bear restructuring costs, such as termination costs, severance payments, write-off of assets, depending in particular on the rights and other assets of the restructured entities and on the expected benefits from the restructuring.

  Restructurings do not always involve the downsizing or closing of operations; many restructurings consist in a reallocation of intangible assets and risks within the MNE group (for instance, by transforming a full-fledged manufacturer into a contract- or toll-manufacturer that has limited rights on intangibles and bears limited entrepreneurial risks). In the past 15 years, a strong trend was observed towards the implementation of global, centralised business models that involve the "stripping" of local operations to the benefit of a principal, often situated in a tax friendly jurisdiction. Such restructurings are typically accompanied by a reallocation of a large share of the profit potential to the newly created principal, while the stripped operation is typically left with a small but guaranteed profit. In a downturn economy, these models may lead MNE groups to report a net loss in the country of the principal, while still reporting taxable profits in the countries of the stripped entities, with an immediate effect on the MNE group's effective tax rate.

- **Attribution of profits to permanent establishments - designing a modern article 7 of the Model Tax Convention.** The OECD is on the verge of finalising a major piece of work it undertook more than 10 years ago with a view to clarifying and harmonizing the rules for the attribution of profits to permanent establishments – an increasingly prominent aspect of international tax. In July 2008, the OECD Council approved

for publication the Committee on Fiscal Affairs' *Report on the Attribution of Profits to Permanent Establishments*, the conclusions of which were partly implemented in the 2008 update of the Model Tax Convention. The next step is for the OECD to draft a new Article 7 that will allow the full application of the conclusions of the 2008 report. At the conference, panellists will focus on the main differences between the existing article and the proposed new one.

- **Transfer pricing and customs**. Valuations of cross-border related party transactions for transfer pricing and for customs duties purposes follow different sets of rules, thus creating additional compliance and enforcement costs. Furthermore, they can be subject to competing interests (the higher the value of a cross-border sales transaction, the higher the customs duties basis, but the lower the taxable profit reported in the country of import). Panellists from the World Customs Organisation, from the government and from the private sectors will discuss difficult questions that arise in relation to the possible convergence of valuation rules, the acceptability for customs purposes of transfer pricing adjustments and vice versa, and more generally with respect to the coherence of a "whole of government" approach in that area. Many countries that have reduced or are in the process of reducing their customs duties are at the same time paying increasing attention to transfer pricing. On the other hand, in a downturn economy, customs duties that are assessed on transaction value (rather than on profits) become a bigger concern for those enterprises whose profits are reduced. Countries are also looking at ways of using scarce administrative resources more efficiently, eg. by improving information flows between direct tax and customs administrations.

- **Treaty and transfer pricing aspects of intangibles characterisation**. Intangible assets take a variety of forms. Currently, the attention of transfer pricing practitioners is focusing on "soft intangibles", ie. elements that are not necessarily legally protected intangibles and not always intangible assets recognised for accounting purposes, but are nevertheless regarded as significant value drivers economically and as such may need to be remunerated for transfer pricing purposes. Examples of such items include marketing intangibles, workforce in place, goodwill, synergy gains, location savings, etc. Disputes can arise both about the recognition of an intangible and its valuation, keeping in mind that the amounts at stake can be huge.

- Finally, time will be spent at the conference to discuss a series of **recent court decisions** dealing with transfer pricing and treaty issues. It is in effect remarkable that transfer pricing disputes that were traditionally resolved at the audit level in many countries are now progressively reaching the courts (India being probably the country where transfer pricing case law is developing the fastest).

Conclusion

Transfer pricing legislation and enforcement activities are expanding in OECD and non-OECD countries. The task of the OECD is to broaden and deepen the international consensus on transfer pricing, in an effort to limit the instances of double taxation created by differing country views and to make the arm's length principle workable in a satisfactory manner in the globalised economy where domestic systems are highly interdependent. It is hoped that the 21-22 September 2009 conference "Transfer Pricing and Treaties in a Changing World" will contribute to that objective, by facilitating a constructive dialogue between private sector representatives and tax administrators and between representatives from OECD and non-OECD economies. ■

For further information, please visit the Conference website http://www.oecd.org/tax/ttpglobalforum.

1. *The views expressed in this article are those of the author, not necessarily those of the OECD and its members.*

Draft of the German Administration Principles – Transfer of Business Functions

Oliver Wehnert is the head of German Transfer Pricing practice at Ernst & Young GmbH, Germany

Detailed transfer pricing regulations explicitly addressing the cross-border transfer of functions were incorporated into the German Foreign Tax Code in January of 2008. According to the regulations, the taxpayer is required to establish if a (transferring) German entity is entitled to an arm's length compensation in cases where a function (ie. manufacturing, distribution, research & development) is transferred from Germany to another related party. On 17 July 2009, the Federal Ministry of Finance (BMF) released a draft document outlining the administration principles for the examination of income allocation between related parties in cases of such cross-border transfers (Administration Principles - Transfer of Business Functions, hereinafter referred to as "draft"). The draft includes 72 pages of questions and clarifications concerning the application of Section 1, subs. 3 of the Foreign Tax Code (*Außensteuergesetz* – AStG) and the Order Decree Law on Transfer of Business Functions (*Funktionsverlagerungsverordnung* – FVerlV).

Pursuant to Section 2.12 of the draft, the FVerlV directly applies for all cases of transfer of functions which were completed in a fiscal year ending in the tax assessment period of 2008 and subsequent periods. Furthermore, the draft declares large parts of the regulations that came into effect starting 2008 also applicable to transfers of functions before 2008.

Elements of a transfer of functions

A transfer of functions occurs when an entity (transferring entity) transfers assets and other advantages as well as the associated opportunities and risks to another related party (receiving entity) so that the receiving entity may exercise a function which was formerly carried out by the transferring entity. If the function in the transferring entity is limited by this transfer, this constitutes a transfer of functions.

Commonly occurring "transfers of products" would be, according to the draft, each a separate transfer of functions. This applies in the BMF's opinion even if the production of the transferred product is replaced with the production of another, comparable product.

The elements of the statutory definition of a "limitation of functions" are based on the **revenues** earned from the concretely defined function (see example under Section 2.1.2.2 of the draft). Whether or not the transferring entity is in the actual legal or economic position to continue the performance of a certain function is immaterial.

Exemptions

The draft clarifies several cases that are not considered to be a transfer of functions:

- Cases where a function being performed locally is "duplicated" across borders **(duplication of functions)** and the duplication does not lead to a limitation of the said function locally, ie. no **revenue reduction** within a period of 5 years;

- **Immaterial or temporary transfer of functions** (bagatelle cases like eg. the transfer of a single order) having an irrelevant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effect on profits;

- Cases which fulfil the formal elements of a transfer of functions but are carried out in a manner which is in the **normal course of business** and would among third parties not be considered a transfer of functions (eg. cancellation of contracts in due time, expiration of a contractual relationship);

- Cases where the receiving entity exclusively performs the transferred **(routine) function** for the transferring entity and receives a cost-plus remuneration in accordance with the arm's length principle, since it is assumed that the respective transfer package did not include any significant intangible property or other advantages.

Valuation of the transfer package

In the case of a transfer of functions, the taxpayer is generally required to calculate the compensation for the "function as a whole". The valuation of the so-called transfer package is based on the **profit potential** of the function from the perspective of both the transferring and the receiving entity (hypothetical arm's length test). A net present value approach based on the financial surpluses after borrowing costs and taxes (net earnings) is the primary method to ascertain the profit potential in a hypothetical arm's length test. Nevertheless, the draft clarifies that the selection of a discounted **cash-flow method** is not objectionable. In any case the underlying financial data should be derived from the **planned** annual profit and loss calculations.

Regarding the taxes that are to be considered in the calculation of after-tax profits, the draft provides that "taxes shall also take into consideration the tax effects of the calculated value of the transfer package for both the transferring entity and the receiving entity".

Further, the draft clarifies that the legal and economic bargaining position and hence the action alternatives of the contracting entities is to be considered in the hypothetical arm's length test. The draft establishes that the transfer price for the transfer package is selected from the bargaining range at the value which is most likely to meet the arm's length test. Basically, the draft confirms that in cases where the taxpayer is unable to substantiate a value within the bargaining range, the midpoint is then to be chosen.

Discount rate and period

In determining the arm's length discount rate, customary interest rates for a quasi risk-free investment in both the transferring and the receiving country should be calculated (*base rate*, see IDW S. 1 version 2008 Section 116), whereby the expected duration of performance of the function and the economic life-span of the significant intangible property should equal the maturity of the comparable investment. A functional and risk adjusted premium should then be calculated on this base rate. Furthermore, it should be considered that the expected rate of return is greater in cases of higher debt financing since the risk generally increases.

Section 2.6 of the draft specifies that an **infinite** discount period is regularly to be taken if the transferring function is an entire business, an operational unit (Teilbetrieb) or at least a stand-alone economically viable unit. To the extent to which the transferred functions reside under the threshold of an operational unit (Teilbetrieb), the *better* are the taxpayer's chances of showing satisfactory evidence of a limited discount period. The draft explains this aspect as an important focal point in a tax audit as the discount period significantly influences the calculated value of the transferred function.

Price adjustment clause of the taxpayer

In case of a significant departure of the actual profits from the planned profits which formed the basis of the transfer price calculation the tax authorities may, pursuant to Para. 1 subs. 3 clause 11 AStG, impose a retroactive adjustment on the transfer price for the transfer package established by the taxpayer within an examination period of 10 years. The taxpayer can avoid such an adjustment via establishing an arm's length price adjustment clause (eg. a revenue or profit based license).

Documentation

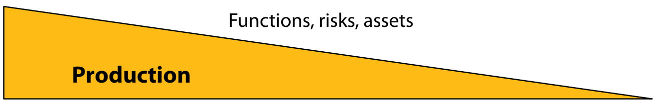
The taxpayer is required to produce documentation in cases of a transfer of functions according to Para. 90 subs. 3 German General Tax Act (*Abgabenordnung* – AO). A transfer of functions is, as a general rule, an extraordinary business transaction and the documentation thereof must be contemporaneous. The draft includes in Section 3.1.3 a list of documents to be prepared by the taxpayer. A notable peculiarity in the draft is that a duplication of functions, which is by definition not considered a transfer of functions, *could* represent an extraordinary business transaction, thus requiring contemporaneous documentation.

In cases where the taxpayer fails to provide records through a foreign related party, the tax authorities are entitled under Para. 162 subs. 3 AO to apply an estimation to the point within the bargaining range most disadvantageous for the taxpayer. This expanded estimation power of the tax authorities is only applicable for tax assessment periods as of 2008.

Specific types of transfer of functions

The draft presents entity characterizations, which were so far mainly customary in an international context. The graphic below displays in an abridged form those for production and distribution entities:

Concerning the entity characterizations the draft exemplifies the conversion of a fully fledged distributor to a commission agent or agent. In such a conversion, a transfer of functions is assumed if the customer accounts and warehousing functions (and thereby the credit default and inventory risk) have been transferred to a related entity. This is due to the position of the BMF that in such a case assets have been transferred and the business activity of the transferring entity is limited. On the contrary, no transfer of functions should occur if only the credit default risk is transferred to a related entity but no assets are transferred. ■



Fully-fledged manufacturer

- Production (with complete risks)
- Marketing

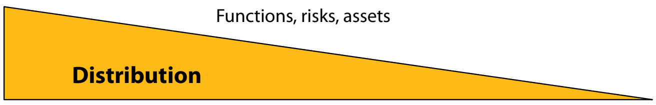
Contract manufacturer

- Production (without production risks)
- No own market opportunities
- No own product development
- No decsion making concerning production and distribution

Toll manufacturer

- Similar to contract manufacturer -

- In addition, appropriation of raw materials by the principal



Fully-fledged distributor

- Marketing with full decision-making responsibilities, risks and relevant assets (eg. customer base)

Contract distributor

- Similar to fully-fledged -

- Inclusion in the sales function of the manufacturer
- No own customer base
- Involvement in pricing and promotion activities

Commission agent/Agent

- No further specification -

"Swiss Practices" For the Determination of Transfer Prices

Dr Raoul Stocker, Head of Transfer Pricing Switzerland, Ernst & Young AG, lecturer on taxation and transfer pricing at the University of St Gallen and Christoph Studer[1], Senior Economist Transfer Pricing, Department for International Affairs, Swiss Federal Tax Administration

Swiss tax authorities are showing a growing interest for transfer prices of international companies. Although no specific transfer pricing regulations have been defined so far in the Swiss fiscal law, the applicable fiscal law and various administrative directives contain numerous references on transfer pricing issues in Switzerland, preferred methods and resolutions of transfer pricing conflicts. Chosen aspects of "Swiss Transfer Pricing Practices" are therefore presented below.

Introduction

Under the assumption that the determination of transfer pricing would enable income and capital tax revenue to be transferred to Switzerland due to the lower tax burden, the Swiss tax authorities have always rejected to scrutinize their legal compliance. Therefore, in the past, transfer prices of Swiss companies had to be mainly defended abroad and the possible economic double taxation had to be resolved through mutual agreement solutions. With the centralization and internationalization of companies' business activities and the growing inclusion of zero or low-tax countries in group structures, there is a risk that Swiss groups, respectively Swiss subsidiaries or branches of foreign corporations, shift their income and capital tax revenue from Switzerland to other countries. Thus, the determination of transfer prices for multinationals is an issue that has been increasingly addressed by the Swiss tax authorities.

Legal basis and administrative directives

So far Switzerland has not released any specific transfer pricing regulations. Intercompany transactions between a company and a shareholder respectively related parties need to be determined according to "third-party prices" under the Federal Law on Direct Federal Tax (DBG) and the Federal Law on the Harmonisation of the Cantonal and Communal Taxes (STHG). These legal principles define the calculation of taxable profits and enable Swiss tax authorities to correct the income statement for tax purposes. The corrected amount includes non-economically justified expenses and non-credited revenues.

According to the established jurisprudence of the Federal Court on hidden dividend distribution, a transfer price may be adjusted if the following three cumulative conditions are met:

- A service is performed, which is not compensated by an adequate remuneration, so that the service is considered as a withdrawal of company funds, since it reduces the profit and loss account of the declared company results;
- The transaction benefits a shareholder or a related party, ie. the benefit is directly or indirectly received, which supposes it is omitted and immaterial. Thus the benefit remains insofar unusual and does not follow appropriate business conducts;
- The disparity between service and remuneration must have been noticeable for the acting bodies, so that it can be assumed that the preferential treatment had been consciously intended.

In the Decisions of the Federal Supreme Court from 21 May 1985, a clear disparity between service and remuneration is explicitly required, thus minor differences are not sufficient for the adjustment of transfer prices. Based on the Swiss understanding, a correction of intercompany transactions can therefore only be considered in the case of a clear and easily identifiable disparity.

Although the Swiss legislative body has waived specific regulations on transfer pricing in the fiscal law, there are a number of administrative directives (including circulars and circular letters), which implicitly or explicitly refer to the determination of intercompany transfer prices. The circular letter of 4 March 1997 from the Federal Tax Administration regarding the "1995 OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (including 1996 Addendum)" encourages cantons to apply the OECD Transfer Pricing Guidelines for Multinationals and Tax Administrations in the determination of transfer prices for multinational companies. In this circular letter, since there are no geographical restrictions, the Swiss tax authorities will also apply the OECD transfer pricing guidelines to transactions in non double tax treaty (DTT) countries. In addition, administrative directives referring to so-called "safe-harbour regulations" exist and enable to determine transfer prices without any specific documentation or justification (as long as these comply with the "safe-harbour regulations"):

- Circular from 3 February 2009 regarding interest payments between related group entities (updated yearly);
- Circular letter Nr. 4 from 19 March 2004 referring to the taxation of service companies;
- Circular letter Nr. 8 from 18 December 2001 regarding international profit allocation of principal companies;
- Circular letter Nr. 6 from 6 June 1997 regarding hidden equity;
- Circular letter Nr. 24 from 1 June 1960 regarding the taxation of foreign companies maintaining operating premises in Switzerland;
- Circular letter Nr. 14 from 29 June 1959 regarding the taxation of domestic companies which mainly perform their business activities abroad.

In all cases, Swiss taxable entities are subject to providing evidence for more favourable "third-party prices".

Shareholder and related parties

Legal entities presenting a shareholder position (interest holders) are primarily perceived as recipients of hidden dividend distribution. The law does not require the directly or indirectly benefiting shareholder to have a dominant position or a specific influence capability. The decisive fact consists in the actual provision of the benefit *"societas causa"*, ie. solely made on the basis of the distribution of ownership. A dominant position of the shareholder can be seen by the law as evidence to support the fact that it concerns a hidden dividend distribution. Secondary, shareholder related parties can be considered as recipients of hidden dividend distribution. These are perceived by jurisprudence as non-shareholder associated to interest holders. Indeed, associated non-shareholders are recognized as entities connected to the shareholders through affiliated or favourable relationships or through common interests. Finally, entities which are contractually allowed to use the company as their own are considered to be associated to the shareholder.

According to Swiss legal understanding, the review of transfer prices strictly presupposes that there is no controlling relationship between the company and its shareholders. Analysing whether the apparently inappropriate determination of transfer pricing is justified by a distribution of ownership is of utmost importance. Consequently, transactions with minority interests can also be scrutinized in a legal transfer pricing examination.

The conditions of double taxation treaties (DTT), reproduced in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Article 9 of the OECD Model Tax Convention, are restricting the Swiss tax authorities during the review of transfer prices when companies are associated to the management, control or capital through a direct or indirect participation. A definition of the minimum degree of association is neither to be found in the OECD Model Tax Convention nor in the relevant Swiss DTT. The DTT refer in such cases under statutory interpretation on domestic law (OECD Model Tax Convention Article 3 § 2), which is why, for Swiss purposes, the practice of the federal Court on hidden dividend distribution applies as mentioned above.

Selection of the method

In general

With absence of Swiss reservation to the OECD Transfer Pricing Guidelines and on the basis of the 1997 Circular from the Federal Tax Administration, Swiss tax authorities are instructed to apply the international guidelines when reviewing transfer prices[2]. The adequacy of transfer prices can be reviewed according to the OECD specifications thanks to a number of methods: traditional transaction methods (Comparable Uncontrolled Price, Resale Price and Cost Plus) and transactional profit methods (Profit Split and Transactional Net Margin). The taxpayer is largely free to select the best transfer pricing method for its intercompany transactions[3]. According to the OECD, the arm's length principle requires that the taxpayer does not use more than one method or justifies why certain methods cannot be applied[4]. This is to be compared to the US regulations, where a justification for not using the other methods is required. In addition, the application of other methods than the ones described (specified) by the OECD are usually allowed. However, the chosen method must be compatible with the arm's length principle. In practice, so-called profitability methods (such as return on equity or return on assets) or the Berry ratio are often used. Non transactional methods such as the profit split method are not considered compatible with the arm's length principle and cannot be applied.

According to the OECD, traditional transaction methods are primarily to be used when reviewing intercompany transfer prices. Within these methods, if actual comparable transactions with third parties are available, the comparable uncontrolled price (CUP) method is the preferred method. If there is a lack of sufficient comparable transactions and if adjustments are not possible, other traditional transaction methods have to be applied.

In exceptional situations, ie. if traditional transaction methods do not bring reliable results or otherwise fail, because there are no data available or the available data are not of sufficient quality to compute directly or indirectly arm's length prices, it may become necessary to use transactional profit methods. The same applies in those complex economic real life situations which put practical difficulties in the application of the traditional transaction methods or where transactions are so integrated it might be that they cannot be evaluated on a separate basis. Transactional profit methods are, according to the OECD, last resort methods. However, the practice indicates that transactional profit methods are being increasingly applied (especially in the context of Advanced Pricing Agreements for the analysis of so called *Limited Risk Distributors* and in integrated businesses such as global trading or for the analysis of results obtained from traditional transaction methods) while traditional transaction methods are being used to a lesser extent[5].

Preferred methods in Switzerland

The CUP method is considered to be the preferred method in Switzerland. In addition, other methods such as resale price or cost plus methods are also applied. The transactional net margin method is typically used to determine appropriate transfer prices for distributors, especially Limited Risk Distributors. Together with the operating profit margin, the Berry ratio is used in Switzerland as a profitability level indicator to evaluate transfer prices for distribution services. The transfer pricing analysis of production and services usually relies on the cost plus method in Switzerland.

It is important to note that the cost plus method is no longer considered the most adequate method in determining transfer pricing for services. In this context, in the Circular Letter No. 4 of 19 March 2004, the Federal Tax Administration explicitly mentions financial services and managements functions. This limitation in the application of the cost plus method supposes that the choice of the appropriate transfer pricing method must be supported by an analysis of the functions and risks. The tax administration follows the OECD concept of the so-called *"Key Entrepreneurial Risk Taking (KERT) Functions"* in the profit distribution of operating companies. The profit allocation and hence the choice of the appropriate transfer pricing method in accordance with the functions performed are determined by the ones carrying out substantial operating risks and which are managed on a daily basis. In addition to the use of KERT functions, it is necessary to regularly verify financial services and management functions in accordance with the OECD transfer pricing guidelines by using the cost plus method.

In order to determine the taxable net income of service companies thanks to the cost plus method, the Swiss tax administration uses in principle the primary costs (or full costs), including all direct and indirect costs. Following regular practice, tax provisions will also be included in the cost base and a corresponding mark-up will be attributed. However, this practice should be rejected, as it contradicts the OECD transfer pricing guidelines. Therefore, the costs which are not associated with the performed functions nor incurred in connection with activities provided by independent third parties should be excluded from the cost base when determining mark-ups on costs.

The transactional profit split method is rarely used in Switzerland. In the financial and banking services sector (including in the area of investment and asset management), some cantonal tax authorities tend to validate the applied transfer prices using transactional profit methods. From the perspective of the OECD transfer pricing guidelines, this practice can be problematic if the tax payer finally justifies that another arm's length traditional method should be used.

Price comparison and application of ranges

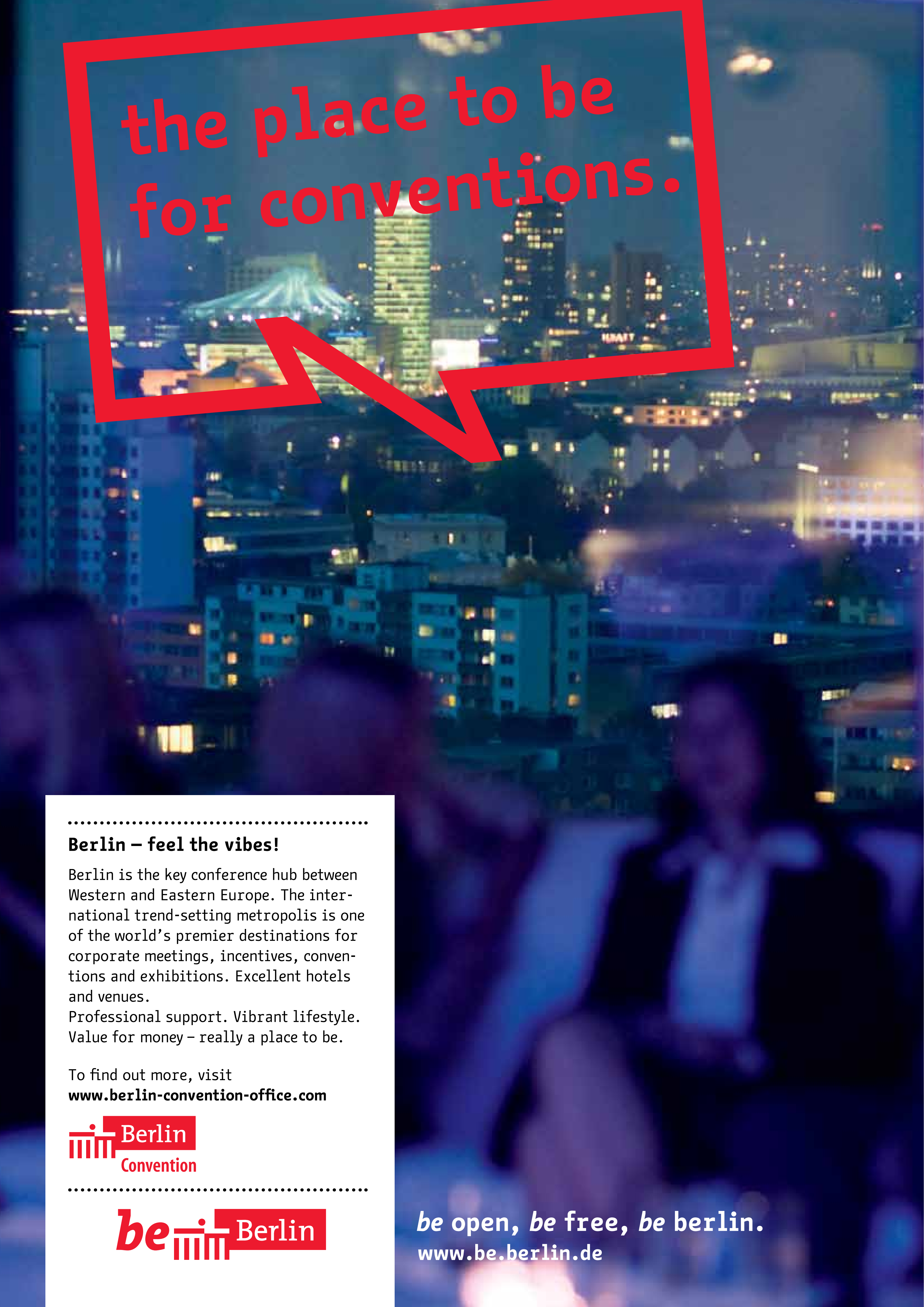
Transfer pricing is not an exact science, so the application of the most appropriate method or methods generally leads to a range of values, which can all equally be considered to be arm's length. A transfer price residing within this range of values is sufficient to meet the need for arm's length conformity. This is particularly applicable, if based on reliable data and complete information, business conditions are deemed fully comparable. In such cases, according to the practice of the Federal Court regarding hidden dividend distribution, the lowest arm's length price applies for the applicability of arm's length prices between Swiss company transactions and foreign transactions. When the range consists of values which have only limited comparability, it is useful to narrow them down (ie. by eliminating the 25% smallest and 25% largest values, through the creation of inter-quartiles). To assess whether a transaction is arm's length, the transfer prices need to be included in the narrowed range. If the effective transfer price is below or above the corresponding quartiles, in practice, an adjustment towards the lower or the upper quartile end will usually occur. An adjustment towards the mean or median is not compatible with the practice of the Federal Court regarding hidden dividend distributions.

Exceptionally, it will be possible to apply the arm's length principle so that it results in a determined price which is considered the most reliable in the assessment of the arm's length conformity.

To establish arm's length prices, it is generally necessary to analyse data of audited years, as well as data from previous years. Indeed, the analysis of multi-year data may bring to light facts which have influenced the determination of transfer prices (ie. losses in comparable companies).

Documentation requirements

The Swiss fiscal law does not mention any specific requirements for companies to prepare a transfer pricing documentation for its intercompany transactions. However, based on the Federal Law on Direct Federal Tax, taxpayers must do everything possible to allow a full and proper assessment and, if requested by the authorities, provide written or oral information and present account books, bills and receipts and other certificates and records relating to the business operations. Upon request of the tax authorities, companies are thus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obliged to provide all information, including records of intercompany transfer prices, to enable a full and proper assessment.

Although it can be concluded from the Federal Law on Direct Federal Tax that, in principle, a taxpayer, upon request of the tax authority, shall prepare transfer pricing documentation, the Swiss fiscal law gives little indication regarding the structure of such documentation. Based on the references to the OECD transfer pricing guidelines in the Circular letter from the Federal Tax Administration in 1997, compliant transfer pricing documentation to the OECD (functional and risk analysis, description of comparable companies, adjustments calculation and validation of arm's length prices) is accepted in the official languages[6] of the Swiss tax authorities. Due to the lack of sufficient independent comparable companies on the Swiss market, it is usually allowed to apply the arm's length remuneration of Swiss functions and risks with Western European comparable companies.

Adjustments in transfer pricing

Primary adjustments

The DTTs signed by Switzerland usually include the right of a state to make income adjustments and to tax additional profits, if the transfer prices between directly or indirectly affiliated companies are not arm's length. The basis for the primary adjustments in Swiss fiscal law can be found, as already mentioned, in the Federal Law on Direct Federal Tax and the Federal Law on the Harmonisation of the Cantonal and Communal Taxes. It enables tax authorities to increase the reported profits of a company or qualify expenses as non tax deductible, if improper transfer prices between related parties have been arranged. An assessment may occur up to five years after the end of the fiscal period of the due tax. In this process, the burden of proof regarding the inappropriateness of transfer prices lies with the tax authorities.

Corresponding adjustments

If the increased profits were already taxed in another contracting state, a primary adjustment by a contracting state may cause economic double taxation. Corresponding adjustments, mentioned in Article 9 §2 of the OECD Model Tax Convention, can solve this issue by avoiding economic double taxation, insofar as the concerned contracting states agree on an arm's length price.

According to Swiss practice, if an assessment is not yet final, in principle, nothing goes against a corresponding adjustment to the extent that the correctness of the primary adjustment is accepted by the tax authority. In the case of a final assessment, a corresponding adjustment can only occur through a mutual agreement procedure. The Swiss fiscal law excludes double taxation on the inter-cantonal level, while on the international level the taxpayer is entitled to initiate and implement a mutual agreement procedure. The right to eliminate double taxation, as stated in the Arbitration Convention of the member states of the European Union, does not apply.

Secondary adjustments

Commercial and fiscal income statements can be conciliated thanks to secondary adjustments. In doing so, two options can be applied: repatriation and requalification. The repatriation will effectively return the overcharged amounts which were taxed. If the amounts collected are renamed, such as contractual obligations or as participation deductions, one speaks of requalification.

According to jurisprudence and practice, secondary adjustments outside of mutual agreement procedures lead to withholding tax consequences (parent - affiliates and sister relationships). The reimbursement of the withholding tax depends on the relevant double tax treaty. If the amounts charged abroad due to inappropriate transfer prices follow the Swiss understanding of the arm's length principle and if, in comparable cases, results have been achieved through mutual agreement procedures, secondary adjustments should be enforced without withholding tax consequences, especially for administrative and economic reasons, even outside mutual agreement solutions.

Mutual Agreement Procedure (MAP) and Advance Pricing Agreement (APA)

In practice, it proved to be useful to resolve complex transfer pricing assessments by using unilateral and bilateral advance pricing agreements. An APA consists in a binding cross-border fiscal arrangement. The parties involved in the agreement are the taxpayer and the corresponding tax authorities. This enforces legal protection regarding the relevant price basis for future transactions. In addition, legal assessments of the applied transfer prices and high litigation costs can be avoided.

Unlike many other tax jurisdictions, Switzerland does not have any formal APA procedure, but subsumed APA procedures under mutual agreement procedures, with the difference that a situation is examined in advance and not with hindsight. APA procedures are carried out in accordance with the applicable rules for mutual agreement procedures. All the Swiss signed DTTs usually contain a provision on the mutual agreement procedure, under which the Swiss Federal Tax Administration can launch an APA process. According to the treaty, any entity based in Switzerland or in the other contracting states shall have the right to apply for a mutual agreement procedure, including an APA procedure. Following this legal basis, taxpayers can initiate APA procedures in Switzerland. In this process, for bilateral APAs, it is also important to follow the procedural requirements of the contracting state.

Information exchange in connection with maps

A controversial issue is the exchange of information between tax authorities in the context of mutual agreement procedures. Based on the Article 271 (illicit acts on behalf of a foreign state) or Article 273 (economic espionage) of the Swiss Penal Code, some taxpayers have tried to elude foreign tax authorities requesting the annual financial statements of Swiss companies. The following must be objected: mutual agreement procedures are initiated by the concerned taxpayer. This implies that, in accordance with the federal assistance practice, all information regarding the correct implementation of the double tax treaty must be exchanged. This exchange of information also relates to the appropriate determination of transfer prices. As long as information is needed for the determination of transfer prices, it must be exchanged within the scope of the mutual agreements negotiations. This also requires following the principle of good faith. Therefore, a reference to the Article 271 of the Penal Code does not help, because Article 25 of the DTT forms the required legal basis for the exchange of information. In addition, according to practice and jurisprudence of the Federal Court, Article 273 will not apply if the economic entity, namely the company, initiating the mutual agreement procedure, agrees on the release of available information. This applies even more in a MAP when a transfer of business information does not directly affect either public or third party valuable interests. ■

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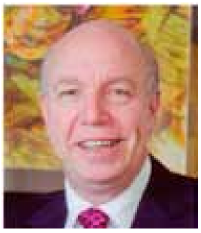
1. The following explanations solely reflect the personal views of the author and do not bind in any way the Swiss Federal Tax Administration.
2. Within the existing OECD trends, allowing countries reservations on certain paragraphs of the OECD Transfer Pricing Guidelines would be a regrettable step, as it would further impair the already unsteady legal protection regarding the review of transfer prices.
3. OECD, Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations Paris 1995, § 1.36.
4. OECD, Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations Paris 1995, § 1.68 f.
5. It is currently being discussed within the OECD to give up the priority order between transactional profit methods and traditional transaction methods.
6. Swiss tax authorities can also sometimes accept English documentation when justifying arm's length prices.

Tax Benefits of Using SE Companies in Group Structures of Multinational Enterprises



There seems to be a common wisdom in Europe amongst tax practitioners that the use of SE entities (Universal European Limited Companies) are detrimental to a multinational enterprise's tax position. In this article, Joseph Peters MBA of Merlyn Tax Solutions Group will prove otherwise: SE's can be very beneficial from an international tax reduction viewpoint.

What is an SE?

SE stands for Societas Europeae: a common European Limited Liability Company. It was introduced by the European Commission in 2004 as an option, in all of the company law systems in the EU, for multinationals to operate in the EU with only one legal entity, the SE, and to do away with the need for multinational enterprises to work with GmbH's or AG's in Germany, SpA's in Italy, A/B entities in Sweden, SarL's in France, BV's in the Netherlands, NV's in Belgium, and so forth. All these local legal entities operate under a different company law (and often tax law) system, which is a hindrance to the development of the internal common market within the ever-expanding European Union.

Why are tax advisers generally against the use of SE's?

The introduction of the SE legal concept in European law was effected without paying any attention to the tax aspects. This implies that for existing business models, a conversion from the present, historically grown group structures (with all the above different legal entities in different EU countries) would imply the deemed sale of the various businesses from the existing entities to the SE's, thereby leading to (fictitious) dividends, liquidations, capital gains on assets (including all intangibles) and the creation of "branch offices" of the surviving SE's in all countries where the group operates. This could cost multinational enterprises hundreds of millions of corporate income tax and capital gains tax, without any other corresponding benefit than obtaining some more legal and contractual flexibility. In 99% of the cases, that benefit is by far not worth the additional taxes involved.

So the general view amongst tax practitioners in the EU is: the SE is a still born baby. No-one in his right mind should consider a conversion of his existing legal structure, as long as the European Commission does not offer a large number of "reorganisation facilities", in corporate Income tax, in capital gains tax, in transfer taxes, in VAT etc. etc. And there are no signs whatsoever that the European Commission is even thinking about this. And the issues the Commission is thinking about may take 50 years to get introduced (there is a cross-border loss compensation draft Directive which dates back to 1967: no progress has been made with this –very important – subject, since).

Why would an experienced tax adviser then promote SE's in the first place?

There is no disagreement between my views and those of other experienced international tax advisers. The **conversion** of present, complex, legal groups structures in the EU to SE structures is a complete no-go for the reasons mentioned. However, the cards lie entirely differently when a multinational enterprise would be **setting up new business structures**. In those cases, setting them up in the SE format from the beginning may be very tax beneficial, since none of the conversion issues apply!

When setting up new businesses in Europe, multinational enterprises are well advised to now take a closer look at the possibility to set up SE's for these new departments. Especially, since SE's can be perfectly combined with hybrid branch structures which the Netherlands Supreme Tax Court has allowed in a landsliding tax case in 2003: many multinationals, by setting up an SE in the European Union with its main seat in the Netherlands, will be able to benefit from this verdict, which says that in a number of cases, when a Dutch entity charges its foreign branches for certain expenses, which will then be tax deductible in these foreign branches under article 7 of the tax treaty which that country has concluded with the Netherlands, may not be seen as taxable income in the Netherlands in the hands of the head-office of the SE. This case law is final and the Dutch government has even adapted its tax legislation to accommodate this decision after 17 years of litigation.

If SE's cause a multinational enterprise to "automatically" operate outside the country where the SE is located in the form of branches (one of the main points of criticism to SE's), it must be relatively easy to then take the further and almost final step to hybridise these branches: the foreign tax authorities see a different foreign legal entity as the local tax payer than the Dutch tax authorities and certain income falls between the ship and the shore and does no longer become taxable; even if it involves relatively vast amounts.

Hybridising a foreign branch of a Dutch legal entity is something which most controllers or finance managers have done before in the Netherlands, although they will not have perceived it as such. It is a genuine "piece of cake" without any complexities.

Is there any news about an EU exit for the low taxed income which an SE may bring?

After the effective corporate income tax burden of an SE has been brought down to maybe 12% (as compared to the Dutch statutory corporate income tax rate of 25.5%) by using our "hybrid foreign branches" concept, the question arises how to get this high after tax income out of the EU (out of the Netherlands) without suffering the 15% Dutch dividend withholding tax. In many case this 15% will be greatly reduced, often even to 0%, under the Dutch tax treaties (dependent on where the parent of the Dutch intermediate holding company is located), but if not, we have developed neat tax planning techniques to arrive at 0% dividend tax nonetheless. We do not normally recommend using Cyprus as an exit and we also have a problem with the often advertised possibility to use a Dutch "Cooperative Association" for this purpose.

These set-ups can be very risky: one avoids the Dutch dividend tax, but the dividends, plus any interest payments, plus a potential capital gain on a sale of the Dutch shares, may become subject to Dutch corporate income tax, an ill-understood risk even amongst experienced international tax practitioners. The Dutch tax authorities have recently opened massive attacks on both these exits and the first compromises have already been closed (so the Dutch dividend tax did not go down to 0% but remained at around 10%, a nasty surprise).

The problem with both the Cyprus route and the Cooperative Association (usually held by a tax haven entity) is the Dutch "Substantial Interest" concept. One needs to find a country with which the Netherlands has a (regular) tax treaty to resolve this problem. This country will then have to exempt Dutch dividends and capital gains from tax and it should not employ a dividend tax itself. Fairly recently one of the EU countries changed its tax rules in such a way that it now qualifies as the "perfect EU exit". The alternative, waiting till the Netherlands and Cyprus enter into a tax treaty, seems far away still, as negotiations between the two countries on a tax treaty have been stalled.

Success fee

We sell our services on a success fee basis only. This implies that companies should feel free to get into contact with us to discuss whether or not an SE structure with hybrid branches can help them save substantial tax on parts of their business profits worldwide. The discussions with us will be free of charge until it has been established that this may well be the case. We will (only then) enter into an agreement whereby our assistance will be rewarded on the basis of a percentage of the (audited) annual tax savings which our advice and support will yield. ■

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New Reporting Obligations for Luxembourg Securitisation Vehicles

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Recognising the interactions between the activities of financial vehicles corporations engaged in securitisation transactions (FVCs) and monetary financial institutions, the European Central Bank (ECB) has adopted on December 19, 2008 Regulation (EC) No 24/2009 concerning statistics on the assets and liabilities of FVCs (ECB/2008/30) (the ECB Regulation). The ECB will establish and update, for statistical purpose, a list of securitisation vehicles in order to monitor financial activities within the eurozone. FVCs residing in EU member states that have adopted the euro (the Participating Member States), form the reference reporting population.

On June 8, 2009, the Luxembourg Central Bank (*Banque Centrale de Luxembourg*) (BCL) has adopted circular BCL 2009/224 on new statistical data collection for securitisation vehicles (the BCL Circular) specifying the modalities of application of the ECB Regulation in Luxembourg. The ECB Regulation is directly applicable and applies to Luxembourg FVCs, notably (i) securitisation vehicles, subject to the Luxembourg law of March 22, 2004 on securitisation (the 2004 Law) and (ii) securitisation vehicles established as ordinary commercial companies (often referred to as *sociétés de participations financières* or Soparfi) outside of the scope of the 2004 Law. Luxembourg FVCs are obliged to provide BCL with certain statistical information. The BCL will forward the information to the ECB who shall establish the complete list of securitisation vehicles for the entire eurozone and make such list publicly available.

Definitions of FVC and securitisation

The ECB Regulation defines "FVC" as an undertaking which is constituted pursuant to national or European law under one of the following: (i) contract law as a common fund managed by management companies (such as a Luxembourg securitisation fund (*fonds de titrisation*)), (ii) trust law, (iii) company law as a public or private limited company or (iv) any other similar mechanism;

and whose principal activity meets both of the following criteria:

(a) it intends to carry out, or carries out, one or more securitisation transactions and is insulated from the risk of bankruptcy or any other default of the originator;

(b) it issues, or intends to issue, securities, securitisation fund units, other debt instruments and/or financial derivatives and/or legally or economically owns, or may own, assets underlying the issue of securities, securitisation fund units, other debt instruments and/or financial derivatives that are offered for sale to the public or sold on the basis of private placements.

Monetary financial institutions (within the meaning of Regulation (EC) No 25/2009) (MFIs) and investment funds (within the meaning of Regulation (EC) No 958/2007 of the ECB of July 27, 2007 concerning statistics on the assets and liabilities of investment funds) are excluded from the definition of FVC.

"Securitisation" is defined as a transaction or scheme whereby an asset or pool of assets is transferred to an entity that is separate from the originator and is created for or serves the purpose of the securitisation and/or whereby the credit risk of an asset or pool of assets, or part thereof, is transferred to the investors in the securities, securitisation fund units, other debt instruments and/or financial derivatives issued by an entity that is separate from the originator and is created for or serves the purpose of the securitisation, and:

(a) in case of transfer of credit risk, the transfer is achieved by:

- the economic transfer of the assets being securitised to an entity separate from the originator created for or serving the purpose of the securitisation. This is accomplished by the transfer of ownership of the securitised assets from the originator or through sub-participation, or

- the use of credit derivatives, guarantees or any similar mechanism; and

(b) where such securities, securitisation fund units, debt instruments and/or financial derivatives are issued, they do not represent the originator's payment obligations.

The ECB Regulation defines "originator" as the transferor of the assets, or a pool of assets, and/or the credit risk of the asset or pool of assets to the securitisation structure.

Quarterly statistical reporting requirements

An FVC, residing in a Participating Member State, has to provide certain statistical information. If an FVC does not have legal personality, the persons legally entitled to represent the FVC, or in the absence of formalised representation, persons that under the applicable national laws are liable for acts of the FVC, shall be responsible for reporting the statistical information.

The FVCs shall provide to the relevant National Central Bank (NCB), data on end-of-quarter outstanding amounts, financial transactions and write-offs/write-downs on their assets and liabilities on a quarterly basis, in accordance with Annexes I and II of the ECB Regulation. Luxembourg securitisation vehicles must periodically report specific information to the BCL, which comprises (i) quarterly statistical balance sheet and (ii) information on transactions made by such securitisation vehicles.

NCBs may grant derogations to certain requirements in the circumstances specified in the ECB Regulation, notably:

(a) for loans originated by eurozone MFIs and broken down by maturity, sector and residency of debtors, and where the MFIs continue to service the securitised loans, the NCBs may grant FVCs derogations from reporting data on these loans in certain circumstances;

(b) the NCBs may exempt FVCs from the reporting requirements set out in Annex I of the ECB Regulation apart from the obligation to report, on a quarterly basis, end-of-quarter outstanding amount data on total assets, provided that the FVCs that contribute to the quarterly aggregated assets/liabilities account for at least 95% of the total of FVCs' assets in terms of outstanding amounts, in each participating member state;

(c) to the extent that certain data referred to in the ECB Regulation can be derived from other statistical, public or supervisory data sources, the NCBs may, after consulting the ECB, fully or partially exempt reporting agents from the requirements set out in Annex I of the ECB Regulation.

Submission of information and timing

The information/reports shall be submitted by the FVCs or their agents to the relevant NCBs.

An FVC that has taken up business on or prior to March 24, 2009 should have informed the relevant NCB of its existence by the end of March 2009, irrespective of whether it expects to be subject to regular reporting under the ECB Regulation. An FVC that has taken up business thereafter has to inform the relevant NCB of its existence within one week from the date on which it has taken up business. FVCs that take up business after December 31, 2009 shall, when reporting data for the first time, report data on a quarterly basis as far back as the original securitisation transaction. The reporting shall begin with quarterly data as of December 2009.

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The concept of taking up business is very wide and will include the warehousing phase of a securitisation transaction.

Penalties

The ECB's sanction regime laid down in Regulation (EC) No 2533/98 of November 23, 1998 concerning the collection of statistical information by the ECB will apply to FVCs. Fines of up to €200,000 may be imposed for certain infringements.

Conclusion

The adoption of the ECB Regulation and the BCL Circular created a new compliance framework for the Luxembourg securitisation industry, by introducing new reporting obligations. New administrative procedures have to be implemented in relation to the securitisation vehicles and their service providers in order to ensure compliance with the new regulations. In the absence of any specific provisions, the documentation of the existing securitisation structures has to be amended in order to ensure that the service providers (notably collateral/asset managers and corporate administrators) will prepare and provide the information required under the ECB Regulation.

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Loyens & Loeff Luxembourg comprises more than 100 fee-earners and is committed to offering the highest standard of integrated tax and business law advice. The Luxembourg office is affiliated with Loyens & Loeff, which has over 900 fee-earners in 17 offices in the Benelux and the main financial centres of the world. ■

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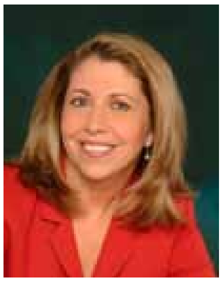
Anticipating the Role of Customs Agencies in Trade Facilitation



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Can we achieve a consistent approach to trade facilitation in the 21st century? Inquiring minds – or at least businesses that rely on moving goods across international borders – want to know.

Although trade facilitation itself can have a very broad definition, this article will focus primarily on those matters relating to the efforts of customs administrations as they attempt to not only redefine their role, but ensure compliance with policies and laws applicable to cross-border movement of goods.

Over the years, as more business transactions involve cross-border transportation of goods, the international business community increasingly has expressed concern for greater transparency, efficiency, and procedural uniformity in this area. The ability to get goods to market in a timely, cost effective and efficient manner is key to remaining competitive and providing shareholder value. A fluid supply chain is reliant on effective and timely customs clearance at the border.

Current customs challenges

The challenges faced by customs administrations today are many, including globalization of business and trade, complex new governance rules, international terrorism, environmental protection, and poverty reduction. Responsibilities in relation to the international movement of goods have broadened, and will continue to do so, from the traditional role of collection of duties and taxes, to include executing controls and other activities that serve a wider set of government objectives.

A good example of how customs responsibilities have broadened to encompass other government objectives can be found in the trade security arena. The increasing number of security threats has certainly changed the focus of numerous customs administrations over the past eight years. The 9/11 incidents in the United States heightened the awareness that international supply chains are vulnerable to exploitation by terrorist groups. This form of disruption can bring international trade to a standstill. As a result, immediately following the 9/11 incidents, various customs administrations shifted focus from the more traditional roles of managing compliance to imposing measures that would enhance trade security.

In late 2001, US Customs and Border Protection (CBP) introduced its Customs-Trade Partnership Against Terrorism (C-TPAT) program. The program is a voluntary government-business initiative to build cooperative relationships that strengthen and improve overall international supply chain and US border security. By participating in this program, companies ensure a more secure supply chain and the ability to experience expedited customs clearance as a "low risk" importer.

Following the introduction of the C-TPAT program, the World Customs Organization[1] (WCO) adopted the SAFE Framework of Standards to Secure and Facilitate Global Trade (the framework). Much of the framework was modelled on the principles of the C-TPAT program. However, the framework did provide a broader scope in the fact that the program engaged both importers and exporters, where C-TPAT is an importer focused program only. As of June 2009, 157 member countries have expressed their intent to implement the framework – a sign that trade security is not viewed as solely a concern of the US or countries traditionally identified as havens for terrorist groups (eg. Indonesia). Some are further along than others. Beyond the efforts of the US, new voluntary security initiatives have come into play in the European Union (Authorized Economic Operator (AEO) Program), Singapore (Secure Trade Program), Jordan (Golden List Program), Canada (Partners in Protection Program), Japan (AEO Program) and New Zealand (Secure Export Scheme), to name a few.

Voluntary security initiatives however are only part of the equation. In addition to programs such as C-TPAT and the framework, customs administrations implemented new security regulations such as those requiring the trade to provide more advance data for screening and targeting high risk cargo. In the past, most data relevant to an import shipment was reviewed at time of entry. Targeting of high risk goods took place after the cargo had already arrived the country of importation. In the post 9/11 environment, targeting is taking place prior to the goods departing the country of origin, commonly referred to as "pushing back the borders." This can be seen in regulations such as the Trade Act of 2002 which requires manifest data to be provided to US Customs electronically prior to goods arriving in the US.[2] Furthermore, the United States recently implemented the Importer Security Filing (ISF) rule, which requires importers as well as carriers (for vessel cargo only) to provide additional data elements 24 hours prior to cargo being laden on board at foreign origin to conduct more thorough risk assessments of US bound cargo. Similar actions that are pending, or already in place include, but are not limited to, customs administrations in China, Canada and the European Union.

Arguments could be made that these new security programs and regulations will assist with trade facilitation by identifying high risk cargo, so that customs administrations can allocate their limited


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resources to those shipments that pose the greatest risk. In doing so, importers with "low risk" status would enjoy the benefits of expedited customs clearance, thereby meeting customs goal of facilitating legitimate trade. This, of course, is an over-simplified viewpoint. In reality, although participation in voluntary initiatives (eg. AEO) may help a company achieve an expedited clearance on arrival, there are costs involved to participate in the voluntary programs. These costs may be justified if nations' voluntary security programs become mutually recognized. If this happens, participants in one country's security program will be deemed "low risk" by their trading partners, resulting in further benefits of expedited clearance at both origin and destination.

On the other hand, pushing advance data filing requirements further back into the supply chain is problematic for most businesses. Cargo could realistically sit extra days at origin while a company tries to collect the necessary data needed to file prior to departure. This additional time needed at origin has a negative impact on facilitation by delaying cargo that otherwise would have been in transit. If we add to this the potential requirements for 100% scanning of vessel cargo prior to departure, the anticipated costs and delays of this type of action would certainly have a negative effect on trade facilitation. The question as to whether trade security initiatives have a positive or negative impact on trade facilitation at this time remains unanswered, as most companies continue to struggle with various stages of implementation, and nations wrestle with what is the perfect balance between facilitation and security.

"So how do customs administrations plan to adapt to meet the demands of the 21st century?"

Unexpected roadblocks to facilitation

The above illustration of the impact of trade security initiatives on customs facilitation is just one of the many challenges that will need to be addressed in the 21st century. Moreover, customs administrations will continue to struggle with finding ways to streamline documentation requirements, increase automation and use information technology, improve transparency and consistency of processes and procedures and generally modernize cross-border administration. All this while adjusting to unexpected incidents that require new ways of doing business.

An example of an unanticipated roadblock to increased facilitation would be the recent upsurge in incidents of product recalls in the global market due to safety concerns. Over the past few years, there has been an increasing number of incidents involving product safety in the global marketplace. A short list of issues includes dangerous levels of lead found in paint and children's products, melamine in milk products, antifreeze in toothpaste, heparin blood-thinner contamination and various incidents of food product contamination. These incidents were not isolated to any one region and have had a global impact on supply chains as customs administrations, along with other government agencies look for ways to target these risks earlier in the supply chain.

In addressing unexpected risks such as product safety, it will be imperative that customs administrations coordinate their efforts, where possible, to make use of advance data already being provided to avoid redundancy for businesses. Again, companies identified as "low risk" traders should benefit from streamlined reviews to facilitate legitimate trade.

Issues such as trade security and product safety are just two of numerous examples of cross border complications that can have a direct impact on how customs administrations manage daily transactions. When you couple these challenges with indications of increased protectionism in the existing economic climate, facilitation of trade can sometimes seem out of reach. In the current and future business environment, businesses as well as nations, will become increasingly interconnected and interdependent. Without a global vision for customs processes, individual nations will develop and implement narrowly focused programs that may be effective on a local or regional level, but will stifle trade in the global marketplace.

The future of customs

So how do customs administrations plan to adapt to meet the demands of the 21st century?

In June 2008, the WCO Consulate drafted *"Customs in the 21st Century, Enhancing Growth and Development through Trade Facilitation and Border Security."* The document was the result of an understanding with leaders of the world's customs administrations that a new strategic perspective was needed in the 21st century.

In the 21st century, the WCO views the accepted mission of customs to "develop and implement an integrated set of policies and procedures that ensure increased safety and security, as well as effective trade facilitation and revenue collection." This new strategic direction, as outlined by the WCO, has ten strategic building blocks:

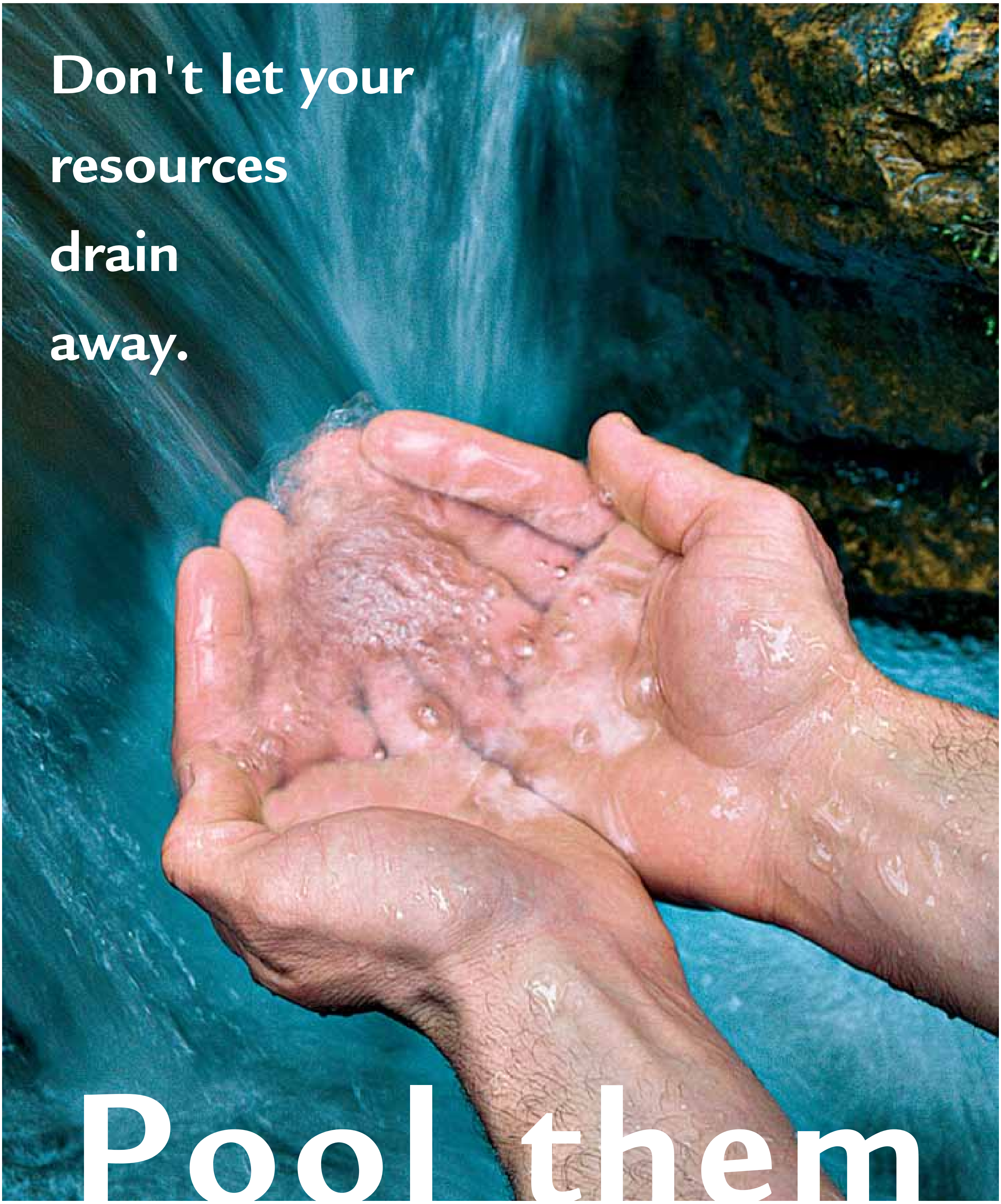
1. Globally networked customs – the need for an "e-customs" network that will ensure seamless, real-time, paperless flows of information and connectivity. This is needed for customs-to-customs transactions as well as customs-to-business transactions. Mutual recognition is a key enabler in this building block, which is further supported by an internationally standardized data set, interconnected systems, mutual recognition and coordination protocols between export and import transactions (eg. Authorized Economic Operators), and a set of rules governing the exchange of information between customs administrations (including data protection). Although much work needs to be done in this arena, efforts are certainly underway with the ongoing work on a "WCO Data Model."

2. Better coordinated border management - this involves better coordination and communication between the various border agencies and authorities. It also includes recognizing customs as the lead front-line administration at national borders for controlling the movement of goods. Additionally, there is a need for an electronic "single window" (eg. the International Trade Data System in the US (ITDS)) that allows the trade to provide all necessary information and documentation once to the designated agency that in turn distributes it to relevant agencies. Efforts along these lines can be seen in a number of areas, including coordinated efforts in the US between Customs and other US agencies, such as the Consumer Product Safety Commission and US Department of Agriculture. Additionally, in the current version of the WCO Data Model, the scope is being broadened to include requirements for other cross-border regulatory agencies, such as Agriculture and Human Health.

3. Intelligence-driven risk management - a more sophisticated understanding of the risk continuum is needed. Scarce resources require that targeting be done at the higher end of the risk spectrum. The key here will be the development of feedback learning loops that allow customs administrations to integrate risk-related activities to learn from past decisions to build more forward-looking organizations, rather than just being responsive (eg. targeted container review vs. 100% scanning).

4. Customs-trade partnership - customs should enter into strategic pacts with trusted economic operators (eg. C-TPAT, AEO). The relationships must result in mutually beneficial outcomes.

5. Implementation of modern working methods, procedures and techniques - the demand for rapid movement of goods, combined with complex regulatory requirements, calls for more audit-based controls undertaken away from the border, moving from transaction-based controls to system-based controls (eg. the US' Automated Commercial Environment (ACE)), and moving away from paper systems. Additionally, there is a need



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6. Enabling technology and tools - taking advantage of new and emerging technologies to enhance processing, risk management, intelligence and non-intrusive detection.

7. Enabling powers - the appropriate legislative provisions must be implemented to strengthen enforcement powers, provide for advance information, and sharing of information domestically and internationally. This is needed especially in the area of combating organized crime, while protecting the safety of customs officers.

8. A professional, knowledge-based service culture - movement towards a more customer-oriented model. Staff competencies need to support timely customer-focused processes and services that minimize the administrative burden on legitimate trade. Effective change management and leadership skills will also need to be developed.

9. Capacity building - customs administrations need to ensure they have the capacity and skills across all dimensions of the operating model to perform customs functions efficiently and effectively. Leadership from developed customs administrations is critical to ensure sustainable capacity building (eg. the WCO Columbus Programme).

10. Integrity – the fight against corruption will remain an important task that will need to be undertaken for years to come. All capacity building efforts could be undermined without this key building block.

These building blocks provide solid guidance for customs administrations in the 21st century to ensure not only an environment that will facilitate legitimate trade, but also allow customs administrations to focus limited resources on those areas deemed highest risk.

However, the decisions on how the above goals are to be accomplished will require a collaborative effort between customs and the trade. It will be essential for customs to maintain a continuous dialogue with stakeholders. In this context, consultation with the business sector must be enhanced. As a business involved in global trade, it will be important to not only have direct communication with customs (where feasible), but also to provide input through trade associations and advisory groups who in many cases are regularly invited to seminars and working groups to give their input to the development of new policy and legislative initiatives.

In the 21st century, companies expecting to remain competitive in the global arena will need to ensure that efforts to maintain a healthy, fluid supply chain include a thorough understanding of global customs activities, as well as being actively engaged with those government agencies responsible for managing cross border movement of goods. ■

1. The WCO, established in 1952 as the Customs Co-operation Council (CCC), is an independent intergovernmental body whose mission is to enhance the effectiveness and efficiency of Customs administrations. The WCO represents 174 Customs administrations across the globe that collectively process approximately 98% of world trade.

2. Deadlines for providing manifest data vary by mode of transportation.

Investing In India: How Recent Developments in the Cayman Islands Facilitate Inbound Investment

Chetan Nagendra (chetan.nagendra@harneys.com) is Head of the India Practice for international offshore law firm Harneys.

The second and third quarters of 2009 brought good news from the Cayman Islands, favouring a seemingly unlikely investment destination: India.

In the first instance, the Cayman Islands Monetary Authority's (CIMA) highly anticipated acceptance as a full member to the International Organization of Securities Commissions (IOSCO) was obtained on 10 June 2009 at the meeting of the Presidents' Committee during IOSCO's 34th Annual Conference in Tel Aviv, Israel.

In the second instance, the Organisation for Economic Cooperation and Development (OECD) on 13 August 2009 moved the Cayman Islands to its 'white list' of jurisdictions that have substantially implemented the OECD tax standard.

Both these developments are very positive for India bound transactions.

IOSCO membership to boost Cayman FII presence in India

The Cayman Islands is the world's largest fund domicile. Most of the largest closed-ended and open-ended funds investing in India's growth story are domiciled in the Cayman Islands.

IOSCO is the global, standard setting body that brings together the regulators of the world's securities and futures markets. IOSCO, along with its sister organizations, the Basel Committee on Banking Supervision and the International Association of Insurance Supervisors, together make up the Joint Forum of International Financial Regulators. Currently, IOSCO members regulate more than 90 percent of the world's securities markets.

With its admittance to IOSCO as an ordinary member, CIMA officially becomes a party to the IOSCO Multilateral Memorandum of Understanding Concerning Consultation, Co-operation and the Exchange of Information. Ordinary members are the primary regulators of securities and/or futures markets in a jurisdiction.

CIMA's admission to IOSCO demonstrates the jurisdiction's willingness to engage other regulators to facilitate cross-border information exchange and assistance. It is believed that the Indian securities regulator, the Securities and Exchange Board of India (SEBI) will treat this development positively and allow for speedier and less cumbersome registration of Cayman domiciled funds as foreign institutional investors (FIIs) in India.

Registration is mandatory for foreign institutional investors in India. Cayman Islands domiciled investment funds have historically faced challenges when seeking to invest in Indian listed securities. SEBI has previously required extensive due-diligence on funds domiciled in the Cayman Islands, citing CIMA's lack of IOSCO membership. It is expected that with IOSCO membership, Cayman domiciled funds that invest in India can now directly register as a FII with SEBI rather than investing through intermediary funds based in another jurisdiction or through participatory notes.

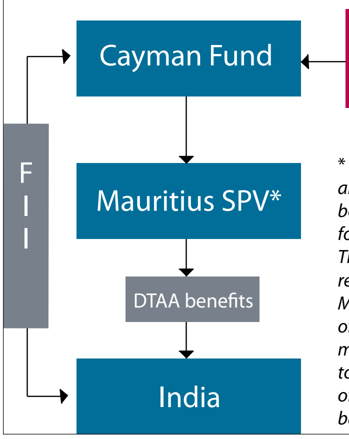
OECD 'white-listing'

The Cayman Islands moved onto the OECD 'White List' after signing its 12th tax information exchange agreement ("TIEA"). The 'white-listing' elevates the Cayman Islands to the category of jurisdictions which have 'substantially implemented the internationally agreed tax standard' in the 'Progress Report' initially published by the OECD

Secretariat on 2 April 2009.

In the aftermath of the turmoil in the world financial markets in 2008-09, the OECD presented a three-tiered classification for offshore financial centres following the G-20 summit in April 2009. Per this classification, an offshore centre may be classified as 'white', 'grey' or 'black' based on the number of TIEA's entered into. Prior to 13 August 2009, the Cayman Islands was on the grey list.

Example of an open-ended Cayman fund structure for India



** There are additional management and control requirements that need to be documented in Mauritius in order for the SPV to claim tax treaty benefits. These include a registered office and resident directors to be present in Mauritius, the meetings of the Board of Directors to be held, chaired and minuted in Mauritius, the requirement to keep accounts at the registered office and to maintain the principal bank account of the SPV in Mauritius.*

A TIEA is a bilateral agreement laying out the foundation for exchanging information in tax evasion cases. In addition to its 12 TIEAs, Cayman is proposing to enter into unilateral tax information sharing arrangements with a number of countries. As the Cayman Government has indicated that it intends to implement the TIEAs, it is reasonable to assume that the Government will negotiate a TIEA in due course.

The OECD 'white-listing' is a key development and growth driver, as it is indicative of a transparent and financially well-regulated offshore jurisdiction and should lead to increased investment flows between the Cayman Islands and India.

Tax advantaged jurisdictions are still key

Unlike Mauritius or Cyprus, the Cayman Islands do not enjoy the benefit of a double tax treaty with India. Given that the Cayman Islands are a British Overseas Territory, it is unlikely that the jurisdiction would be in a position to negotiate a tax-advantaged treaty for investments into India.

This means that a structure involving a Cayman Islands fund would still need to route its investments through a tax-advantaged jurisdiction such as Mauritius vis-à-vis the investors to complete the picture. However, recent developments in the Cayman Islands are likely to speed up and streamline the FII registration process, which is required irrespective of the use of a tax-advantaged jurisdiction such as Mauritius.

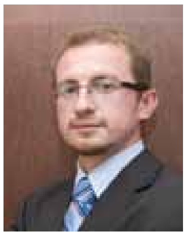
Advantage Cayman

Establishing a fund in the Cayman Islands has a number of advantages. For one, the Cayman Islands have a long established, up-to-date and flexible corporate legislative regime based on English Law. The Cayman Islands has long been favoured by investment managers and investors on both sides of the Atlantic. Its proximity to the United States, its well-regulated and well-resourced legal and financial services sector add additional advantages to the marketability of a fund to overseas investors.

There are important differences between an established offshore financial centre and many tax treaty-advantaged jurisdictions. In the long run, issues of flexibility in company structures, credibility of the jurisdiction, marketability to investors, stability to investors, and familiarity with the legal system often tip the balance in favour of long-established offshore financial centres such as Cayman. In the case of investing in India, a mix of a tax-treaty benefited jurisdiction with the world's largest fund domicile offer great flexibility to investment managers and unmatched returns to investors. ■

The Role of the Capital Market in Poland

Rafał Dajczer works at Chałas & Partners Law Firm, Poland



The role of the capital market in Poland is generally connected with the public shares market – the Warsaw Stock Exchange (WSE). The primary objective of the stock market in the market economy is to provide companies with capital and value this capital, whereas the effectiveness of the stock market is determined by three criteria: allocation productivity, transaction productivity and effective information policy. Especially significant remains transaction productivity. The shortage of cheap and effective transaction system will attract neither entrepreneurs nor investors. At present, WSE fulfils all these criteria to the same extent as stock markets in Western Europe. Moreover, Warsaw stock market, despite existing for over 18 years, has not worn out its potential for growth, which serves as a means for realizing the above-mentioned objectives.

"...the Warsaw Stock Exchange is the leader in the Central and Eastern Europe region"

In spite of the fact that WSE is the leader in the Central and Eastern Europe region, by trading in stocks as well as capitalization, its share in the domestic investments is still smaller than the European average. It is a very positive signal for prospective investors and entrepreneurs seeking capital, or for institutions that want to allocate their surplus. What is more, as a stock exchange of an EU member state, it becomes a place where the companies out of the EU but in countries still aspiring for membership, for example the. Ukraine, will seek the capital and at the same time will increase their prestige in the WSE, which is nearby and financially attractive.

It is worth mentioning that apart from a well-established stock exchange position, the capital market in Poland will gain in importance as far as the development of territorial units and public utilities is concerned. It is especially relevant for the municipal bond market, which in times of restricted access to budgetary means and the necessity for acquiring significant funds for pre- and co-financing the activities carried out with the support of European Union's funds, should start to develop quite quickly.

An example of the trend is the successful issue of Warsaw City Eurobonds worth €200 million in foreign markets carried out in May 2009. A venture capital/private equity funds market waits for recovery, after a considerable restriction of its activities as a result of the economic crisis. The role of that market as an important link of the capital market, which is a direct background for public market, should be accompanied by erosion of the crisis to grow significantly in forthcoming years. It should be noted that even today venture capital/private equity funds are driven by the national treasury to be more active (incentives for the purchase of dozens of companies from privatization plan). Also adequate incentives for them are EU funds to invests in innovative business start-ups. ■

Competition Law in Brazil: You Should Take It Seriously

Ricardo Inglez de Souza is a partner of the Competition Practice Group at Demarest e Almeida

The International Competition Network - ICN - mentions that more than one hundred countries around the world have a competition law. Brazil is one of these countries. In fact, we have had a competition law since the early 60's. However, for decades the excessive control of the market by the Brazilian government, among other factors, left the enforcement of the Brazilian law weaker than would be expected. The Brazilian market was opened in the 90's and Brazil enacted a new competition law in 1994.[1] Since then, the enforcement of the competition rules in Brazil has developed very fast and now there is no doubt that Brazil already represents a concern in the agenda of all businesspeople doing business in the country.

As in many other jurisdictions, Brazil has control over the market structure through merger control and illegal conducts' repression. Both aspects are applicable to foreign entities and individuals due to the fact that the Brazilian law applies to all acts that may affect the Brazilian market no matter where it takes place.

The Administrative Council for Economic Defense (CADE) is the decision-making authority in Brazil in charge of the enforcement of the Brazilian Competition Act. CADE is supported by two secretariats, the Secretariat of Economic Monitoring (SEAE), of the Ministry of Economy, and the Secretariat of Economic Law (SDE), of the Ministry of Justice. These three bodies together are known as the Brazilian System of Competition Defense (SBDC).

SEAE focuses its analysis mainly on the economic aspects of the cases under SBDC's review. On the other hand, SDE is more concerned with legal issues and is also the authority in charge of investigating competitive misconducts such as cartels. Both secretariats issue non-binding reports to CADE which then makes the final decision based on its own discretion.

The Brazilian Competition Act and its enforcement have improved in many aspects since its enactment in 1994. The new merger guidelines, the leniency (amnesty) program and the establishment of stronger investigative powers are some examples of Brazil's current legal framework on competition enforcement. All these improvements have a direct impact on the marketplace and affects companies and businesspeople doing business in Brazil.

Merger control

In merger control cases, the Brazilian Competition Act provides for two thresholds to identify transactions that must be submitted to CADE's approval. Notification is mandatory whenever a transaction involves companies (i) that hold a 20% or greater market share in a given relevant market; or (ii) that registered a gross revenue equal to or superior to R$400 million (approximately €133 million) in the previous fiscal year. The gross revenue criteria should be calculated based on the Brazilian revenue.

As there is no provision in the law regarding the minimum effect that a merger must have on the Brazilian market in order to be subject to review, this omission results several unnecessary notification of transactions with minor (if any) effects in Brazil - more than 95% of the transactions submitted to CADE's analysis were approved unconditionally.

Nonetheless, CADE may block or condition its approval of any transaction submitted to its analysis. Generally, CADE has preferred to adopt alternative measures, such as structural or conduct conditions, instead of rejecting transactions. The blocking-decision that prevented Garoto's acquisition by Nestle represented an important precedent in Brazilian case law, although it was subject to judicial reversion.

In fact, in 2008, CADE unanimously decided the unwinding of the Brazilian share of the transaction by which Owens Corning acquired the fibre glass strengtheners manufacturer, Compagnie de Saint Gobain. The acquisition was closed on February 2007 and it involved an amount of approximately $640 million. It was subject to the approval of regulatory authorities in Europe and the United States. This was the first time that CADE blocked an international transaction (ie. the Brazilian portion of it). Given the high concentration that the transaction could cause in some of the relevant markets in Brazil (over 90% in some cases), CADE unanimously blocked the transaction. According to CADE's decision Owens Corning should (i) sell the units acquired in Brazil, (ii) hire, upon CADE's approval, an independent company to evaluate the assets and conditions of payment; and (iii) hire, upon CADE's approval, an independent company to monitor the selling process and identify potential purchasers.

Repression of illegal conducts

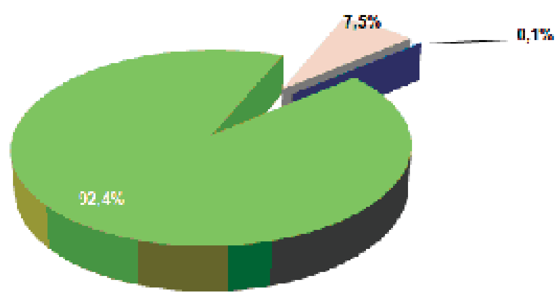
Additionally and maybe more important than the merger control, Brazil has drastically changed its focus to cartel persecution and other anticompetitive conducts in the last few years. Fines applied by CADE in such cases have increased significantly and many individuals have already been condemned in Brazil.

It is important to note that the decision on whether a certain practice is to be considered illegal shall be determined on a case-by-case basis.

For the repression of illegal or anticompetitive conducts SDE has powers to, with a judicial authorization, conduct seek and seizure procedures (down raids) to obtain direct evidence, such as objects, papers of any nature, commercial books, computers and files from the company or individual. Besides, SDE may request information from authorities and third parties, request hearings; in general, seek for evidence of the conduct by any means admitted by law.

The Brazilian Competition Act provides fines for the involved companies from 1% to 30% of their pre-tax gross revenue in the year before the initiation of the administrative proceeding. The company's managers or employees, directly or indirectly involved in the conduct, may also be fined from 10% to 50% of the fine applied to the company. Whenever the fine cannot be defined considering the revenue criteria, for example, trade associations, the fines will be established between R$6 thousand and R$6 million.

Merger control decisions Jan 2004 - Jul 2009



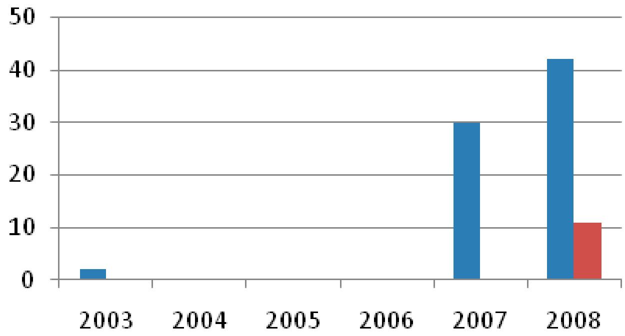
■ Unconditionally approved ■ Approved with restrictions ■ Blocked

Source: CADE

There are other penalties that may be applied by CADE, such as, for example, prohibition to deal with public financial entities and to pay fiscal debts in instalments, as well as prohibition to participate in bid promoted by the government for at least five years.

Thus, for individuals, including foreign citizens, the Brazilian legislation (specifically the Criminal Act)[2], also provides for imprisonment penalties, which may vary from two to five years. It is also possible for SDE to request temporary or preventive imprisonment measures in order to preserve evidence.

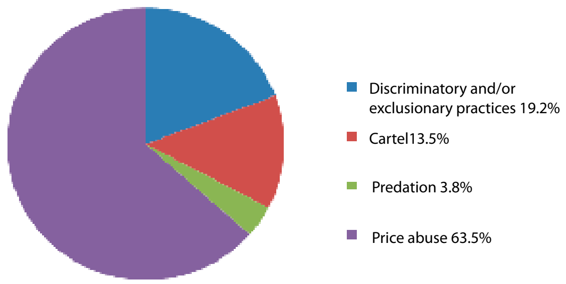
Temporary and preventive imprisonments, per year



Source: SDE

With regard to the conducts investigated by the Brazilian authorities, it is possible to verify that most of the cases initiated by the SDE involve accusations of price related practices, such as predatory or abusive pricing. Although cartel does not represent the major quantity of cases (only 13.5% of the cases analyzed by SDE in the last year), it has been subject of unprecedented fines.

Type of Conduct Analyzed by SDE at Administrative Proceedings in 2008



Source: SDE

One of CADE's recent most important decisions was the condemnation of AMBEV (a major multinational brewer company) due to its fidelity program (*Tô contigo*). The program was considered abusive in view of AMBEV's dominant position. AMBEV was penalized to the highest fine ever applied by CADE to a single company, it was fined to approximately R$350 million. In addition, CADE imposed (i) the immediate discontinuance of the fidelity program; (ii) the publishing of CADE's decision in Brazilian major newspapers; and (iii) the register of the company in the National Registry of Consumer Defense.

Another important sector that is being analyzed by the Brazilian authorities is the payment card service. Currently, SDE is fighting against exclusivity in the payment card services market. It recently adopted injunctions against the major players with presence in Brazil to refrain them to maintain the exclusivity provisions provided in their agreements.

Although there are important actions being adopted by the Brazilian authorities in other kinds of violations, cartel is still the main target. This infringement is highly condemned by the international competition community since it significantly limits or even eliminates competition among competitors in order to increase profit through a monopolistic price. According to estimates of the Organization for Economic Co-operation and Development (OECD), cartel practices may result in prices increases of 10% to 20%.

As mentioned before, the Brazilian authorities are showing themselves more rigorous in recent years. In the first ten years of the Competition Act, CADE used to keep the pecuniary penalties at the minimum provided in the law, which means, 1% of the gross revenue of the condemned companies. Nonetheless, CADE has recently changed its approach. In most recent cases, the fines applied to cartels reached 22.5% of the pre-tax gross revenue of the companies (ie. in the cartel in the sand extraction market).

A very visible case judged by CADE was the crushed stone cartel. The companies involved in the cartel were penalized in fines that reached 20% of their gross revenues. Thus, in view if their significant participation for the effectiveness of the cartel, the trade associations were condemned in more severe fines, that reached approximately R$300 thousand.

Another important decision was the case of the private security company's cartel. This was CADE's first decision involving a leniency program. CADE fined the companies to a total amount of, approximately, R$38 million. The trade associations and unions were each fined in an amount of R$160 thousand. Thus, the individuals involved in the conduct were fined to amounts that totalized approximately R$4.5 million.

If compared with the fines imposed by the European Commission or in the United States, the fines applied by the Brazilian authorities may be considered low. However, the significant increase of the penalties in recent years show Brazil's effort to enforce competition rules in the country. Currently, there are more than 200 cartel cases under investigation by SDE and being judged by CADE, and the perspectives are only in the means of growth.

Not only are the penalties applied by the administrative authorities getting more rigorous, but also criminal prosecution. In the crushed stone cartel, for instance, the Public Prosecutor started criminal law suits against 17 officers involved in the illegal conduct. According to estimates from SDE, more than 100 individuals faced or are currently facing criminal prosecution in Brazil. Not only Brazilian citizens are subject to the Criminal Act, but also foreign persons can be criminally prosecuted in Brazil.

In this regard, Brazil is using international sources to catch foreign participant, for example, it has the possibility to use Interpol's red notice.

Besides administrative and criminal penalties, Brazilian legislation also provides for civil liability of companies and individuals that could be subject to damage actions for the illicit conducts.

In view of this crescent effort from the authorities to enforce the competition law in the country, Brazilian companies and multinational companies doing business in Brazil are starting to be concerned on how to avoid penalties in this field.

The first measure, the preventive one, is the adoption of antitrust compliance. Compliance programs aim to educate employees on antitrust laws in order to avoid anticompetitive practices. An effective program shall not only introduce the rules of "good behaviour", but also provide practical guidance for the employees' day-by-day activities. It is worth mentioning that compliance programs can be approved by SDE. The secretariat has enacted a regulation that provides minimum conditions for a program to be officially recognized by the Brazilian authorities. However, due to the strictness of the requirements only one entity had its compliance program approved by SDE so far, the Brazilian Association of Importers of Popular Products– ABIPP

There are also options for companies that identify illegal practices and wish to avoid the penalties. The first one is to step forward and enter into leniency programs. This is a practice that is being encouraged by the Brazilian authorities. There are currently more than 10 leniency agreements being negotiated by SDE. A leniency program may provide not only administrative exemption, by also criminal immunity to the involved individuals. However, its does not exclude civil liability.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The second opportunity to avoid administrative penalties is to enter into a Cease and Commitment Agreement. This is applicable in case the violation has already been discovered by the Brazilian authorities. By this agreement, the company agrees to cease the illegal conduct in change for the discontinuance of the investigation. In some cases, the authorities may impose a pecuniary contribution.

The Brazilian competition authorities are becoming more rigid and selective in enforcing the Competition Act. While in merger control it is focusing its resources in analyzing and imposing conditions to more relevant transactions, in conduct repression it is focusing in prosecution of those practices that are more harmful to the Brazilian market. In any case, Brazilian and foreign companies must nowadays give more attention to Brazilian competition rules in conducting its business. On one hand compliance to the law is recommended, on the other, leniency is to be kept in mind in case of non-compliance. ■

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1. *Law No. 8,884, of June 11, 1994 ("Competition Act").*
2. *Law No. 8,137, of December 27, 1990.*

The Fifth Global Congress on Combating Counterfeiting and Piracy

Joseph Clark is the Executive Director of the Global Congress Secretariat

Government and business leaders from around the world to gather in Cancun, Mexico in December for the most important meeting of the year on fighting counterfeiting and piracy

In this time of worldwide economic uncertainty, leaders involved in the fight against counterfeiting and piracy are going to be challenged on how to maintain the commitment to protecting intellectual property and providing the resources needed to prevent the organized criminal networks from taking further advantage of the economic crisis.

This opening debate will set the tone for the Fifth Global Congress being held in Cancun, Mexico on 1-3 December 2009, the first time a Global Congress will be staged in the Americas. It is being hosted by INTERPOL and the Mexican Government agency Instituto Mexicano de la Propiedad Industrial (IMPI).

The Fifth Global Congress will build on the successes of the first four Global Congresses. It will be focussed on developing tangible solutions to the current challenges in fighting counterfeiting and piracy globally, and will include special sessions devoted to the increasing problems in Mexico, Central and South America.

Up to a thousand delegates are expected to attend and participate in panel discussions with over 50 senior government and business speakers from around the world. The Congress will be opened by leaders from the Global Congress Steering Group [INTERPOL, the World Customs Organisation (WCO), the World Intellectual Property Organization (WIPO), the International Chamber of Commerce (ICC) through its BASCAP initiative, the International Trademark Association (INTA) and the International Security Management Association (ISMA)], and ministers and high ranking officials from Mexico. They will then be joined by speakers from North, Central and South America, Europe, Africa, the Middle East and Asia.

Following the economic crisis lead-off discussions, the focus will turn to five themes that consistently have emerged as the key focus areas for concrete actions to combat counterfeiting and piracy. In addition, the Fifth Global Congress will again feature special sessions on the challenges facing free trade zones and transhipment countries, and counterfeiting and piracy over the internet.

Challenge 1 – cooperation and coordination

Over the years, Congress participants have reaffirmed that the global problems of counterfeiting and piracy are too great to be solved by individual governments, enforcement authorities, business sectors or companies. While some progress has been made, and there are an increasing number of achievements, the consensus is that more can, and should be done to improve cooperation and coordination among and between government authorities and the private sector.

At the Fifth Congress, speakers and delegates will explore current global and regional initiatives on counterfeiting and piracy and their prospects for success. Case studies will showcase how the public and private sectors are working together to implement practical solutions.

Challenge 2 – improving criminal and civil legislation and enforcement

In past Congresses, speakers and delegates have called on governments to further improve legislation dealing with the enforcement of IP rights, streamline procedures and implement already existing international obligations. There has also been broad acknowledgment that even if good laws are in place, they are often poorly enforced. In order to update national and regional IP protection regimes and to make the enforcement of intellectual property rights more efficient, decision-makers in the public and private sectors need to be made aware of the requirement to allocate additional human and financial resources.

At the Congress in Cancun, speakers and delegates from the judiciary, legal and enforcement communities, will focus on the role and readiness of the judiciary and explore models of criminal sanctions.

Challenge 3: the health and safety risks counterfeit products pose to consumers

Past Congresses have widely recognized that counterfeiting and piracy harm society in many ways that are not immediately obvious. This is particularly true for counterfeit medicines and over-the-counter drug products and consumer goods that are not tested to the same safety standards as genuine products. These fake products can seriously injure or even kill consumers, and at a minimum, do not deliver the expected and promised benefits of the real products. In addition to health hazards presented by medicines, other consumer product categories, such as foods, beauty and health care products, agricultural products, fake auto and aircraft parts and electrical goods, present significant risk including the fact that consumers often act in good faith and are not aware of, and therefore not in a position to assess, the risk.

The Fifth Congress will bring together public and private sectors speakers dealing with the enormous challenges and risks presented by the dramatic rise in counterfeit medicines, especially in the developing markets such as Africa. Experts will present examples of what is working and what challenges are getting in the way of progress, not only with regard to medicines and drugs but a range of other counterfeited goods that present health and safety risks to consumers and society in general.

Challenge 4: building anti-counterfeiting capacity and capabilities

Successive Congresses have recognized that a country's effectiveness in protecting IP rights is partially dependent upon its capacity to enforce them. Therefore, in addition to prescriptions for better legislation, stronger enforcement and penalties, speakers also suggested methods for improving knowledge, enhancing training and developing skill capacities.

In Cancun, a number of public and private sector speakers will showcase their capacity building successes but will also address the substantial challenges ahead.

Challenge 5: raising awareness on the full economic and social costs of counterfeiting and piracy

Over the years, many Congress speakers and delegates have addressed the need to increase public and political awareness and understanding of counterfeiting and piracy activities and the associated economic and social harm. They also agreed that as a matter of priority, young consumers should be educated about the dangers and consequences of the counterfeiting and piracy trade. Greater steps in raising awareness can lead to informed consumers that better understand the harms associated with purchasing and consuming counterfeit and pirated goods; likewise, well-informed policymakers are in a better position to make appropriate decisions, implement policies and allocate resources.

The Fifth Congress will feature a number of speakers from the public and private sectors showcasing their programs, successes and obstacles. A portion of the session will be dedicated to measuring the full cost of the illegal trade.

Special Challenge: free trade zones and transshipment countries

At the Fourth Global Congress in Dubai, the Congress recognized the legitimacy and benefits of Free Trade Zones and the use of countries for transshipment purposes, but noted there is abuse by counterfeiters and organized criminal networks facilitating the movement of counterfeit and pirated goods into third countries. Speakers and delegates encouraged countries to develop and/or apply required legislation, appropriately enforce the legislation, develop risk assessment procedures and criminally punish traffickers of counterfeit and pirated goods.

Speakers at the Fifth Global Congress will present models of good practices, highlighting the difficulties faced by governments, enforcement agencies and the private sector.

Special challenge: collaborating on fighting counterfeiting and piracy on the internet – are we making progress?

At the Fourth Global Congress in Dubai, participants overwhelmingly recognized the importance and urgency of finding concrete and practical solutions to this challenge. Congress speakers emphasized that the internet is not "the Wild West" and there is an urgent need to implement concrete practical solutions to eliminate or at least significantly disrupt counterfeiting and piracy transacted over the internet. This was considered a collective responsibility, requiring action from all including intermediaries and government authorities to enforce IP rights.

At the Fifth Congress, speakers and delegates will explore a number of issues including:

- What are, if any, are the key achievements in the last year in controlling counterfeiting and piracy over the internet?
- What are the major roadblocks faced in combating the problem?
- What more is needed to make a meaningful impact?
- What are some practical best practices and case studies on how the various stakeholders have worked together to address counterfeiting and piracy on the internet? What more is needed for effective practical collaboration and enforcement?

Confirmed government and business leaders speaking at the Fifth Global Congress

Global Congress Steering Group Leaders

- Ronald K Noble – Secretary General, INTERPOL
- Francis Gurry – Director General, World Intellectual Property Organization (WIPO)
- Michael Schmitz - Director Compliance/Facilitation, World Customs Organization (WCO)
- Richard Heath – INTA President 2009 and VP Legal - Global Anti-Counterfeiting Counsel, Legal Group, Unilever PLC
- Mark Cobben – (ICC-BASCAP) Regional Director the Americas, British American Tobacco and Mr David Benjamin, Senior Vice President for Anti-Piracy, Universal Music

Guest Speakers (In alphabetical order)

- Kira Alvarez – Chief Negotiator and Deputy Assistant US Trade Representative for Intellectual Property Enforcement (USTR)
- Eduardo Rodriguez Apolinario – Technical Deputy Director Customs, Dominican Republic
- Andre' Barcellos – Executive Secretary of the Brazilian National Council for Combating Piracy
- David Benjamin, Senior Vice President for Anti-Piracy, Universal Music
- David Bowers – Universal Postal Union, Security Expert
- Ronald Brohm – REACT
- Alejandro Bustos – Director General Legal Affairs, Televisa
- Jorge A Camero, President, National College of Judges and Magistrates, Mexico
- Mark Cobben – Regional Director the Americas, British American Tobacco
- Luc-Pierre Devigne, Head of Unit for Public Procurement and Intellectual Property, Directorate General for Trade, European Commission (EC)
- Victoria Espinel – Founder, Bridging the Innovation Divide
- Ramón González Figueroa – Director General of the Tequila Regulatory Council (CRT), Mexico
- David Finn – Associate General Counsel, Anti-Piracy & Anti-Counterfeiting Microsoft
- Peter Fowler – Senior Counsel for Enforcement Global Intellectual Property Academy, USPTO
- Jacques Franquet – Vice President Security, Sanofi-Aventis
- Emilio Garcia – Regional Anti-Piracy Coordinator for IFPI/ Latin America
- Gilda Gonzalez – IP Representative Mexico, Security and Prosperity Partnership (SPP) North America and Director IP Protection, IMPI
- Louise Van Greunen – Deputy Director of the Enforcement and Special Projects Division, World Intellectual Property Organization (WIPO)
- Rajiv Gulati – Director Global Anti-Counterfeiting Operations, Eli Lilly
- Justice LTC Harms – Deputy President Supreme Court of Appeal, South Africa
- Jeff Hardy – BASCAP Coordinator, International Chamber of Commerce (ICC)
- Pat Heneghan – Head of Global Anti-Illicit Trade, British American Tobacco
- Kirsten M Koepsel – Director, Intellectual Property & Industrial Security, Aerospace Industries Association
- Judge Ronald SW Lew – Senior US District Court Judge, United States District Court, Central District of California
- Roberto Manriquez – Operation Jupiter Coordinator South America, INTERPOL
- Miguel Margain – President, Asociacion Mexicana Para La Proteccion De La Propiedad Intelectual, AC (AMPPI)
- Johanna Martínez – Head of IPR, Panama Customs
- Counsellor Fabrizio Mazza – Chairman of the Intellectual Property Expert Group of the Italian Presidency of the G8
- Brian Monks – Vice President, Anti-Counterfeiting Operations, Underwriters Laboratories, Inc. and Co-Chair Certification Industry Anti-Counterfeiting (CIAC) Initiative
- Yousuf Ozair Mubarek, Senior Manager, Intellectual Property Rights Department, Dubai Customs
- John Newton – IPR Programme Manager, INTERPOL
- Lucy Nichols – Vice Chair, China Quality Brands Protection

Committee (QBPC), Chair, Anti-Counterfeiting and Enforcement Committee, INTA and Global Director of IPR, Brand Protection, Nokia
- Damien O'Flahrety – Senior Economist, Frontier Economics
- Aline Plançon – INTERPOL-IMPACT Project Manager
- D'Arcy Quinn – Director Anti-Counterfeiting, CropLife International
- Piotr Stryszowski – Administrator, Structural Policy Division, Directorate for Science, Technology and Industry, OECD
- Jere Sullivan – Chairman, Global Public Affairs, Edelman
- Judge Jayin Sunthornsingkarn – Judge and Secretary of the Central IP and IT Court, Thailand
- TAM Yiu-keung – Assistant Commissioner, Hong Kong Customs
- John Tarpey – Director of the Communications and Public Outreach Division, World Intellectual Property Organization (WIPO)
- Edward Torpoco – Senior Litigation & Regulatory Counsel, eBay
- Phil Wright – Managing Director, Worldwide Brand Protection, Cisco
- Koji YONETANI – Director, Intellectual Property Affairs Division, Economic Affairs Bureau, Ministry of Foreign Affairs, JAPAN
- Steve Zidek – Vice President & Director of the Anti-Piracy Intelligence Center, MPAA
- Miroslaw Zielinski – Director Directorate C (Customs Policy) - Taxation and Customs Union Directorate General (TAXUD), European Commission
- Christophe Zimmermann – Coordinator Fight against Counterfeiting and Piracy, World Customs Organization (WCO)

Background on the Congress

The Global Congress on Combating Counterfeiting and Piracy represents a unique, international public private sector partnership that is united in its efforts to identify solutions and facilitate their implementation against the growing menace of the illegal trade in counterfeiting and piracy.

In 2003, the need to address the rapidly growing global problem of counterfeiting and piracy had emerged as a key priority for national governments and intergovernmental organizations concerned about the myriad adverse costs to social welfare and economic development that were resulting from the rampant theft of intellectual property. Notably, trade in counterfeit goods was rising dramatically worldwide and had spread to almost every conceivable type of product. Billions of dollars in revenues were being lost to the black economy. Counterfeit drugs were putting lives at risk. And there was growing evidence that transnational organized crime networks were using profits from trade in counterfeit and pirated goods to fund their activities.

It was clear that better strategies – based on more effective cooperation between stakeholders at national and international level – were needed to combat the multiple threats posed by this damaging trade. To this end, the first Congress was convened by the World Customs Organization (WCO) and INTERPOL with the support of the World Intellectual Property Organisation (WIPO).

A Global Congress Steering Group was formed after the First Global Congress hosted by the World Customs Organization (WCO) at its headquarters in Brussels in May 2004. The Steering Group is chaired, on a rotating basis, by INTERPOL, the World Customs Organization and the World Intellectual Property Organization. The private sector is represented on the Steering Group by the International Chamber of Commerce (ICC) through its BASCAP initiative, the International Trademark Association (INTA) and the International Security Management Association (ISMA).

INTERPOL, the WCO and WIPO are the key international inter-governmental organizations involved in the fight against counterfeiting and piracy, and their views and voice on the issue with their member states and world governments is critical to finding and implementing solutions. The ICC, INTA, and ISMA are global business organizations actively engaged in the fight against counterfeiting and piracy. All three embody the principle that business and governments must work together to achieve more effective protection of intellectual property.

The key focus areas of the Steering Group are as follows:

1. Raise awareness on the problems associated with counterfeiting and piracy
2. Promote better legislation and enforcement
3. Enhance cooperation and coordination
4. Build capacity
5. Promote solutions, particularly in the key focus area of health and safety risks related to counterfeit products

To date, the Steering Group has convened four Global Congresses and four Regional Congresses that have brought together global political and business leaders and experts from law enforcement, the judiciary, academia and the private sector to share strategies, program concepts and identify priorities for action. An "outcomes statement", capturing the recommendations and suggestions, has been produced following each of the eight Congresses. ■

The Economic Impacts of Counterfeiting and Piracy

Piotr Stryszowski is with the Directorate for Science, Technology and Industry at the OECD[1]

The challenge of counterfeiting and piracy

Counterfeiting and piracy[2] are probably as old as markets themselves. But today the extent and complexity of the problem have increased due to globalization and the spread of information and communications technology. Counterfeit and pirated goods now exact a heavy cost on industry, governments and consumers, requiring strong public action. The question is how to make progress?

Understanding the nature of counterfeiting and piracy, the economic mechanisms that drive it, its scale and the areas it affects help in designing appropriate policies to address the problem. Two recent OECD reports have analyzed the counterfeiting and piracy of tangible products (OECD, 2008) and piracy of digital content (OECD, 2009) and provide some answers.

Markets for counterfeit and pirated products

Markets for counterfeit and pirated products are not homogeneous and are driven by a range of factors that differ across market segments. The fundamental distinction in the markets for counterfeit and pirated products is between tangible and digital goods. The term *tangible products* refers to physical products such as clothes, cosmetics, cars, optical discs, audio equipment, spare parts, food, pharmaceuticals, and many more. A growing number of these products tend to be protected by intellectual property rights such as trademarks, patents, copyrights or design rights.

The market for fake tangible goods is not homogeneous either and can be divided into two sub-markets. In the *primary market*, consumers purchase counterfeit and pirated products believing they have purchased genuine articles. The products are often sub-standard and carry health and safety risks that range from mild to life-threatening. In the *secondary market*, consumers are looking for what they believe to be bargains, and knowingly buy counterfeit and pirated products.

Transactions in pirated intangible or *digital products* (ie. a music song, a movie, a computer program etc.) form the other key market for counterfeit and pirated products. In contrast to physical goods, the digital good is intangible and one person's consumption of the good's content does not exclude simultaneous consumption by others. While these properties greatly facilitate the distribution and sharing of digital content they also facilitate its unauthorised use. This market even includes a large group of suppliers of pirated content

Table 1. Seizure percentages of goods by product categories

No.	Category of products (HS Code)	Seizure (%)
1	Articles of apparel and clothing accessories (61, 62)	30.6
2	Electrical machinery and equipment, telecom. equipment, sound and TV recorders (85)	26.8
3	Articles of leather, saddlery and harness, handbags, articles of gut (42)	7.9
4	Footwear, gaiters etc (64)	5.4
5	Tobacco and manufactured tobacco substitutes (24)	5.4
	Total, Top 5 product headings	**76.1**

Source: OECD (2008)

that are willing to provide content at zero prices. Non-price factors (such as legality, availability and quality) are particularly important in understanding the operation of markets for pirated digital products.

Demand and supply drivers

A number of factors affect the demand and supply of counterfeit and pirated products in the tangible and digital segments of the market.

A significant factor in the *demand* for counterfeit products that is common for both types of counterfeiting and piracy (tangible and digital) concerns the attitude of consumers towards counterfeiting and piracy and their awareness of the potential risks it might involve. Even though most consumers of counterfeit and pirated products are aware that they are engaged in an illegal activity, they rarely perceive it as unethical. This perception is particularly strong in the case of digital piracy, especially when no monetary profits are generated by the parties engaged in piracy.

Security problems are also not fully taken into account by consumers of counterfeit and pirated products. Producers of fakes bypass rigorous testing procedures and safety standards, which can present serious health and safety risks, eg. when sub-standard batteries for toys leak or explode, or when fake baby formula causes illness or death. On the digital market, many users of pirated digital goods seem unaware of potential security risks associated with their file exchanging activities, which could leave them exposed to malicious software which is designed to infiltrate or damage a computer system.

The *supply* of tangible counterfeit and pirated products is primarily driven by profit motives. Counterfeiters and pirates often target products where profit margins are high, taking into account the risks of detection, the potential penalties, the size of the markets that could be exploited and the technological and logistical challenges in producing and distributing products.

Unlike in the market for tangible products, the profit motive can be absent in the digital piracy market. Digital products in high demand, especially by younger people, and the ease and very low cost of reproduction and transmission of digital products make these products very attractive to share. Furthermore, a large number of suppliers in the market are not driven by profit motives, but by other non-market factors, such as gaining recognition within a peer group, or providing free access to other users. This behaviour can be sustained because the marginal cost of reproduction and delivery of digital content is zero, or close to zero.

Effects[3]

The effects of counterfeiting and piracy are wide ranging and affect consumers, rights' holders and government. IP infringements also have a broad range of general socio-economic effects, such as effects on innovation and growth, criminal activities, the environment, employment, foreign direct investment, and trade.

Consumers who knowingly buy counterfeit goods might perceive this as a good bargain but the savings that they may achieve by knowingly purchasing lower-priced counterfeit or pirated products need to be considered in a broader context. Depending on the product, consumers can be worse off and expose themselves to health and safety risks. Moreover, consumers are often not aware that the goods they buy are counterfeit. Copying, packaging and labelling have become quite sophisticated, making it difficult to tell fake and genuine products apart. In some cases, counterfeit goods have started to find their way into regular distribution systems and legitimate supply chains.

Criminal networks and organised crime thrive in counterfeiting and piracy activities. They take market share from legitimate businesses and undermine innovation, with negative implications for economic growth. Moreover, bribery associated with counterfeiting and piracy can weaken the effectiveness of public institutions at the expense of society at large. Governments are also affected through foregone tax revenues and the costs incurred in combating the problem. These activities also have longer-lasting effects as they reduce the incentives for firms to innovate or invest.

While the economic, social and development losses from counterfeiting and piracy are large, the precise scale of the problem in terms of lost profits, tax revenues, health and safety, etc. remains uncertain. Data on international trade together with customs data on seizures of fake goods provide some indication of how big the counterfeit and piracy business is – up to US $200 billion in 2005, according to OECD (2008). This figure does not include counterfeit and pirated goods produced and sold within domestic markets, nor the flow of pirated digital products being distributed via the internet, suggesting that the scale of the problem may be significantly larger.

Industry and government responses

Considering the large scale of the problem, renewed national and international efforts are needed to fight counterfeiting and piracy. There is no single remedy, and the OECD reports lists several ways to develop information and analysis, strengthen legal and regulatory frameworks, enhance enforcement and deepen the evaluation of policies programs and practices.

The global nature of counterfeiting and piracy makes it difficult to combat. This is a particularly striking problem for digital piracy that generally cannot be detected at national borders. Closer government/industry co-operation would help to identify and counter counterfeiters and pirates. Many industry groups and associations have launched activities to assist in dealing with counterfeiting.

Moreover, tackling public attitudes is important to address the problem. Although consumers that buy counterfeited and pirated goods are generally aware that it is illegal, they do not always perceive it as un-ethical and continued emphasis should be placed on education and consumer awareness to overcome this perception.

Finally, a better understanding of the scale of the problem would help and would benefit from more comprehensive and comparable datasets. Unfortunately, there is no commonly agreed reporting framework at this time. Further work to monitor and analyze markets for counterfeiting and piracy will be required in the future. ■

For more information on the OECD project on counterfeiting and piracy visit: www.oecd.org/sti/counterfeiting or contact: piotr.stryszowski@oecd.org

References
OECD (2008), The Economic Impact of Counterfeiting and Piracy
OECD (2009), Piracy of Digital Content
1. This note reflects my own views, and not necessarily those of the OECD or its member countries.
2. Counterfeiting and piracy are terms that are commonly used to describe a range of illicit activities related to violation or misuse of to intellectual property rights. In the context of this article they primarily concern infringements of trademarks, copyrights, patents and design rights.
3. The quantification of the impacts of counterfeiting and piracy carried out by the OECD has thus far only focused on the counterfeiting and piracy of tangible goods.

The 2009 Global Public Policy Conference: "Business Technology: An Enabler in Your Economy."

Background
During its twenty-nine year history, WITSA has been involved in numerous activities in support of the Information and Communications Technology (ICT) industry, including its Global Public Policy Summit (GPPS). The GPPS is a flagship event of WITSA and enhances the international dialogue and global cooperation on key public policy issues including electronic commerce, privacy, education, and ICT in developing countries. The conferences are held every two years, on alternate years from the World Congress on Information Technology, and has become an important and valuable event. Between 350-500 senior ICT executives, government officials and policy makers from more than 30 countries normally attend these events, which offers unprecedented networking opportunities. WITSA serves as the oversight organization for the GPPS, which is hosted by one of its member associations. Recent GPPS host associations include:

- 2009 - Hamilton, Bermuda: Business Technology Division of the Bermuda Chamber of Commerce
- 2007 - Cairo, Egypt: Egyptian Information Technology, Electronics and Software Alliance (EITESAL)
- 2005 - Kuala Lumpur, Association of the Computer and Multimedia Industry of Malaysia (PIKOM)
- 1999 - Buenos Aires: Camara des Empresas de Software y Servicios (CESSI)

WITSA is an association of leading ICT industry associations. WITSA was founded over 30 years ago by a small group of likeminded individuals within the IT industry seeking to better understand how other countries (ICT associations) dealt with similar concerns such as government regulations, industry trends and member services. By 2008, WITSA had grown to 69 members. WITSA has a real impact on the global IT environment. It strengthens the industry at large by promoting a level playing field and by voicing the concerns of the international IT community in multilateral organizations, including the United Nations, The Internet Corporation for Assigned Names and Numbers (ICANN), World Trade Organization (WTO), the Organization for Economic Cooperation and Development, the G-8, G-20 and other international fora where policies affecting industry interests are developed.

About GPPS 2009
The Bermuda Chamber of Commerce, Business Technology Division, was awarded the 2009 event, which will be organized in partnership with the Ministry of Energy, Telecommunications and E-Commerce at the Fairmont Southampton in Hamilton from November 1st – 3rd, 2009. The event provides an unprecedented opportunity for Bermuda to highlight its accomplishments in the ICT area to a global audience.

The chosen theme of the summit is "Business Technology: An Enabler in Your Economy." Topics to be discussed by internationally recognized ICT professionals in academic circles, governments, and business, including:

- Can enlightened ICT policy enable your economy and an economic recovery?
- Do policies that promote technology infrastructures that are resilient and secure, and that protect the privacy of personal data conflict with policies that encourage economic expansion?
- Will proposed internet governance policies on the stability, security and private sector leadership of the internet dampen economic recovery and expansion?
- Do environmental policies hamper growth and can enlightened ICT policies and involvement, bridge the gap?
- Is there evidence that institutions can play a positive role in promoting ICT and expanding economies or are they simply relics of the past?
- Are there potential business technology developments on the horizon that will enhance business growth?

Commencing in 1999, as the Global Public Policy Conference, the event is organized by the WITSA member in a different country every two years. This year, for the first time, it will take the more open forum with panel discussions and conclusions to be considered by WITSA and the Global ICT community for further reflection, action or discussion.

Can enlightened ICT policy enable your economy and an economic recovery?

Information and communication technologies continue to play an enabling role for business, economies, government and society. Now, more than ever, ICT can also be a powerful enabler for economic stability and recovery. Reforms will only be successful if grounded in a commitment to free market principles, including the rule of law, respect for private property, open trade and investment, competitive markets, and efficient, effectively regulated financial systems. These principles are essential to economic growth and prosperity and have lifted millions out of poverty, and have significantly raised the global standard of living.

Government leaders need to be proactive in rejecting protectionist trade policy measures and not turning inward in times of financial uncertainty. Governments must refrain from raising new barriers to investment or to trade in goods and services, imposing new export restrictions, or implementing World Trade Organization (WTO) inconsistent measures to stimulate exports. As in the past, WITSA urges governments to reach agreement this year on modalities that leads to a successful conclusion to the WTO's Doha Development Agenda with an ambitious and balanced outcome.

There is a risk that slower world growth could lead to calls for protectionist measures which would only exacerbate the current economic situation. Leaders must refrain from raising new barriers to investment or to trade in goods and services, imposing new export restrictions, or implementing WTO inconsistent measures in all areas, including those that stimulate exports.

In a globally linked economy, investment and work flow not only to the places in the world that offer cost advantages, skills and expertise. It is flowing to countries, regions and cities that offer intelligent ICT-enabled infrastructure—everything from efficient transportation systems, modern airports and secure trade lanes to reliable energy grids, transparent and trusted markets, e-government, and enhanced quality of life.

The private sector is the primary investor in and innovator of ICT infrastructure, products and services. Effective markets are therefore essential to ensuring a sustainable information society. Sound public policy therefore must support the creation of markets by fostering a connected, educated and healthy population that can increasingly become engaged in the information society. Such engagement begins through the use of ICT for economic growth and development. Capabilities based on ICT can serve as vital tools for sustainable economic development, knowledge sharing, societal interaction and freedom of expression, particularly in the world's least developed countries.

Do policies that promote technology infrastructures that are resilient and secure, and that protect the privacy of personal data conflict with policies that encourage economic expansion?

Private industry owns and operates the vast majority of the world's information infrastructure. Protecting global cyber assets is the job of the private sector and the public sector working in partnership as appropriate to secure cyber assets. In both the public and private sectors, information security challenges must be met with a combination of factors, namely: People, Processes and Technology. Individuals must be vigilant in maintaining the security processes laid out by organizations; organizations must implement and enforce security processes and procedures; and business and government must use multiple layers of security technology to deter threats.

Countries and multilateral organizations are increasingly embracing cyber security policy and practices, which is a positive development as that provides more opportunity for collaboration and progress for global cyber security efforts. We appreciate the work of organizations such as: the Organisation for Economic Cooperation and Development (OECD), the Asia Pacific Economic Cooperation (APEC), the United Nations (UN), the International Telecommunications Union (ITU), the Organization for American States (OAS), the Council of Europe (COE), the European Union (EU), the North Atlantic Treaty Organization (NATO), the Group of 8 (G-8), l'Organisation internationale de la Francophonie, l'Union Africaine and other regional groups on their various efforts to address cyber security and cyber crime. However, we believe that multilateral efforts need to reflect the flexibility needed to respond to the evolving environment, and to complement, rather than duplicate the efforts of related organizations.

In order to ensure sound economic policy which maximizes global information security while laying the ground work for sound economic growth, WITSA suggests that the following principles be observed:

- The internet and information networks are global in nature; therefore, cyber security requires international collaboration through bilateral and plurilateral efforts and through multilateral organizations that enables flexibility, innovation, and private sector leadership;

- Information networks are ubiquitous and used by so many for their communications needs and operations; therefore, governments and organizations should address cyber security as a fundamental and cross-cutting issue;

- Industry and government share an interest in the proliferation of a free and open internet, electronic commerce, other value-added networks, and an efficient, effective information infrastructure; therefore, cyber security efforts should be undertaken in a way that does not inhibit innovation;

- There is no static or one-size fits all solution to "perfect" cyber security; therefore, cyber security efforts should be part of a dynamic, risk management-based approach to protection, detection, and mitigation;

- No one entity can solve cyber security issues alone; therefore, government and industry must find ways to collaborate, share information and analysis, and identify appropriate roles and responsibilities for protection, detection, and mitigation efforts both domestically and internationally, including adapting existing laws, if necessary;

- Our global networks provide critical communications and operational services to government, industry, and individuals around the world; therefore, in order to further assure those services, cyber security should be considered as a fundamental and foundational tenet in all efforts such as the development of government services, company product design, and consumer behaviour;

- Companies and individuals have been increasingly targeted by cyber criminals from all over the world; therefore, law enforcement agencies must have the ability to collaborate and cooperate on a global basis, and criminal statutes must incorporate cyber crime so that those criminals can be prosecuted.

Will proposed internet governance policies on the stability, security and private sector leadership of the internet dampen economic recovery and expansion?

The internet has become an essential component of economic activity and will assume an even larger role in trade and commerce in coming years, deepening its reach; broadening its capability; embracing mobility and changing to further reflect the diversity of users and geographies that it connects. The internet is changing not only in access technology, but in the breadth and spread of its distribution, as well as in the applications that it is able to access and transport. Today, the internet reaches a billion users. Our immediate challenge will be connecting the next billion users around the world in a stable, secure, and sustainable environment, and then finding ways to connect the next yet unconnected four billion users.

To date, the internet has grown in a largely unregulated environment, and has shown an ability to thrive in a wide variety of market environments under competitive conditions. This freedom from centralized and heavy regulations has produced impressive results over a relatively short period of time, delivering innovation, productivity and opportunity to a growing numbers of users in all parts of the world. Notably, the internet has grown fastest in markets where there is competition for the provision of underlying telecommunications facilities, as well as for access and related services. Today, policy makers at both national and global levels are considering a wide number of regulatory approaches to dealing with the challenges of cyber security, access, management of spam and malware, protection of intellectual property and other issues.

WITSA believes that the internet must continue to thrive in an open and competitive marketplace unencumbered by unnecessary regulations. WITSA supports private sector initiatives to develop and deliver market based solutions to the challenges faced by the internet and its users. For example, in addition to technological approaches to improving security of information and networks, increased cooperation with law enforcement and policy makers can address many of the issues of concern to both governments and end users in cyber security. Innovations in technology delivered by the private sector are bringing affordable options in access, and combined with an enabling environment of legal, regulatory, and investment policies can further improve the availability of internet access. Concerns of some governments seeking a more centralized regulatory oversight of the internet and the applications it delivers through international forums can be better addressed through a deepened industry-government dialogue and collaboration on solutions that maintain the largely unregulated commercially driven environment that has supported the internet's initial success.

WITSA re-affirms its principles to ensure the internet's further expansion and its positive impact on the economic growth and calls upon all stakeholders to work together:

- To keep the internet open and accessible to all of society;
- To ensure reliable and secure access to information and communications networks and services;
- To promote the value of the Internet Governance Forum, in particular for emerging economies and developing countries;
- To recognize the multi-stakeholder nature of internet governance and to strengthen and broaden involvement and leadership of industry in relevant forums;
- To promote the transition from the current internet addressing system (IPv4) to an addressing system capable of supporting continued internet expansion and new applications for the foreseeable future (IPv6);
- To ensure that global public policy and governing national systems enable the use of ICT products and services throughout societies.

Do environmental policies hamper growth and can enlightened ICT policies and involvement bridge the gap?

Environmentalism: ICTs should play an integral part in any comprehensive environmental policy framework. The ICT sector is in a unique position – while our products consume energy, we also provide technologies that help other sectors become more energy efficient. ICT enhances existing processes, enables new ways of working and transforms behaviour, helping to create a lower-carbon economy.

The timely adoption of low carbon technologies is a critical success factor in tackling climate change. Research suggests that the rapid implementation and uptake of new energy-efficient technologies can produce much greater energy savings than policy measures. It is an obvious fact that the earlier we implement these new technologies, the better. This is because the longer we take to reduce emissions, the greater the accumulation of greenhouse gases in the atmosphere, and it is the concentration of those gases that influences climate change.

The early implementation of low carbon technologies will play a critical role here, so we must do everything we can to identify those technologies as quickly as possible, to accelerate their development and support their adoption.

The ICT sector has a lot to do. We need to develop a more systematic approach to monitoring and measuring the energy demand of our own products and services. We need to improve environmental performance within our own supply chain by sharing best practice. We need to stimulate and encourage behavioural change. Most importantly, we must find ways to identify those technologies that have the greatest potential to tackle climate change, and accelerate their development and adoption. We believe that there are two, interdependent solutions to the problem of climate change - the intelligent use of technology, and innovation.

Bridging the gap: business has been working hard through independent projects to provide assistance to disadvantaged economic groups, localities, regions or countries, aimed at transforming the digital divide into a digital opportunity. Almost any sizeable company today has taken up some local or regional responsibility in bridging the digital divide.

Developing countries can reap these benefits resulting from the technological innovations that have led to the commercialization of the internet - they can leapfrog technologies and become active participants in the online global economy. However, governments needs to adopt a policy framework that ensures that access to digital information and communication networks is a viable option for the citizenry at large.

WITSA has developed a ten-point plan which governments should observe:

1. Assemble and provide the fundamental building blocks of the Information Society:

- reliable access to secure information and communications networks and services;
- sound and broadly available education and training systems to build human capacities; and
- appropriate integration of ICTs in the provision by governments of essential citizen services, such as healthcare and other systems, to expand capabilities, reduce costs, and improve productivity and the quality of life for people.

2. Establish national legal systems that are predictable, transparent, clear to everyone and that respect the principle of non-discrimination.

3. Ensure that public policies and regulations governing national systems promote competition as a preferred means of governing markets for ICT services and products.

4. Create a legal, policy and regulatory environment that stimulates the needed private investment in ICTs including:

- strong intellectual property protection consistent with existing international agreements;
- trade liberalization;
- technology neutrality with respect to user choice; and
- respect for negotiation and implementation of commercial, value-based agreements between businesses.

5. Make sure that policy making is based on effective communication between governments and business at national, regional and international levels.

6. Remove barriers that hinder innovation, entrepreneurship and the creation of new businesses, including small and medium size enterprises.

7. Use public-private partnerships to create educational and training facilities, and access points, capable of developing the skills people need to participate in the Information Society. Information and communications technologies should be included in the curriculum at all levels of educational systems and as part of worker continuing education and national education strategies.

8. Expand programs to encourage businesses of all sizes to integrate ICTs in their operations and thereby improve the performance and

the productivity of their employees.

9. Combat cybercrime with a global culture of information and communications network security and an appropriate legal framework.

10. Work to incorporate ICTs into national and international social and economic development strategies that promote an information society for all.

Is there evidence that institutions can play a positive role in promoting ICT and expanding economies or are they simply relics of the past?
While today's framework of rules for the traditional business model have been developed and refined over many decades, the consensus for globally consistent rules for global business is not as well developed. As these rules must take into account the constantly evolving and inherently international nature of electronic commerce and business, any changes should be implemented only after a thorough discussion with all the parties involved and governments should support business-led rules development where possible.

Should government regulation be necessary, the regulations ought to be internationally coordinated, as incompatible national laws create a fragmented global market with significant uncertainty as to what rules apply. In addition, extraterritorial application of a country's laws - and claims for far-reaching application of a country's regulatory schemes - poses a significant problem to business, users and consumers and is a threat to global commerce. Therefore, non-discriminatory treatment of regulatory schemes affecting global commerce (eg. financial industry including capital and securities markets, financial services, insurance and banking, transport, advertising, consumer protection schemes, taxes) is crucial. Jurisdiction, choice of law agreements, and enforcement issues must be dealt with in a responsible manner and with full involvement of commercial actors.

For this reason, WITSA voices the concerns of the global ICT industry at an international level with such organizations as the World Trade Organization (WTO), the Organization for Economic Cooperation and Development (OECD), the World Bank, the Asia Pacific Economic Cooperation (APEC), the international Telecommunications Union (ITU), the Internet Governance Forum (IGF), and other international forums where public policies affecting industry interests are discussed, developed, or implemented.

An example of how important such institutions can be is the WTO and its ongoing efforts to conclude Doha Development Round of multilateral trade negotiations. The economic benefits that potentially can be reaped from a successful conclusion of the Doha Round are tremendous, and by WTO's own estimates, may result in tariff cuts of at least US$150 billion per annum.

Further inquiries
GPPS 2009 is a must-attend event for senior IT executives, senior government officials, academics and research scientists, and industry analysts. Take this opportunity to be part of a world-class event in an exotic location and gain valuable insights from some of the world's greatest minds. Forge strategic partnerships with ICT players from among the world and participate in and gain a first-hand perspective on global public policy issues relevant to ICT by prominent industry players. ■

More information about GPPS 2009 and how to register can be found at the official website: http://www.gpps2009.bm/.

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2009 Global Public Policy Summit (GPPS)

There are compelling reasons why IT professionals from around the world want to attend the 2009 Global Public Policy Summit (GPPS) of the World Information Technology and Services Alliance (WITSA). The conference is being held in Bermuda, which in itself is a good enough reason to attend, but on a more serious note, the conference will offer delegates extraordinary opportunities.

The three-day summit is the flagship event of WITSA, a consortium of almost 70 information and communications technology (ICT) industry associations from economies around the world.

The GPPS will be a summit meeting of global technology leaders. Issues affecting the industry will be keenly debated, allowing delegates a say in shaping policy proposals that members will take back to their governments. A number of declarations are expected, and it is anticipated that several decision papers will be prepared for onward transmission to governments around the world.

Those who attend will thus have a hand in formulating plans that will ultimately influence the future direction of IT development around the globe.

The GPPS also offers attendees the opportunity to meet with high-level individuals and senior authorities in the industry, to network and to create meaningful and lasting relationships that will enable delegates to bring greater dimension to their work.

More than 350 people are expected to attend the Summit, with representatives from countries as diverse as Australia, Canada, Chinese Taipei, Nigeria, Malaysia, Mexico, South Africa, the UK and the US already among those confirmed to be in attendance. A sizeable contingent from Bermuda will also be present.

The Summit has been held every two years since 1999. The theme of this year's gathering is "Business Technology: An Enabler in Your Economy", with a focus on global policies affecting the ICT industry.

GPPS 2009 will host valuable discussions of the "state of the world" in relation to public policies affecting the industry. The Summit aims to promote and educate industry and governments regarding the growth potential of the digital economy and, at the same time, examine key ICT public policy issues and explore the key policy concerns of ICT businesses.

Among a host of distinguished individuals who are confirmed to appear are:

- Dan Khoo, WITSA Chairman;
- Billy Hawkes, Data Protection Commissioner, Ireland;
- Nigel Hickson, Deputy Director, EU ICT Policy, Department for Business Enterprise and Regulatory Reform, UK;
- Dr Tarek El-Sadany, Senior Advisor to the Minister of Communications and Information Technology for Technology Policies, Arab Republic of Egypt Government;
- Waudo Siganga, Chairman, Computer Society of Kenya;

- Markus Kummer, Executive Coordinator, Internet Governance Forum;
- William Munson, Vice President, Policy, Information Technology Association of Canada;
- Lee Tuthill, Senior Counsellor, Trade in Services Division, World Trade Organization;
- Andrew Wyckoff; Head Information, Computer, and Communications Division; Organization for Economic Cooperation and Development; and
- Sarbulund Khan, Executive Coordinator, Global Alliance for ICT and Development (GAID), United Nations.

Among topics to be discussed at the Summit are:

- whether business technology is indeed an enabler in your economy;
- if enlightened IT policy can enable your economy and assist in its recovery;
- whether policies that promote technology infrastructures that are resilient and secure, and those that protect the privacy of personal data, conflict with policies that encourage economic expansion;
- how proposed internet governance policies on the stability, security and private sector leadership of the internet might dampen economic recovery and expansion;
- if environmental policies hamper growth — and whether enlightened IT policies and involvement can bridge the gap;
- whether there is evidence that institutions can play a positive role in promoting IT and expanding economies, or if they are simply relics of the past; and
- what potential business technology developments are on the horizon that will enhance business growth.

A pre-summit workshop will be held on October 31, entitled "Incubators as a catalyst to developing a strong IT sector". WITSA will also hold its regular board and committee meetings in Bermuda on the weekend preceding the start of the Summit.

Founded in 1978, WITSA has increasingly assumed an active advocacy role in international public policy issues affecting the creation of a robust global information infrastructure, including:

- increasing competition through open markets and regulatory reform;
- protecting intellectual property;
- encouraging cross-industry and government cooperation to enhance information security;
- bridging the education and skills gap;
- reducing tariff and non-tariff trade barriers to ICT goods and services; and
- safeguarding the viability and continued growth of the internet and electronic commerce.

As the global voice of the ICT industry, WITSA is dedicated, inter alia, to:

- advocating policies that advance the industry's growth and development;
- facilitating international trade and investment in ICT products and services;
- strengthening WITSA's national industry associations through the sharing of knowledge, experience, and critical information; and
- providing members with a vast network of contacts in nearly every geographic region of the world.

WITSA strengthens the industry at large by promoting a level playing field and by voicing the concerns of the international IT community in multilateral organisations, such as the World Trade Organisation, the Organisation for Economic Cooperation and Development, the G-8 and other international fora where policies affecting industry interests are developed.

The 2009 GPPS is being organised by the Bermuda Chamber of Commerce's Business Technology Division, in partnership with the Ministry of Energy, Telecommunications and E-Commerce. Bermuda is already positioned as an IT-centric jurisdiction. Holding the 2009 Summit, the only conference of its kind that brings governments and business together, on the island is a sign of a growing acceptance of Bermuda among the international IT community.

Spaces at the Summit have been filling up, but at press time, reservations could still be made at the event's website, www.gpps2009.bm.

Bermuda: a leader in ICT

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

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 to electronically identify offenders. The island's Tech Innovation Awards have gone from strength to strength.

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. The banking, trust, accounting, custodial and legal services 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 comprising four diverse bandwidth routes, top quality hosting facilities with maximum security and full redundancy, as well as the spectrum of telecommunications options.
- Location: An hour ahead of the Eastern Seaboard, four hours behind the UK, and seven to 12 hours behind the Middle East and Far East countries makes Bermuda an excellent location for operating international businesses. Easy access by air to most international centres, and the appeal of a sub-tropical paradise with literate, helpful people. Bermuda 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. Bermuda exempted companies are usually granted exemption by the Bermuda Government for an exemption from paying any taxes until 2016.

E-readiness

For a number of years Bermuda has placed among the top tier in the world in the 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.

E-readiness is the "state of play" of a country's information and communications technology (ICT) infrastructure and the ability of its consumers, businesses and governments to use such technology to their benefit. When a country does more online — or, as is increasingly the case, wirelessly — the premise is that its economy can become more transparent and efficient.

The e-readiness rankings also allow governments to gauge the success of their ICT strategies against those of other countries, and provide companies wishing to invest in online operations with an overview of the world's most promising investment locations from the e-readiness perspective.

Government initiatives

The Ministry of Energy, Telecommunications and E-Commerce (METEC) has been highly active of late. The Minister, the Hon Michael J Scott, 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.

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 as its burgeoning financial services sector kept growing. Bermuda was the first to elevate e-commerce to a cabinet post, a clear sign to industry participants of its serious intent.

"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 as its burgeoning financial services sector kept growing. 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 electronic 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 global 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.

In the Bermuda context, e-commerce does not mean giant server farms or warehouses stocked with goods to be bought online. Like all its business activities, Bermuda e-business is all about brains. Its developing pool of intellectual capital is proving to be a smart place for outsourcing solutions.

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.

An exhaustive review

As part of its ongoing commitment to keeping Bermuda's service offerings current, the Ministry is conducting a total telecommunications regulatory review that is addressing all such aspects of the island's telecommunications infrastructure. A new model has been proposed that is undergoing public and industry consultation.

The Ministry is also continuing to implement its ambitious e-government plans, which will lead to all the functions of the Bermuda Government being fully online.

The Bermuda Government has built its own Certificate Authority and expanded its pilot programme out of internal digital certificates. A Bermudian company, QuoVadis, has moved into the European market, playing an important role in the establishment of the new Extended Validation Guidelines for SSL (website) certificates.

The energetic METEC has ongoing support initiatives in computer security, protecting the Island's satellite slots, and in privacy and data protection legislation.

Current initiatives

The Electronic Transactions Act and Standards are being reviewed. Public safety electronic emergency messaging and top-level domain initiatives are under way. An Island-wide e-mentoring project has begun that will enable young people to interact with those employed in the electronic services sector.

The island's annual Tech Week — motto: Everyday; Everywhere; Everyone — once again proved to be a great success this year. A range of activities enhances public awareness of the electronic world and its possibilities, with a special emphasis on educating the Island's students.

A solid field of entries in various categories of competition for the 2008 Tech Innovation Awards was judged by a panel of representatives from local business organisations and, amid strong competition, awards were made in eight categories.

On the roads, the Government has placed RFID chips on all vehicles in a move widely applauded and now being studied elsewhere. The chips enable various government departments to provide more accurate service and are beginning to cut down on the operations of unlicenced vehicles.

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 hive of activity. The island is among the world's most highly wired communities. Just about every business is online, wi-fi usage has been on the increase throughout the island, with Bermuda International Airport the latest to come on board, and latest surveys put broadband internet access among the local population above 80 percent.

Given that the island is 800 miles from its nearest neighbour, the embrace of the electronic future has broad support throughout the community. ■

Mazovia - Poland's Economic Leader

Mazovia, the central region of Poland, is the country's economic leader. The dynamic transformations of the last decade are best seen in Mazovia. Due to its central location, large and growing market of over 5 million, as well as its educated and qualified population, Mazovia is the most commonly chosen and attractive region for foreign investors.

Almost 30% of the largest foreign investments in Poland are located in Mazovia. Centrally situated and at the crossroads of trade routes, Mazovia has today the greatest potential to become a vibrant region in the European Union. Mazovia is the leader with regards to foreign investments. Poland is the main beneficiary of foreign direct investments in Central Europe: in years 2006, 2007 and 2008 an average FDI of around **€**14.4 billion. According to the Polish Agency for Foreign Investments (PAIZ) the most important factors for investors to choose Poland as an investment location are the size and absorbency of the market (almost 40 million inhabitants – the largest country in central Europe), the low labour costs (one of the lowest on the continent), good business environment, growing integration with the world economy and the success of Polish privatisation. Over 70% of the capital invested in Poland comes from European firms.

Mazovia is the leader in Polish change

Mazovia is the fastest growing voivodship (province) in Poland and quickly took advantage of the transformations in Poland to become the economic leader among Polish regions. In no other region of the country was the transformation so quick and so successful. Mazovia is the voivodship with the greatest economic potential and is well-prepared to play an important role among the regions of Europe.

Doing business in Mazovia

For over four centuries Mazovia (Polish: Mazowsze) has been the gateway to Poland. It is the centre and the seat of the national capital. It lies at the crossroad of trade and communication routes connecting the east and the west of Europe. It is here, in Poland's most populous province, where hundreds of the biggest domestic and foreign companies have established their headquarters. It is here that all the major government offices are located. Mazovia is the leader of Polish transformation and the country's fastest growing region.

Economy

In terms of absorptive capacity, potential and infrastructure, the province remains the country's most attractive region for foreign investors. The economy has been mostly privatised with the private sector producing over 75% of GDP.

Over the past decade, Poland has enjoyed a high annual GDP growth rate, and inflation now stands at less than 1%. More than 600,000 firms now operate in Mazovia. The main sectors include trade, telecommunications, financial services, insurance, IT, motor and petrochemical industries. Outside Warsaw, Mazovia is a predominantly agricultural region. Regional agricultural production delivers background for the food-processing sector. The region has a considerable capacity for developing modern farming and related industries.

Mazovia in Europe

Mazovia is the province with the greatest economic potential in Poland, well placed to play a major role among European regions. For a few years now, Mazovia has played an increasingly important role in the economy of the enlarging European Union. Trade with EU countries now accounts for over 70% of Poland's overall trade. Given the size and potential of the Polish market, this role will continue to grow.

An investor's guide

Thanks to its central location, a big and absorptive market (the region has a population of over 5 million) and highly qualified population, Mazovia is the region attracting the highest number of foreign investors, leaving the other regions far behind in terms of investment attractiveness.

The Mazovia Province (Polish: Województwo Mazowieckie) is Poland's key communication junction.

The region is crossed by routes of crucial importance to the European economy, including the Paris – Berlin – Warsaw – Moscow road (Europe's main east-west communication axis), as well as a road from north-eastern Europe to Central Europe. An extensive rail and road network connects Mazovia with the country's other regions. It is here where Poland's principal airport of Okęcie is located, servicing over 80% of the country's air passenger traffic.

Mazovia is the province attracting the highest percentage of foreign investors. Many companies have found investing in Mazovia to be the easiest way to establish their business presence both in Poland and in Central Europe. Almost 30% of Poland's top foreign investors have chosen to base their operations in Mazovia. Over one thousand companies have invested a million dollars or more.

The companies that have invested over $1 billion in the region include France Telecom, Citigroup, Gazprom, Vivendi, European Bank for Reconstruction and Development, UniCredito Italiano and Nestle. The biggest investments are in telecommunications services and the financial sector.

Five reasons why investors choose Mazovia

- Easy access to the Polish market, the largest in Central Europe (almost 40 million people), and to the regional market (5 million people)
- The role of Warsaw as Poland's decision-making centre and the fact that Mazovia is Poland's best developed region
- Convenient connections with the rest of the country and Europe
- Good infrastructure and business environment: from office space standards, through telecommunications, transport and business services
- Low labour costs and well-educated human capital

The Mazowieckie voivodeship

An attractive area in Europe and in the world, Mazovia is an unusual area on the map of Poland because of its location in the centre of the country, the capital city, the biggest area that takes eleven percent of the country's territory, and the biggest local community that numbers over five million people. The main advantages of the region are: high research potential, the highest in the country index of foreign investments, existence of main offices of some financial institutions, skilled staff of Mazovia, and people with the highest income in Poland who live in Warsaw. An average gross salary in the enterprise sector in the Mazowieckie Voivodeship, in 2008, amounted to **€**936. The unemployment rate in the Mazowieckie Voivodeship is 7.3%. In the region there are qualified and relatively cheap employees.

Investors are encouraged to allocate their money here as the scale of market in the region and in the country is enormous, and because Mazovia has a very good production and services infrastructure. ■

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Executive Development and the Challenge of Authenticity

Dr Sally Watson is Director of Executive Education at Lancaster University Management School

The first article of the Lancaster series proposed a radical rethink in the field of executive development and education. In the context of a global recession, the author argued that the current market in executive education is flawed in approach and unlikely to develop the style of leadership needed to promote collaborative economic or political activity across the world.

A challenge was directed at providers of executive education and leadership development in their failure to equip leaders with the personal resilience and collaborative skills to face the complexity of a rapidly changing world.

The initial commentary on macro issues will now turn to the pressing issue of how leaders in business need to work to build a more sustainable economic future. This article will share the approach taken by Lancaster to developing business leaders. All opinions are supported by evidence from evaluation data gathered from 600 leaders over a six year period and case studies of business outcomes.

Why is current executive development flawed?

Many programmes of learning draw from historical approaches to education and training which are not fit for purpose in a rapidly changing world.

MBA and executive education programmes are largely focussed on the individual acquisition of knowledge, skills and qualifications. A closer look at their features and benefits indicates a functional approach to knowledge acquisition which at face value is efficient for the purchaser and economical for the provider. The purchaser can immediately recognise the product and be in a position to rationalise the purchasing decisions to their sponsoring organisation. The provider can organise their resource around this form of delivery and predict profits and trends. Both parties believe their needs are met. The big question is:

What is learned by the executive that makes a tangible and sustainable difference to their leadership?

The quality of senior leadership is a major concern to CEO's in boom conditions and recession alike. The development of functional competence in a talented executive can been planned, trained and monitored through succession planning and talent management. An expectation that the development of leaders can be prescribed and managed in a similar way is deeply flawed.

The major headaches for the leaders in business are: the human capacity to work with other people and an inability to adapt to change.

Over the past decade, the import of training methods and processes to the development of leaders has contributed to the rise of competency frameworks and scorecards. Performance measures applied to leadership development may provide data for the HR department but it rarely provides useful information for a CEO about the effectiveness of his or her leaders on the ground.

To put it simply, leadership effectiveness is the ability to live with others and roll with the ever changing punches presented by unsettling effects of the global economic and political events.

This view is supported by executives who join Lancaster programmes who demand learning that is practical, sustainable and that helps them develop emotional resilience in themselves and their people.

How well do you know yourself and your people?

The speed and unplanned nature of the challenges facing business requires a smarter approach to leadership development. The leaders of today and tomorrow need to develop the ability to continuously learn and challenge themselves as a part of their repertoire. Functional knowledge and qualifications will have an important place in their career but the process of being a leader needs continuous learning and self awareness. What businesses need are leaders who can anticipate the future, challenge the assumptions of fellow executives and sell new ideas to their people.

A simple and yet profound idea is that learning about leadership is actually learning about yourself. It is logical to predict that this type of learning has a fundamentally different starting point from the training or education that brings success at an earlier career stage. Learning about leadership can become a sustainable process that executives can tap into throughout their career irrespective of the context in which they are operating or the challenges they face.

At Lancaster, we believe that learning about leadership is a lifelong process of growing wisdom and authenticity and using these strengths to transform situations. The acquisition of skills, behaviours or competences is time limited and centred on business priorities that are continuously shifting. When the scenario changes and the systems and measures fail to predict the future, we have few resources to cope and little emotional reserve to challenge the status quo.

It is critical that leadership development is seen as a journey or apprenticeship that is continuously evolving as circumstances change. This is not a soft option, a one off training course, but a vital part of the growth of sustainable businesses and the daily routine of a business leader. Consider the Zen teaching

'Before enlightenment chop wood and fetch water: after enlightenment chop wood and fetch water'.

The challenge for business leaders

Each generation of leaders have assumptions which relate to experiences gained in a historical, social or political setting. How often do we really consider the impact of importing our dated thinking into a new challenge? When we admire the great leadership acts of famous individuals and aspire to their leadership style, we diminish our own qualities and deny the complex nature of everyday experience and futures yet to emerge.

The Lancaster approach helps individuals and groups examine their leadership and acknowledge where challenge is appropriate both personally and within the business. We work from the premise that authenticity in our dealings with others is an important ingredient in the development of leaders of the future.

Several eminent writers[1] are framing leadership as an inner resource of wisdom and authenticity and while there are differences in language, the essence of their thinking matches our experiences with practising leaders. A consensus is emerging between theory and practice that a profound change is needed in the way we view leadership development and the importance of authenticity in our dealings with others.

The challenge of authenticity

How well do you know yourself? Many of us are accomplished fugitives from ourselves. We take on a range of distractions and responsibilities to fill the quiet space in our minds.

We blame our job role, pace of change and shrinking resources for our working patterns and rarely look inside ourselves for an answer. We close down the reflective space that allows us to become aware of our values and gifts. Ironically this is the place where deep wisdom about leadership resides and where we can start to become an authentic person. Being fully conscious of own values makes us more emotionally resilient and able to make decisions that resonate with other people.

Working with business leaders in an authentic way is challenging but the clarity of purpose that starts to emerge for both individuals and teams, on our programmes, is tangible and practical.

'I had the chance to stand back and reflect away from the workplace, gaining enhanced knowledge in respect of strategic decision making' - CEO, Health Care

'For me, the experience was the start of a paradigm shift' - Senior executive, petrol chemical company

'I came back feeling more contented that I had been for years determined to remodel my approach to life and relationships' - Senior manager, Aerospace

Developing authentic leaders

We take a structured approach to learning about leadership by creating the environmental conditions that promote both reflection and authenticity. Our leadership programmes and team development workshops involve a short period of retreat which involves time out from the working environment in settings that are beautiful and tranquil. We avoid the traditional executive development classroom setting or hotel environment because they do not promote reflection or fresh thinking.

We show participants how to be critically reflective about their learning so that the ideas emerging can be transformed into workable solutions back in the business. Back at work their endeavours are made sustainable through executive coaching.

This approach is founded on the assumption that leadership is primarily learned from work experience not the classroom. The informal learning from the challenges in the business presents opportunities to learn about leadership and work up new solutions.

However, the working environment rarely presents the space and time to reflect and tap into our wisdom, as individuals and teams, and fully understand what we are learning. The process of reflecting and learning from personal experience makes tangible our values an excellent starting point for greater self awareness and authenticity.

The short periods of retreat recharge business leaders and illuminate the issues they face without the distractions of daily business. Executive teams can gain great benefit from spending time in a setting that is conducive to developing new thinking and working through complex problems. This does not take the form of the traditional 'away day' where problems and agendas are recycled back into old issues. Emergent thinking needs an environment that frees executives temporarily from the demands of the business.

'I found a completely different perspective of myself and realised that my initial views were shallow' - Manufacturing leader

Challenging assumptions

The biggest challenge to the Lancaster approach is the assumptions that business leaders have about leadership development. Participants arrive with expectations of a competitive and physically challenging programme and are surprised at the impact of a peaceful environment on the quality of their thinking and learning. The use of the outdoors on a Lancaster programme is for reflection and quality thinking – the quiet space to challenge old thinking and assumptions.

Outdoor development has had a significant influence on leadership development from the mid 1980s and retains popularity with both purchasers and consumers of executive development. The consistent challenge to this approach, from research studies, is the lack of sustainability of both individual and team learning on return to the business.[2]

Team development exercises where leadership is rotated, raft building and zip wires can bring exhilaration or terror. In our discussions with business leaders, we can find little evidence that this form of leadership development brings sustainable results back in the business. The extreme emotional experiences and subsequent 'corporate stories' are more likely to distract participants from conducting the quality of reflection and bring practical change to their leadership effectiveness.

Another consideration is the growth over 25 years of spiritual leadership development which involves spiritual retreats where individuals are encouraged to find inner peace and boost performance at work. With a strong emphasis on the individual there is no acknowledgement of the wider economic and political pressures which businesses face.

Both outdoor and spiritually based leadership development fail to address the problem of how learning adds value to sustainable business outcomes. Both methods were considered in the development of the Lancaster approach to developing authentic leaders. Our experiences over several years have clarified the key criteria for the development of authentic leaders.

Authentic Leadership - critical success factors

'My team performs better as a result of me making better choices' - Participant in a team workshop

From practical experience of working with leaders in diverse business settings and our research findings, we are confident in the benefits of the Lancaster approach.

When you consider the development of your leaders do you:

- Create space physical and mentally to allow individuals and teams to think about change
- Pay attention to the physical location of the learning
- Reduce external interference to allow individuals to slow down and think before tackling new challenges
- Legitimise the importance of emotional development to leadership effectiveness
- Encourage leaders to take personal responsibility for their learning – and take action on return to work
- Show people how to reflect – then support their efforts back at work to build reflection into their routine

When you consider the development of your business do you:

- Challenge assumptions about the business and future trends
- Challenge the data used for decision making
- Challenge the current method of decision making
- Challenge the need for 'away days'

And above all, do you challenge the approach your business takes to leadership development and question whether it is producing the quality of leadership you need for the future? ■

1. Scharmer, Senge, Cashman and Gallwey: 'Presence', Peter Senge & Otto Scharmer , 'Leading from the Inside Out', Kevin Cashman , The Inner Game of Work', Tim Gallwey
2. Jones P. and Oswick, J. "Outcomes of outdoor management development: `articles of faith?`" Journal of European Industrial Training, vol 17 No. 3 p.10