



Supplier of Choice, SI3 and HPHT dominate WFDB Presidents Meeting

A packed agenda confronted the leaders of the international diamond trade, as they began the first session of the two-day WFDB Presidents Meeting on June 30, in the South African resort of Sun City. But three topics in particular were to dominate the discussions—the Supplier of Choice policy of the Diamond Trading Company; the implementation of a decision by the WFDB General Assembly in 2001 to introduce the SI3 clarity grade into gem labs that comply with International Diamond Council Rules; and the implications for the diamond trade of High Pressure-High Temperature (HPHT) diamonds.

Undoubtedly, it was the issue of Supplier of Choice that generated the most intense discussion, with the Presidents Meeting coming only weeks after the Diamond Trading Company informed clients who would on its new sightholder list.

In his opening speech to the gathering, which was a joint session held together with the International Diamond Manufacturers Association, WFDB President Shmuel Schnitzer, took the DTC to task for undermining the stability of the diamond industry in the way it has chosen to implement its Supplier of Choice program. “Our trade is built like a pyramid, with a wide base. At the top, there are a few big companies; in the center there are medium-sized companies; and at the base there are many, smaller sized companies. I have always expressed the opinion that, without a strong base, the future of the whole industry is

jeopardized. Obviously, Supplier of Choice did not take this situation into consideration,” he said.

In his speech, Mr. Schnitzer referred to a meeting held in London in May, involving a delegation from the WFDB and senior executives of the DTC, who were led by the DTC’s executive director of sales and marketing, Gareth Penny. “Our main proposal was to expand the Supplier of Choice plan to all those who contribute added value to the trade. They don’t necessarily have to be manufacturers. They can be dealers or wholesalers as well,” he said.

On the second day of the Presidents Meeting, Penny was provided the opportunity to address the issues the WFDB members had raised. Speaking at a second WFDB-IDMA joint session, he responded to the grave concerns that had been voiced, according to which fewer rough and polished diamonds will reach the open market under his organization’s new sales policy. In his speech, Penny said that the number of rough diamonds that will be sold through De Beers’ Diamdel rough dealerships to non-sightholders will be increased to \$500 million per annum. This he described as being equivalent to the annual production of a major diamond mine.

During their final session, the WFDB delegates passed a resolution in which they expressed their opinion that Supplier of Choice

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Message from the President

Dear friends,

I believe that I would not be overstating a fact if I described the recent Presidents Meeting, which took place in Sun City, South Africa, as one of the most memorable and most important in the history of the World Federation of Diamond Bourses (WFDB). The spectacular Lost Palace Hotel, which has as its backdrop the vast beauty of the African bushveld, provided an experience that for most of us who attended was absolutely unique. And so were our hosts, who throughout were uniformly friendly, helpful and efficient. Our hats go off to my vice president, Ernie Blom, the president of the Diamond Dealers Club of South Africa; Mark Reichman, who invested countless hours in coordinating this practically faultless event; the men and women of the South African diamond community, so many of whom contributed to its organization; and to the corporate sponsors of the various dinners and lunches.

Of course, we did not travel to South Africa only to sample the country's many attractions. Our agenda was packed with a variety of topics, many of which will have a profound influence on the way in which the diamond business is conducted. Several of these are expanded upon in this edition of the *WFDB Newsletter*.

Undoubtedly, the issue that generated the most discussion and concern was the implementation by the Diamond Trading Company (DTC) of its Supplier of Choice policy, and in particular its decision made public several weeks before the Presidents Meeting to reduce the size of its sightholder list. There obviously is a range of opinions within the WFDB, but judging from the sentiments that were expressed—often passionately—in Sun City, I think that I am correct in saying that our members are greatly concerned that even more rough is being channeled to a smaller number of companies, who already are contracted to supplying specific groups of retailers in the consumer markets. A number of strategies were suggested, some of them relatively extreme—including a formal appeal by the WFDB to the European Commission to protest the DTC's policies. My feeling was that a more conciliatory strategy should be adopted, with a solution to our predicament being sought through dialogue, with both the DTC and other producers. I am pleased to be able to report that my approach won the support of the WFDB leadership.

We soon will begin our dialogue, through the auspices of a special committee that we set up in South Africa. Its members include bourse presidents from both rough and polished diamond trading centers. I am hopeful that we will enjoy full cooperation from all the rough producers, and especially the DTC. What motivates us is the desire to ensure that all members of our trade are provided the opportunity to earn a reasonable living—at whatever position in the diamond pipeline they are located.

We do not disagree with the primary hypothesis of the DTC's plan, which is that a strategy must be formulated by which diamonds are marketed as a luxury product, and not simply traded as a commodity, as they have in the past. But we are concerned that any program that undermines the future of the diamond business' primary asset, its people, is counterproductive.

We do not aim to be confrontational, and believe that an equitable solution to the challenges that confront us can be found in the dialogue between us and the DTC, as well as with other producers of rough diamonds. That dialogue was served by the visit of Gareth Penny, the executive director of sales and marketing at the DTC, to the President Meeting in Sun City. Gareth's commitment, which was made at the meeting, to increase supply of rough diamonds to smaller and medium sized firms through its various Diamdels, to a value of up to \$500 million per annum, was a good start.

Gareth was invited to express in the *WFDB Newsletter* the DTC's position in our debate about Supplier of Choice. He graciously agreed to do so, and his comments are included alongside those of two of our presidents. I wish you pleasant reading.

Shmuel Schnitzer
WFDB President

Message from the WFDB Promotions Committee Chairman

Dear colleagues,

The Presidents Meeting that was held at Sun City in South Africa is past us, as is all the hard work that went into its organization. What lies ahead now is making sure that our business and our members prosper. It is this that will ensure that the diamond business, which we all love, regains its rightful place as the purveyor of the most desirable of luxury items in our segment of the market.

Sun City and the surrounding African countryside afforded the delegates, observers and accompanying persons to the Presidents Meeting with a wonderful time, which included a golf day, hypnotist show, game drives, bush barbeques, a trip down a Platinum mine, and a splendid gala dinner with South Africa's own "Three Tenors." But it was not all play and no work. Among the most important topics discussed at the Presidents Meeting were the introduction of an SI3 clarity grade by gem labs working according to the rules of the International Diamond Council, of which the WFDB is a founder member; the challenges posed to the industry by the proliferation in the market of diamonds whose color has been altered by High-Pressure-High Temperature (HPHT) treatments; the implications for our business which will result from the implementation of the Patriot Act in the United States; and, of course, Supplier of Choice. All these topics are covered in more detail in this issue of the *WFDB Newsletter*.

We also were privileged to have some very important persons with us in Sun City, including Abbey Chikane, the chairman of the Kimberley Process; Eli Izhakoff, president of the World Diamond Council; and Gareth Penny, executive director of sales and marketing at the Diamond Trading Company, who spoke about Supplier of Choice.

Although much was said—both positive and negative—about Supplier of Choice, the reality is that it is with us, and we should look for ways in which we can live with what is being expounded, rather than expending too much energy in long, and ultimately futile struggle to prevent change.

I have always believed, and still do believe that there will be a place in our business for all diamantaires, provided that we keep evolving with the times and understand what is expected from us by the ever-changing environment. I said it at the Gala Dinner and I repeat it again, "Small business cannot do without big business, but, likewise, big business cannot do without small business."

This edition of our WFDB Newsletter is a bumper one, because of all the important subjects that were covered at the Presidents Meeting. When you receive it, some of you will be going on holiday and others already will have returned. I hope you will enjoy or have enjoyed your well-deserved break, and that you start the new season with renewed and increased vigor.

Ernest Blom

WFDB Vice President

Chairman, WFDB Promotions Committee

Presidents Meeting in Sun City

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has created a situation in which the rough market has become concentrated in fewer hands, seriously threatening the business structure of the established wholesale diamond sector, and is likely to have a major adverse effect on the future of the entire wholesale diamond trade and industry.

The resolution also resulted in the creation of a committee, which will investigate any actions that will protect the best interests of the members of bourses affiliated to the WFDB. This will include an approach to all major diamond producers to

discuss their future commitment to the overall health of the international diamond sector, and more specifically the future continued supply of rough diamonds to the open market.

Participants on the committee will be Shmuel Schnitzer, president of the WFDB and the Israel Diamond Exchange; Jacob Banda, president of the Diamond Dealers Club of New York; Anoop Mehta, president of the Bharat Diamond Bourse of Mumbai; Willy Rotti, president of the Diamantclub van Antwerpen; Ernest Blom, president of the Diamond Dealers Club of South Africa; Eli Izhakoff, honorary life president of the WFDB; Derek Parsons, president of the Diamond Bourse of the Southeast United States; and Freddy

Hager, president of the London Diamond Bourse and Club.

The debate about the SI3 clarity grade stemmed from a resolution passed at the World Diamond Congress in London in 2003, by which the General Assembly of the WFDB, acting in its capacity as one of the founding members of the International Diamond Council (IDC), required the IDC board of directors to instruct all gem labs operating according to its rules to include SI3 as a legitimate grade after SI2. However, as a flurry of correspondence indicated prior to the Presidents Meeting, this has not occurred.

Following a lengthy and sometimes heated debate, the WFDB leadership reiterated its earlier decision—essentially signaling to the SI3 detractors that the discussion about SI3 had been terminated in London, and now was the time to begin implementation.

But, as was expressed by both WFDB office holders and gemologists at the meeting in Sun City, before SI3 can properly enter the IDC Rule Book, proper agreement has to be reached about exactly where it is located along the grading scale.

The Presidents Meeting also tackled the issue of High Pressure High Temperature-treated (HPHT) diamonds on the market. A report on the subject, delivered by Jacob Banda, the president of the Diamond Dealers Club of New York, quoted a study that suggested that about 0.75 percent of diamonds being issued grading certificates may be HPHT-treated, but are not recognized as such by even the major labs.

To help deal with the issue of HPHT-treated diamonds in the marketplace, the Presidents Meeting passed a resolution in which it was agreed that a committee would be created to liaise with the major gemological laboratories and investigate ways in which HPHT-treated diamonds can be prevented from infiltrating the market undisclosed. Representatives of the DTC and the International Diamond Manufacturers Association will be invited to participate.

In a letter sent to the WFDB president before the start of the Presidents Meeting in South Africa, De Beers disclosed that it will be making available to the gem labs an instrument that will help in identifying certain HPHT-treated diamonds. The instrument will become available in September.

A host of other issues were raised at the meeting in Sun City, including a number of legal matters that will have to be brought before

the WFDB General Assembly, when it meets at the next World Diamond Congress in 2004.

A highlight of Presidents Meeting, was the launch of the newly refurbished WFDB website, which is located on the Internet at **www.worldfed.com**. The website was updated following a decision taken in London in 2003 to transfer responsibility for its management and hosting to the WFDB Secretariat in Antwerp. WFDB Secretary General Michael Vaughan paid tribute to the website's founder, Derek Parsons, president of the Diamond Bourse of the Southeast United States, and urged all members of WFDB bourses to take advantage of their right to establish a WFDB e-mail address. In future it is planned that most correspondence within the organization will be conducted through the WFDB online network.

Among the participants at the Presidents Meeting was the chairman of the Shanghai Diamond Exchange, which has applied for membership in the WFDB. He delivered a report on the bourse's activities. Also addressing the meeting were Abbey Chikane, chairman of the Kimberley Process, and Mark Van Bockstael, the director of the International Affairs Department of the Antwerp Diamond High Council (HRD), who discussed recent developments in the Kimberley Process.

Eli Izhakoff, who is chairman of the World Diamond Council, updated the members about the council's participation in the process. He also reiterated the diamond trade's obligation to support the Kimberley Process Certification Scheme by maintaining a system of warranties and guarantees that will confirm that polished diamonds were processed from properly certified rough material.

The Presidents Meeting confirmed that the next World Diamond Congress will be held in the spring of 2004 in New York.

As it will for the subjects that were tackled, the 2003 Presidents Meeting will be remembered for its spectacular setting—Africa's entertainment capital, which is set in the hills of the Pilansberg Game Reserve.

Participants were treated to a variety of unforgettable experiences—culinary, cultural and natural. These ranged from a hypnotism show; to an evening game drive, followed by a barbeque in the bush and a dance to a marimba band around the campfire; to a golf tournament on the world's premier courses, to a Gala Dinner, where the guests were serenaded by South Africa's own Three Tenors.

THE SUPPLIER OF CHOICE DEBATE

Does the DTC's new strategy offer new opportunity, or damage the interests of smaller-sized diamantaires?

As fate had it, the Presidents Meeting in South Africa was scheduled to take place only a few weeks after De Beers' Diamond Trading Company (DTC) had revealed the identity of the companies that would be included upon its new sightholder list, which is the first that has been compiled within the framework of its new Supplier of Choice policy. As it had intimated that it would, the DTC reduced the number of companies eligible to receive from it a direct supply of rough diamonds.

Among the participants at the WFDB Presidents Meeting in South Africa, there was a strong feeling that the composition of the new sightholder list undermined the interests of independent diamond dealers. This opinion was challenged by Gareth Penny, the DTC's executive director of sales and marketing, who addressed the meeting and contended that Supplier of Choice would create improved opportunities for the entire trade.

The *WFDB Newsletter* invited two presidents of affiliated bourses—Derek Parsons of the Diamond Bourse of S.E. United States, and David Marcus of the Diamond Club West Coast, Inc., to express their opinions of Supplier of Choice. It also invited Mr. Penny, to present the position of the DTC. All three men kindly agreed.

'Supplier of Choice' will restrain, not ignite the diamond trade

By Derek Parsons, President, Diamond Bourse of S.E. United States

From its inception three years ago, the Diamond Trading Company's "Supplier of Choice" program has been seen as a threat to many members of the traditional distribution channel, created by De Beers many decades before. Conceived by the consulting firm Bains, it drew comparisons between the marketing expenditure of the diamond industry and that of many other luxury products.

It concluded that the growth rate of the diamond industry was below that of other luxury goods because the diamond industry did not reinvest enough of its sales revenues back into marketing. According to Bains, The purveyors of

most luxury goods reinvest in excess of 10 percent of sales revenues back into their marketing budgets. The diamond industry reinvests approximately 1 percent.

To correct this situation it was suggested that to be chosen to be a member of the redesigned distribution channel (Supplier of Choice), a sightholder would need to possess some or all of the following abilities:

- To be able to add value to their diamonds (possibly, by branding).
- To develop marketing programs to promote their products.
- To provide additional financing to accommodate vertical integration, so as to service retail jewelers directly.
- To develop management skills to coordinate this whole scenario.

This would allow the DTC to manage the diamond industry from the demand side rather than the supply side.

Unfortunately this strategy does not involve a role for thousands of small dealers or small manufacturers. Indeed, it not only excludes them, but it also deprives them of the most sought-after sizes and grades of diamonds.

The most ironic aspect of this is that the consulting plan is badly flawed and based on incorrect assumptions.

Let us examine the flaws:

If you examine the budget of any major corporation, it will have under its "marketing budget" the major expenditures for both "sales force" and "advertising." When the consulting report claims that other luxury products spend in excess of 10 percent of revenues on marketing, they refer to the combined sales and advertising expense. The 1 percent spent by the diamond industry is almost exclusively the cost associated with advertising. What is neglected in the equation is the cost of the diamond industries' "sales force."

And what do I mean when I refer to the "sales force?" I am talking about the thousands of dealers and their salesmen who sell, supply on memo, finance, educate, motivate, promote and generally support the retail jeweler. How would the "buy-shy" jeweler in the United States function without the critical support of the local diamond dealer?

What greater “value adding” can you have than a small dealer helping a group of jewelers compete in a very difficult market?

The dealers in the distribution channel work on very small margins. Yet they plough more than 10 percent of their revenues into the cost of their sales force. If you eliminate 50 percent of the dealers, as the Supplier of Choice program may eventually do, you will reduce, not increase the marketing expenditure of the diamond industry.

Since the branded diamond will be marketed in a restricted manner (like a Rolex watch), then neither dealers nor jewelers outside the Supplier of Choice program will have access to them. And, since the diamond grades and sizes in greatest demand will be distributed to participants in the Supplier of Choice program first, it will create a shortfall of available rough from which to manufacture the generic diamond shapes that the rest of the dealers need to survive. Hence a shakedown among the dealers is almost a certainty. In fact, jewelers are already complaining that diamond profit margins are very lean due to price competition.

While the jewelers with the branded diamond may increase their margins, the majority, once deprived of the support of their local dealers, might switch to other jewelry products such as watches, colored gemstones, pearls, and precious metals. This will reduce the rate of growth of the diamond industry.

Supplier of Choice does not account for long-time marketing and ethics of trade

David Marcus, President, Diamond Club West Coast, Inc.

De Beers’ Diamond Trading Company’s new Supplier of Choice program rests on a number of foundations. One is that the diamond industry is to be encouraged to reinvest a greater portion of its revenue in marketing, to bring it in line and better able to compete with other luxury product sectors. Another is that more added value could be provided to the business through the introduction of brands, which De Beers believes are grossly lacking in our business. Third are what the DTC refers to as Best Practice Principles, which will ensure that the integrity of the diamond product remains sound.

I suggest that several of the premises that the DTC has made in formulating its Supplier of Choice program do not correspond with

conditions as they exist. Comparing our business sector to the luxury goods sector fails to recognize that the profit margins with other luxury goods are significantly higher than ours.

The figures used by De Beers also seem inaccurate. In other luxury goods sectors, advertising equals about 10 percent of revenue, whereas De Beers to date has been spending about 2 percent. Total diamond advertising in the United States is about 5 to 6 percent.

Regarding the branding issue, De Beers has failed to recognize the successful branding over the years in the industry by firms such as Tiffany, Cartier, Van Cleef & Arpel, Bulgari, Lazare Kaplan, Graff and others.

As for confidence about the product, our industry has been advocating and supporting confidence in diamonds for the past 100 years. As for best practice etiquette in the industry, is this not the very foundation of the World Federation of Diamond Bourses?

In conclusion, the Supplier of Choice program requires each supplier to submit to the DTC the names of its customers and the specific diamond needs of each such customer, and, accordingly, De Beers then doles out the rough diamond supply to meet those specific needs. This restricts the ability of sightholders to compete for new business and could amount to an allocation of customers and an agreement to divide up markets.

The severe reduction in the number of sightholders likewise reduces competition and threatens to eliminate the network of manufacturers, dealers and wholesalers who traditionally have served the industry. This is compounded by the DTC’s proposed purchase of a significant portion of Russia’s rough diamond production, which would reduce competition from other manufacturers (and the dealers who buy from them).

Therefore, I think the move by De Beers is a bad one for the industry as it exists, and for consumers around the world.

Supplier of Choice and the changes we face together

Gareth Penny, Executive Director of Sales & Marketing, Diamond Trading Company

In July, at the WFDB and IDMA Presidents’ Meeting in Sun City, I had the honor of addressing the leaders of the international diamond industry. I would like to take this

opportunity to reiterate and embellish some of the points I made then on recent changes to the way we conduct our business at the Diamond Trading Company.

It is now an accepted truth that, for the past 12 years, the diamond industry has been outperformed by its closest competitors in the luxury goods sector and has lagged behind world economic growth. The difference in performance between our industry, and that of other luxury goods and the economy as a whole is what we call the “opportunity gap.”

The most important conclusion to draw from this is that the consumer has been telling us—all of us, and for more than a decade—that our product has been less desirable than other goods, such as watches, expensive cars and exclusive holidays.

Whilst virtually every other industry, from car manufacturers to multiple retail chains and, in particular, the luxury goods sector, underwent significant restructuring and consolidation, the diamond industry remained static and unyielding to a changing economic and competitive environment.

The DTC, like every other company in the diamond industry, has been affected by this new world economic order. We have seen our market share of rough distribution reduce from 80 percent to 55 percent. Our share of mining production, too, has fallen as new competitors join the field.

During this time, we carried on with “business as usual,” financing expensive stocks, distributing goods in a somewhat piecemeal, possibly inconsistent manner to many businesses who, like ourselves, were more supply-driven than demand-driven, with little focus on adding value for consumers. Our sales strategies did not compete effectively with the stronger and more sophisticated luxury goods rivals, who were increasingly encroaching on the share of consumer wallet attributed to the diamond jewelry industry.

There is an old Chinese proverb that says, “If we don’t change direction, we are likely to end up where we are headed.” By the end of the 1990s we, the international diamond industry, were “headed” for further marginalization and an ever increasing “opportunity gap.” We simply had to change direction.

We were adding nothing to the value of our product and the consumer was not impressed.

As we continued to trade diamonds, we paid scant regard to the efficiency of the pipeline,

which did not add value to consumers. We also ignored the needs of the consumer and what it was they required from a piece of diamond jewelry. Philip Kotler, one of the 20th Century’s foremost marketing gurus, had a simple analogy to illustrate this. He stated that when a carpenter went into a hardware store to purchase a drill, it wasn’t a drill he was buying but a hole. The drill, if you like, is the diamond, whilst the hole is the “diamond dream,” a collection of those ethereal and emotional attributes that the consumer is really interested in.

This apparent neglect of the consumer and their needs left the diamond industry increasingly vulnerable. That is why we embarked upon our strategic review and eventually developed the suite of strategies that has become known as Supplier of Choice.

Supplier of Choice was not developed in a vacuum, or on the whim of an insensitive management eager to confound the rest of the industry. It is a serious and overdue attempt to rise to the challenges we face in the marketplaces of an increasingly competitive and unsentimental global economy.

Supplier of Choice is a reaction to the changes around us—that we must all address—and not the cause of them.

We do not pretend that the changes required are easy. We are sensitive to the fact that many will find the coming few years challenging; indeed, we have found the changes challenging ourselves.

However, for those who embrace these challenges, we strongly believe that the rewards are real and attainable. For example, we have recently witnessed the opportunity gap beginning to close as businesses develop and implement marketing strategies that have effectively challenged and, in some cases, out-performed other luxury products. In the meantime, the DTC will continue its generic advertising campaigns, promoting exciting, new product ranges such as the popular and successful Trilogy and, more recently, the Right Hand Ring.

We must now, as an industry, recognize the need to evolve and fully embrace these new challenges. By taking responsibility for the success of our individual businesses and demonstrating a greater awareness and understanding of consumer demands, we can all contribute to the future prosperity of our industry by increasing the desirability and integrity of our unique and beautiful product.

Finally, at the DTC we believe that a healthy and dynamic secondary market is important to the growth and vitality of this industry and we are committed to ensuring that this vibrant element of the diamond market continues to trade effectively and will continue to supply medium and smaller sized companies through the Diamdels. As

always, we look forward to continuing our dialogue with the WFDB.

The opinions expressed are those of the authors, and do not necessarily express the official position of the World Federation of Diamond Bourses.

DEFINING SI3

WFDB commits to the addition of an SI3 grade, but no agreement as yet about its definition

One of the more contentious issues on the agenda of the leadership of the World Federation of Diamond Bourses in Sun City was the issue of the SI3 clarity grade. It had been discussed two years earlier at the Presidents Meeting in Idar-Oberstein, where it was decided to put forward a proposal to include it as a legitimate grade between SI2 and P1 (or I1) in the so-called IDC Rules. That proposal was ratified by the WFDB General Assembly at the 2002 World Diamond Congress in London.

The IDC Rules are the diamond grading guidelines devised by the International Diamond Council (IDC), which was set up in 1978 by the World Federation of Diamond Bourses (WFDB) and the International Diamond Manufacturers Association (IDMA). There are currently five gemological laboratories worldwide that apply the IDC Rule Book. They are

1. The Certificates Department of the Antwerp Diamond High Council (HRD), Belgium;
2. The Swedish Testing Institute, Stockholm, Sweden;
3. The Jewellery Council of South Africa Laboratory, Johannesburg, South Africa;
4. The Diamant Prueflabor, Idar Oberstein, Germany.
5. The Diamond Certification Laboratory of Australia, Sydney, Australia;

To date, none of the above laboratories has introduced the SI3 into its clarity grading scale. But what sparked the debate at the Presidents Meeting was an e-mail message sent on June 25 by Dieter Hahn, the WFDB Treasurer General and the president of the Diamant-und-Edelsteinbörse, to the various presidents of the bourses affiliated to the WFDB. In the message, Mr. Hahn, who unfortunately was unable to attend the Presidents Meeting for personal reasons, urged his colleagues not to proceed with the introduction of the SI3 grade. Among the reasons

he provided to explain his position was that a questionnaire submitted by the WFDB and IDMA to their members, in which they were asked to indicate the correct positioning of SI3 within the clarity grading scale, did not elicit any clear indication as to where SI3 should start and end. Furthermore, he wrote the Gemological Institute of America has indicated its opposition to SI3, and even of European labs that operate according to the IDC Rules are reluctant to introduce the grade.

Mr. Hahn's appeal was reinforced by a letter signed by the presidents of Belgium's four bourses and its two manufacturer organizations. It was written on June 23. "Introducing a new and additional clarity grade would mean a fundamental change in the IDC grading system, in theory and in grading practice and grading reports of those labs currently working with the IDC. We feel that such an important step should only be taken if and when all aspects are supported by a large majority within the diamond community, and with due attention to consumer confidence," the letter stated.

But a memorandum submitted to the Presidents Meeting by Lionel Noach, the vice chairman of the Diamond Dealers Club of South Africa, challenged Mr. Hahn's contention. "I remind everyone that the principle of SI3 was accepted at the Presidents Meeting in 2001, by a 17 to 3 vote" he wrote. "Since then we have been occupied in definition and implementation. With respect, if anyone seriously wished to challenge the principle, this could have been done at the World Diamond Congress in 2002. To raise it now just before the Presidents Meeting in 2003 is not satisfactory."

It was Mr. Noach's arguments that swayed the participants at the Presidents Meeting in Sun City, who agreed that the SI3 issue had already

been resolved, and once again reiterated that it should now be implemented. But an informal poll conducted by the *WFDB Newsletter* of IDC labs indicates that, even though the labs may be prepared to follow the IDC's instructions in principle, there is still no agreement as to how SI3 should be implemented.

Speaking from his office in Amsterdam, Edward Asscher, the IDC president, said, "We will certainly implement what the WFDB and IDMA decide. IDC is, after all, an executive body that follows the joint rulings of the WFDB and IDMA. However, it is imperative that the issue what SI3 is exactly is not resolved in the political arena, but by experts, who are recognized gemologists that can offer a clear-cut and razor-sharp definition of SI3."

Peter Borgmans, the quality manager of the Certificates Department at the HRD, was involved in the organization of the poll of the WFDB and IDMA membership. "Once we had collected and summarized all the data," he recalled, "we understood that we had been maneuvered into a kind of deadlock. While the majority of the respondents of the WFDB were in favor of the introduction of SI3, only a minority answered our queries of how exactly SI3 should need to be defined. Therefore, based on the inconclusive results of the survey, it was concluded that we could not possibly reach a reasonable decision as to how the SI3 clarity grade should be defined."

For many in the trade, the ideal demarcation for SI3 would be the upper end of P1, but for members of the gemological community that is not necessarily ideal. Traditionally, some say, P1 indicated a point where inclusions were visible with the naked eye. That being the case, it may be preferable to assign SI3 to a range that currently is occupied by the bottom end of SI2.

"We function in a predominantly retail market," said Michael Cohen of the Diamond

Certification Laboratory of Australia. "Therefore we have had many requests for the inclusion of SI3. This however must be considered together with the fact that these requests are from sellers who want SI3 to come exclusively out of the top end of P1. We believe the problem exists not because of a gap between the definition of SI2 and P1, but because of the large difference in the price between the grades. The IDC should determine if in fact there is a gap between the definitions, and, if yes, clearly define the parameters. If not, they should possibly address the pricing issue. In our experience there are also good SI1s and heavy VS2s, but no one calls for VS3 because there is no major difference in the pricing."

"There is a clear division in the opinions as to where the SI-3 grade should come from," said Leslie Milner, the executive director and chief gemologist of the Jewellery Council of South Africa Laboratory, "that is, whether it should come off the bottom of the SI2 clarity grade or from the P1 or I1 clarity grade. And, because in practice we cannot introduce the SI3 diamond clarity grade until the IDC comes with a final, decisive directive, and since it does not look like that a broad and decisive consensus on this fundamental issue is close, I do not see SI3 coming in any time soon."

Gerhardt Schmidt, the general manager of the Deutsche Prueflabor in Idar-Oberstein, concurred. "If IDC would eventually decide to bring in the SI3 grade, we would follow," he said. "However, nobody is clear about where between SI2 and P1 it should be positioned. And that, it seems, would be the first thing to resolve before introducing SI3."

HPHT TREATMENTS

WFDB-gem lab-liaison committee created, DTC reports development of HPHT screening device

The issue of diamonds that have had their color changed by being subject simultaneously to extremely high pressures and temperatures had been discussed by the World Federation of Diamond Bourses before it was placed on the agenda of the 2003 Presidents Meeting in Sun City, South Africa. Indeed, it was

the subject of debate and a resolution, passed by the WFDB General Assembly when it last gathered, at the World Diamond Congress in London in October 2002.

The resolution that was passed in London specifically requires that all members of bourses affiliated to the WFDB disclose the proper

identity of an HPHT-diamond on the invoice recording its sale. Failure to do so, the resolution stated, would lead to severe sanctions, including full suspension of diamond exchange membership rights—meaning that an offender would be denied access to any of the WFDB-affiliated bourses worldwide.

“Let us not be caught unawares,” said a delegate addressing the congress. “We’re talking about the ability to manipulate a lower-quality diamond so that it takes on the appearance of a very expensive stone. There may be nothing illegal about selling them, but, if there are those who deal in HPHT stones without reporting their true nature, and we do not have effective means of identification, we could be facing a massive crisis of consumer confidence.”

What exactly is an HPHT-treated diamond? It generally starts out as a brownish stone, in which its color is related to a deformation of the diamond crystal, although the exact nature of the defects causing the color is not yet known. During HPHT processing these crystal defects are rearranged, and as a consequence the color is changed.

The final result depends not only on the parameters of temperature and pressure, but also on the specific properties of the stones that are processed. Extremely pure material, containing only negligible quantities of nitrogen atom impurities (Type IIa diamonds) can be transformed from brown to colorless. In a number of cases, the end product is pink.

If the same processing parameters are applied to brown or gray Type IIb material (containing boron atoms, and negligible quantities of nitrogen), the final color can be blue.

When HPHT processing is applied to a brownish, strained Type Ia material (containing substantial amounts of nitrogen), the structural defects interact with the nitrogen atoms, and this can result in intense yellow-green, strongly fluorescent fancy colors.

Other, less common diamond types may lead to completely different results.

Speaking to participants at the Presidents Meeting in Sun City, Jacob Banda, the president of the Diamond Dealers Club of New York, stressed the need for the WFDB to initiate a dialogue with the leading gem labs, out of a general concern about their ability to identify stones that are subject to HPHT.

“Estimates, and I emphasize these are only estimates, suggest that around three quarters on 1 percent of stones issued grading certificates by a major lab may be HPHT-treated, and missed by the lab,” he said. “This is based on the view that only about 5 percent of rough is treated, and about 85 percent of HPHT treated stones are detected. Thus a lab is failing to note that 15 percent of 5 percent of the stones are treated, or a figure of less than 1 percent.”

“While this situation is better than it was a few years ago, the industry must insist on 100 percent of all stones being detected. Anything less than this figure could lead to an undermining of consumer confidence in diamonds, and hurts our entire industry,” Mr. Banda stated.

“Clearly, we cannot tolerate a situation that may provide so harmful,” he continued. “To prevent this from occurring, I am calling for a special—indeed, unique committee—to bring together the best researchers in our industry. I am asking today for a joint WFDB-gem lab committee that will include representation from the major labs, as well as other industry leaders. Instead of each lab pursuing its research on its own, research would be effective if it was pooled, so that all labs cooperate to find the most effective detection process.”

In response to the DDC presidents appeal, the Presidents Meeting adopted a resolution noting the organization’s concern that more HPHT-treated diamonds are entering the market. It also resolved to create a laboratory liaison committee to investigate and deal with the matter, noting that representatives of the International Diamond Manufacturers Association (IDMA) and the Diamond Trading Company (DTC) will be invited to join the body. The committee was instructed to report on its activities within three months to the WFDB executive committee.

At the Presidents Meeting, WFDB President Ashmuel Schnitzer reported on a letter that he had received prior to the event from Dr. Martin Cooper, the head of the DTC Research and Development Center in Maidenhead, England. In his letter, Dr. Cooper reported on the development of an instrument that will be used for screening Type II HPHT-treated diamonds. The instrument is not yet available to the trade but, when it is, it will be marketed under the name “DiamondPlus.”

Dr. Cooper stressed that the new device is suitable only for screening Type II diamonds, which are essentially of the type that turn

colorless, or, in rare cases blue or pink, under the action of HPHT treatments. This type of diamond represents about 1 percent of the general diamond population, but are the stones that have caused the greatest deal of concern in the trade.

To facilitate screening, loose diamonds must be immersed in liquid nitrogen during the measurement. For this reason the instrument is intended for use in a laboratory environment where liquid nitrogen is generally available and staff are trained in its handling. After performing a measurement, which takes only about 20 to 30 seconds, the instrument is designed to produce a simple "pass/refer" result. Diamonds that receive a "pass" result require no further testing. Those that receive a "refer" result need to be examined in detail, using more sophisticated spectroscopic equipment and techniques, which generally can be carried out at the major gem labs.

In his letter, Dr. Cooper stated that tests have shown that, while the new the instrument will refer all HPHT treated diamonds, it will also refer 25 percent to 30 percent of untreated diamonds. These referred diamonds require the more detailed examinations.

Dr. Cooper emphasized that the new instrument should be regarded as a screening instrument, not as an HPHT detection instrument. It enables 70 to 75 percent of untreated type II diamonds to be passed, taking only 20 to 30 seconds and requiring no user interpretation. This compares to about 30 minutes using standard, commercially available equipment.

He reported that his organization is currently manufacturing a small number of these instruments, which it intends to sell through a third party distributor, hopefully from September. The expected purchase price will be between \$15,000 and \$20,000.

BACKGROUND

Patriot Act to create new regulatory framework for conducting business in the United States

As was explained to participants at the Presidents Meeting in Sun City, South Africa, most diamond companies that trade in the United States are about to be confronted by a new set of rules and regulations that are likely to make doing business in the country significantly more cumbersome. They are being introduced as a consequence of the Patriot Act, which was passed as part of the U.S. government's effort to defend the country from the scourge of terrorism.

As **Ben Kinzler, the director general of the Diamond Manufacturers and Importers Association of America**, explained at a WFDB session in Sun City, the gemstone and jewelry sectors have been earmarked for special attention inasmuch as the U.S. authorities consider them to be particularly susceptible to money laundering.

Mr. Kinzler kindly agreed to outline the Patriot Act for readers of the WFDB newsletter. Given that the fact that the U.S. market consumes about half of all the polished diamonds sold each year by value, the implications of this new piece of legislation are of the utmost importance for the industry.

Following the tragic events of September 11, 2001, the United States government enacted the U.S. Patriots Act, a tough new law intended to

promote the prevention, detection and prosecution of international money laundering and terrorist financing. This new law classifies dealers in diamonds, precious stones, precious metals and jewelry as "financial institutions," and as such requires dealers to establish and maintain comprehensive anti-money laundering policies and procedures. The law recognizes that all "financial institutions" (and not just banks) are vulnerable to money laundering and terrorist financing.

Under this new law, a "dealer" is defined as "any person engaged in the business of purchasing and selling jewels, precious metals, or precious stones, or jewelry composed of jewels, precious metals, or precious stones." Moreover, a "dealer's" failure to comply with these new anti-money laundering rules or, for that matter, the dealer's engaging in illegal money laundering activities, may subject the dealer to significant criminal and civil penalties.

The problems of money laundering were recently highlighted by the reported arrests of various jewelry industry merchants on charges of money laundering. During the past few weeks, there have been further reports in the trade press of the issuance of subpoenas to a number of diamond dealers in connection with a government

investigation into suspected money laundering activities in the diamond and jewelry industry.

In order to implement the Patriots Act, the Financial Crimes Enforcement Network (Fincen), a branch of the U.S. Treasury Department, has promulgated proposed rules governing all dealers in diamonds, precious stones and jewelry. Fincen is currently reviewing the industry's comments on the proposed rules and is expected to issue final rules in the next few months.

Under the proposed rules every "dealer" who purchased or sold more than \$50,000 in "jewels, precious metals, or precious stones, or jewelry composed of jewels, precious metals, or precious stones during the prior tax year or calendar year, will be required to develop and maintain a *written* anti-money laundering program, which is "reasonably designed to prevent the dealer from being used to facilitate money laundering and the financing of terrorist activities." According to the proposed rules, each dealer's program must be approved by senior management and must, upon request, be made available to the Department of Treasury or its designee.

Under the proposed rules, the dealer's anti-money laundering program must, at a minimum, include the following elements:

1. Policies, procedures and internal controls (including provisions for complying with the U.S. Bank Secrecy Act), based upon the dealer's assessment of the money laundering and terrorist financing risks associated with its business. (In assessing the "risk" the program shall take into account various factors, including the types of products the dealer buys and sells; the nature of the dealers customers, suppliers, distribution channels and geographic locations; whether the dealer engages in transactions for which payment or account reconciliation is routed to or from accounts located in jurisdictions that have been identified as sponsors of international terrorism or, designated as non-cooperative with international anti-money laundering principles or procedures by any intergovernmental group or organization of which the United States is a member, or designated by the U.S. government as warranting special measures due to anti-money laundering concerns.)
2. Policies, procedures and internal controls to assist the dealer in identifying transactions that may involve use of the dealer to facilitate money laundering or terrorist financing,

including provisions for making reasonable inquiries to determine whether a transaction involves money laundering or terrorist financing, and for refusing to consummate, withdrawing from or terminating such transactions. (Under the proposed rules, the factors which may evidence a suspect transaction include unusual payment methods—such as large amounts of cash, multiple or sequentially numbered money orders, traveler's checks, or cashiers checks, or payment from third parties; the customer's unwillingness to provide complete or accurate contact information, financial references, or business affiliations; attempts by the customer or supplier to maintain a high degree of secrecy regarding the transaction or an objection to keeping normal business records; purchases or sales which are unusual for the particular customer or supplier; or purchases or sales which are not in conformity with standard industry practice.)

3. The dealer's anti-money laundering program must designate a compliance officer who will be responsible for insuring that the program is implemented effectively; ensure that the program is updated as necessary to reflect changes in the risk assessment as well as updates in the rules and further directions issued by the U.S. Treasury Department, and who is responsible to train the dealer's personnel regarding the various anti-money laundering policies and procedures of the company.
4. The anti-money laundering program must provide for on-going training and education of the dealer's personnel.
5. The program must provide for independent testing to monitor and maintain an adequate anti-money laundering program.

There are two exceptions to the definition of a "dealer" under the proposed rules. The first exception provides that a retailer is a dealer only if it purchased more than \$50,000 in jewels, precious metals, precious stones, or jewelry from persons other than dealers during the prior calendar or tax year. Accordingly, a retailer is not a "dealer" under the proposed rules to the extent that its purchases are made from "dealers." However, if the retailer purchased from sources other than "dealers," then the retailer is a "dealer" under the rules and the retailer must then comply with the rules. By way of illustration, if the

retailer purchases its goods from overseas suppliers who are not subject to the proposed rules, the retailer would then be considered a “dealer” and would be required to have its own anti-money laundering program in compliance with the new rules.

The second exception removes from the definition of a “dealer” a “person buying or selling value-added fabricated goods containing minor amounts of precious metals or gemstones.

It is believed that under the rules, all U.S. dealers in jewels, precious metals, or precious stones, or jewelry composed of jewels, precious metals, or precious stones (including representative offices of foreign companies and salesmen from foreign dealers doing business in the United States) will be required to comply with the provisions of these complex and tough new rules. Under the proposed rules, dealers will also be required to comply with the provisions of the Bank Secrecy Act which mandates that “financial institutions” report the receipt of cash or certain non-cash instruments totaling more than \$10,000 (U.S.) in one transaction or in two or more related transactions.

According to the proposed rules, dealers are also required to detect and report activities (commonly referred to as “structuring”), which are designed to evade the currency-reporting requirement. This may include transactions which involve multiple money orders, travelers checks

or cashiers’ checks or other bank checks, each with a face amount less than \$10,000. The proposed rules also encourage dealers to file with the government a “Suspicious Activity Report” concerning any suspect transaction.

The burdens of the proposed new rules on dealers, both in the initial formulation and implementation of the dealer’s anti-money laundering program, and the ongoing compliance and record-keeping requirements, is expected to be enormous. This task will likely be made even more difficult by the general lack of experience amongst diamond and jewelry dealers in compliance with such new and comprehensive legislation.

The Diamond Manufacturers and Importers Association of America (DMIA), the association of America’s leading diamond manufacturers, importers and dealers, has undertaken to formulate a template for dealer compliance with the new rules and to provide dealers with access to customer identity software, access to government terrorist and watch lists, ongoing technical support, training and education. For further information, you can contact the DMIA’s Executive Director, Ben Kinzler by E-mail at “benler@aol.com”.

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The **WFDB NEWSLETTER** is presented by the WFDB Promotions Committee.

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