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NEWSLETTER

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2008 – The year of the bank?

It looks like I just can't escape the topic of banks. Regular readers may remember the leading article of the LAVECO Newsletter 2008.3, entitled "Bank of the year?", which dealt in detail with the anomalies in the operations of one particular bank. In the meantime, the worldwide credit crunch has spread significantly, and is now not just a financial crisis. We have entered into a global economic recession of such scale that it will not leave anybody unaffected.

To begin with, the politicians spoke merely of a financial crisis, reassuring us that it would only affect certain countries, with the others - the vast majority - being untouched. It has since turned out that in international financial circles everything is related, and the bankruptcy of one country or bank can have a significant influence on the financial sphere of another country. Looking at the process holistically, it was naïve to believe that the real sphere could remain totally unaffected. The financial processes themselves come about as a result of the real sphere, and are not independent from it. In my opinion, what we are really dealing with here is a very deep moral crisis among the consumer society, and this has led to the financial crisis and accompanying recession.

The uncovering of the reasons for and characteristics of the moral crisis are beyond both the scope of the LAVECO Newsletter and my capabilities. An analysis of the recession would be an extremely far-reaching task, but I would like to draw your attention to certain factors relating to the financial crisis, since these are particularly relevant to a large number of our clients and, in my opinion, we are still very much in the early stages of the crisis. We probably have to prepare ourselves for an extended period of recession, and the way we prepare for the next two years, both mentally and in business terms, will be extremely important. Naturally, all I can do is point out certain circumstances which I consider to be particularly important; it is then up to the reader to follow those thoughts through to their conclusions, but I hope these ideas will provide food for thought.

1. You can't have a financial crisis without financial institutions. The banks and various financial service providers represent the area in which I, as a client, can carry out my transactions within the framework offered by the system. Just think how, with cash now being so fiercely driven from the frame as a method of payment, it will soon be impossible to buy a packet of chewing gum, pay for parking or top up the credit on a mobile phone without using a bank card. Of course, this can only work, and the bank can only work, if there is enough money on the card. But can I, as a mere client, influence the behaviour of the bank? Do I know what the bank does with my money either within the bank or externally? Do the banks take risks with my deposits?

2. Greed and voracity were driving forces behind the processes. "Consume more and more, because that is chic. We'll finance it!" In recent years this type of bank advertising has been flowing like tap water. It is not necessary to offer a society raised among the credit hysteria the chance to buy even more "on the never-never", even if they are fully aware of the fact that they are taking out unsecured credit, which, in the long term, they will not have the means to pay back. Production increases as there is a market to sell to. Developing countries pour out their cheap consumer products. Investors believe that share prices will go sky high, and the investment bankers easily sell their investment products, pointing to the amazing yields of the investment funds which had invested in shares in China or India. The investor, quite naturally, wants to make more and more, and as quickly as possible. The high share prices are good for the investment bankers too, as the commission they make is based on this.

3. Commission. Bankers and financial experts receive commission based on the banking products sold. Naturally, therefore, it is in their interest to have the higher valuation accepted, on the basis of which the buyer can receive as much as a 132% mortgage for the London flat he wishes to buy. If the would-be owner "only" receives 66% of the value as a mortgage, and has to provide the remaining third from his own assets, then the basis for commission would be exactly half. But where is the guarantee that market demand will always push the price upwards?

4. Risk. The situation described above is extremely dangerous for investors. The banks take the investors' money, and place it where they think best, exposing it to the effects of the market process. The competing financial offers ultimately increase the risk for investors.

5. Lack of transparency. The question of transparency always arises in connection with offshore assets. I wonder, though, whether today's intricate banking system would be any more transparent without offshore companies and assets. How can it be that one after the other the investment banks, which are audited by the large accountancy firms, are admitting to huge losses as a result of risky investments? And that sometimes the bank's management have no idea where the bank's money is? How can it be that brokerage companies in New York, which fall under the scrutiny of the US financial supervisory authority, can let 50 billion dollars slip through their fingers?

6. What next in the financial recession? We can only partially foresee what is to come, as, in my opinion, there is a considerable lack of transparency in the system. It is impossible to calculate the level of risk taken by the credit card companies and banks offering loans. The Americans have been significantly over-spending for decades, with, according to some sources, 1.5 dollars of credit being available for every dollar earned. At some stage we are going to have to face up to the fact that borrowers in their masses will be unable to pay off their loans or credit – unemployment in the USA was at its highest at the end of 2008 for many years. How will the banks handle this situation? How many state rescue packages will it take to fix all of this?

I could continue asking questions until the cows come home, but where would that get us? Here are the points I consider important:

1. We will not be able to do without the financial system in the future. We need banks for financial transactions. Based on the initial experiences of the recession, however, we need to re-assess our expectations, and develop a suitable financial and political strategy.

2. Greater emphasis must be placed on striving for safer operation of the banking system. Unfortunately, there have already been financial institutions in Iceland and Latvia which, in connection with the recession, have placed a limit on the amount of money available for use each month. Although this sounds unbelievable, it could also happen elsewhere at any time. In order to spread risk, it is worth considering opening and operating accounts in several countries, or in several banks within one country, or even doing both.

3. It is also advisable to put on hold our expectations of high yields. In the uncertainty of the recession, banks which promise a lot are also taking high risks. It is also worth asking bankers what investment-protection guarantees cover our funds. I should point out that in certain countries such guarantees only cover the accounts of private individuals, while in others, such as Ireland for example, the state guarantee also covers corporate accounts until September 28th 2010. Naturally, we must also check what type of accounts are covered by the guarantee, as the Irish guarantee only covers deposits, but is not extended to securities accounts.

4. Strive for high levels of liquidity. A significant number of financial experts recommend that we keep the level of freely movable funds as high as possible, as the recession has not yet hit rock bottom, and the real time to buy is not yet here. Although this is difficult to achieve in practice, it is probably a wise thought.

It is very difficult to be wise today, as the events which we have witnessed over the last quarter previously never even appeared in our worst nightmares. If anybody had predicted a year ago that Wall Street could possibly crumble, they would have been considered a certifiable idiot. Every recession can be survived, but it is important to choose the right path and strategy to pull through. I hope that the preparations we have to put in place will not be too long term, either mentally or physically.

László Váradi
Managing Director

Client identification requirements for European Union banks

The 3rd Anti-Money Laundering Directive of the European Union had to be included in the legislation of all member states by December 15th 2007. The majority of member states have satisfied this requirement, and we are now seeing this being put into force in relation with the banks.

Client identification in itself is not new, and anti-money laundering regulations existed before, particularly in the banking world. The 3rd Anti-Money

Laundering Directive maybe differs in so much as it further widens the sphere of service providers who fall under its power, and increases the amount of information which has to be collected from clients.

And the life of clients who operate offshore companies will not be any easier either, as numerous banks now have to identify the client when the business relationship begins (the opening of the account), and then again every two years, or, in many cases, every year. They have to be able to "identify" the company itself, and the individuals behind the company.

Identifying the company is the easy part. The legal existence of the company can be verified by obtaining a "Certificate of Good Standing" from the relevant state authority.

Identifying the individuals behind the company is more complicated. On the one hand, there are the company officers who appear on the company documents, such as directors, company secretary, and attorneys. On the other hand, however, in numerous cases it is not clear from the paperwork who the owners and beneficiaries of the company are. The names of the shareholders in companies which issue bearer shares do not appear on the share certificate or the share register.

This is one of the reasons why the new anti-money laundering regulations place more and more emphasis on the identification of the real beneficiary, since at the end of the day, that is the person for whose benefit the whole construction is working, whose assets are in question, and in the case of whose possible death the bank must deal with the matter of inheritance.

When the European banks identify the persons listed above, in addition to verifying the personal details, they also ask for a certified copy of the person's valid passport, a bank reference letter and a recent utility bill (confirming the person's address). Furthermore, some European banks (primarily in Switzerland and Liechtenstein, but we have also come across this in Belize), also ask clients to provide reference letters from a lawyer and a Curriculum Vitae.

The situation doesn't get much easier outside Europe either. As considerable attempts are being made to harmonise anti-money laundering regulation throughout the international business world, numerous banks worldwide follow the identification practices mentioned earlier. From the Caribbean banking world to the extremely popular and much requested banks of Hong Kong, we can not escape the identification regulations. To show how typical this is today, I can quote an example very close to my heart: LAVECO. Some seven months ago we started the account-opening process with a bank in the Seychelles, with an eye to offering this service to clients in the future. It looks like we should finally get the account number any day now! We have had to send numerous additional documents for client identification purposes, but not all together – just when we thought they couldn't ask for anything else, they came up with a new request.

Introduction of a new banking partner: EUROBANK

At the end of 2008, LAVECO concluded an agreement with EUROBANK, Cyprus. As a result, LAVECO Ltd. is officially authorised to introduce clients to EUROBANK EFG Cyprus Ltd.

EUROBANK is a relatively new addition to the banks in Cyprus, as the bank was only formed on the island in 2007. Following the accession of Cyprus to the EU, the bank's owners saw long-term potential in the local business environment, and took the decision to form the new bank. The EUROBANK EFG group, whose headquarters are in Geneva, are present through various different banks in 10 countries in Europe, and have some 24000 employees.

Based on the personal meetings I have had with the bank's management, it can be stated that EUROBANK wishes to become a stable partner for our mutual clients, offering a wide range of banking services at relatively low prices. They are particularly interested in serving foreign (i.e. non-Cypriot) clients, which includes clients with offshore companies from just about any country in the world.

The services offered by EUROBANK include the opening of accounts for individuals and companies, Internet banking services, bank cards for individuals and companies, and numerous investment banking products and services.

If you would like to receive more information on the opening of accounts with EUROBANK, you can ask for details from any of the offices of the LAVECO Group.

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