

Financial Transparency, Improved Bankability

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Ladies and gentlemen, colleagues and friends,

It is a both a privilege and pleasure to be addressing you today, both as a first-time attendee to this event, and also as president of one of the youngest bourses in the federation, the Panama Diamond Exchange, the only diamond exchange in Latin America.

On behalf of our members let me thank the gracious hosts of this event, the Dubai Diamond Exchange, for their hard work, generosity and hospitality. I would also like to extend a special acknowledgement to WFDB President Ernie Blom for his insight into the challenges facing our industry, and in particular the critical issue of bank finance.

As some of you know, I am a relative newcomer to the diamond business, having cut my professional teeth not at a diamond polisher's wheel, nor on the trading floor of a bourse, but rather in government and finance. Most recently, I spent six years at Panama's Ministry of Economy & Finance, the last two of which I served as Vice Minister of Finance for the county.

In retrospect, 2015 was a tough year in the diamond business, and 2016 will almost certainly be a challenging one as well, although it has started on a more positive note. Trading at the Panama Diamond Exchange only really began towards the end of the first quarter of last year, so the close to \$130 million in turnover that we registered by the end of December was almost all positive growth. However, as you all know, this was not the situation in the more established diamond trading centers.

What was particularly interesting about last year was that many retail markets were relatively buoyant. Indeed, the precipitous fall in the sale of both rough and polished diamonds, as well as the decrease in prices, came against a backdrop of a record \$39 billion worth of diamond jewelry sales in the United States in 2015. According to DeBeers data released in April, the Chinese market grew at 3% when taking into account overseas purchases and global consumer demand for diamond jewelry grew at 2% when taking into account constant currency rates. Demand for diamond jewelry was not only steady; it actually grew. Why then were conditions so tough in the loose diamond market?

It was not due to a lack of confidence in the products we sell. As the De Beers data shows, demand is growing, albeit at a slower rate than several years ago when Chinese economic growth was at its peak.

What happened was that it became more difficult to do business, primarily because the banks, either deliberately or due to global circumstances, reduced their financing facilities

that had previously been available to market participants. Metaphorically speaking, the gasoline which we need to fuel our engine began to run out, and our motor slowed down considerably. According to a March 2015 Financial Times article, one experienced diamond industry participant says banks are now offering \$3 billion less in a rough market that needs about \$14 billion in financing.

Sales downturns that are driven primarily by market forces are generally cyclical. We are all familiar with them. Markets rise and fall – recessions, are typically followed by a period of accelerated growth. But a sales downturn like the one we lived through in 2015, which was largely driven by a deliberate reduction in liquidity, is systemic. In other words, if we do not act to modify the system in which we operate, the problems we are encountering are likely to persist, and even worsen.

In order to appreciate how we can rectify the course of our industry, we first need to properly consider the situation from the perspective of the banks, whose world has changed considerably since 2008, with the onset of the global financial crisis.

Basel III was introduced in 2011 as a regulatory system intended to strengthen bank capital requirements by increasing liquidity and decreasing leverage. It is a voluntary system, but it has been widely adopted by both banks and bank regulators. The introduction of Basel III rules progressively tightened risk-weighted asset and regulatory capital requirements, and this raised special challenges in sectors like the diamond industry, which for decades had been used to operating with relatively high levels of indebtedness and low levels of personal equity. In addition to the new Basel rules, regulations related to anti-money laundering and those aimed at countering the financing of terrorism are also important developments that are here to stay and will probably get tougher as time progresses.

We must realize that tough banking regulations are a fact of life that we must learn to live with, and they do not necessarily mean that we are being left out in the cold. No problem is insurmountable. To move forward, we need to understand the regulatory environment in which the banks operate, and appreciate that any financial framework that we adopt must meet their specific requirements. **It's a whole new world and Transparency is the key that opens its doors.**

In consultation with our banking partners, we should begin by creating standards that will define exactly what is expected of our members. These standards would highlight the acceptable financial and governance structures, and **outline elements that ensure full transparency**. The end goal should be for our members to comply with International Financial Reporting Standards as do the banks' other corporate clients.

To achieve this goal, we need to appreciate that it may be necessary to change practices that have been common-place for the past 25 years. We need to question the current arrangement by which the midstream of the diamond pipeline - in between the mines and the retailers - which historically has reported the lowest profit margins, bears the almost sole burden of financing rough diamond purchases, while providing generous terms of payment to our downstream clients. This arrangement has greatly contributed to the current situation increasing the level of bank debt incurred by midstream participants.

These are the challenges that stand before us. Our role is one of promoting transparency. This has to become the new normal. From Panama, we look forward to working in unison to bring this new normal to Latin America as we promote the diamond trade and industry in our region.

Thank you.