

The 'Bernard Madoff' Financial Scandal

The year 2008 will be probably be remembered as the year of the global financial crisis that ended with one of the oldest tricks in the books, known as the Madoff Ponzi case. It made headlines around the world, with the estimated losses of around US\$50 billion and involved many wealthy well to do trust funds and sophisticated investors. Many have questioned how the scheme was able to run for so long without being detected by the US Regulators.

In late December 2008, media reports rocked the financial markets in America when the US Securities and Exchange Commission, announced that they were investigating Bernard Madoff. He was a well respected businessman and former Chairman of the NASDAQ Exchange and duped many to invest in his Wall Street firm (Bernard L. Madoff Investment Securities LLC). Many of these investors believed they had a sturdy investment, when it continuously delivered a steady 12 percent return, whether it was a good or bad year. However, last year the scheme began to unravel when too many investors came to redeem their investments. Madoff could not keep up with payments and finally admitted to running a pretty simple Ponzi operation: paying out earnings to those who demanded them - using new commitments of cash from those who wanted it.

How the scheme works?

This scheme thrives on greed. Investors are usually lured by the promise of large returns as

bait, the fraudster takes in money from new investors and uses it to pay off the earlier investors until no more new recruits can be found and the whole scheme collapses, with the newest investors losing everything.

Madoff surprisingly, was able to operate this scheme for many years without being investigated, as it was believed to have been a kind of a hedge fund that did not fall under the scrutiny of the US Securities and Exchange

It made headlines around the world, with the estimated losses of around US\$50 billion and involved many wealthy well to do trust funds and sophisticated investors



Commission. However it appears he may have been abetted by a close family member working for the regulatory authority. Although the returns from his fund were not too high, what was suspicious was that it delivered 12% continuously over long time.

How it originates?

The term Ponzi is named after Charles Ponzi, a 1920s crook who promised investors in New England a 40 percent return on their investment in just 90 days, compared with 5 percent in a savings account. Variations of this scheme crop up every now and again, and there are numerous cases where an entire communities have been defrauded. In fact this was the case in Albania and the Philippines. Here in Fiji similar schemes have also been reported in recent years.

How to detect such schemes

Common types of Ponzi scheme operate under a variety of names but their common characteristics are very high returns with no clear underlying business to generate them.

More complex forms of Ponzi scheme can be harder to detect. They may well appear to be legitimate investments. They may even be part of an investment that includes both legitimate and Ponzi elements. What investors need is to ask questions and not hesitate to withhold their money, until they have had the opportunity to make thorough checks.

Anything that offers very high returns without correspondingly high risk should be regarded with great suspicion. Any investment sold through unusual channels (such as spam email or cold calling) or by a business that is not appropriately regulated (e.g. by the RBF, CMDA or any other regulator) is also both suspicious and probably illegal.

Investors into such schemes are advised to check with the CMDA whether someone selling such investments is regulated or not. Investors can protect themselves by ensuring that they fully understand how the investment product works before they invest.

INSIDE THIS ISSUE

- The Bernard Madoff Financial Scandal
- Share Issue Privatisation (SIP): A Reform Strategy for SOEs in Fiji
- Global Financial Crises in a Nutshell
- Licensing
- 2008 – Capital Markets Investment in Review
- News in Brief
- Share Trading Statistics

UPCOMING EVENTS

- Media Workshop - 5th March 2009
- Series of Corporate Finance Workshop - Dates tbc

Contact the CMDA office for more information

Share Issue Privatisation (SIP)

A Reform Strategy for State Owned Entities in Fiji

Privatisation is a reform process that can be effectively used to develop our capital markets. A very broad term - but most simply, it is a process of changing something from public to private ownership or control. In recent years all levels of government seeking to reduce costs, have begun turning to the private sector to provide some of the services that used to be provided by the state.

Privatisation programs are often undertaken in many ways. Share issue privatization (SIP) is one of the most common types of privatization undertaken in most economies. It is a method of selling state-owned enterprise (SOE) by offering some or all of government's equity in a state-owned enterprise to investors by means of floating the shares on the stock market or stock exchange.

The objective of this method is to involve small shareholders and larger institutional shareholders in the purchase of state owned assets. It can also be used to promote wider shares ownership as all members of the public are invited to participate in the offer. The process often leads to the eventual listing of the reformed SOE on the stock exchange.

The lack of supply of good marketable securities is often recognized as a major challenge towards the development of Fiji's capital market. Several case studies on

other economies have indicated the positive correlation between SIP programs undertaken and the level of financial market development and stock market liquidity. For instance, based on a study by Boutchkova and Megginson [2000], stock trading volume in developed countries outside the US grew from a little over \$460 billion in 1983 to more than \$17 trillion in 1998 while massive privatization plans were in progress.

Public enterprises reforms program through SIP and the eventual listings of state owned entities on the stock exchange can be the answer to the current illiquid state facing Fiji's stock market. This can also be employed as a means of boosting the development Fiji's capital markets, which incidentally coincides with the government's proposal as specified in the NCBBF's State of the National and Economic report.

Why then should Government re-examine their position on implementing privatization programs? For one Government is not getting a satisfactory return on the resources it has invested into its enterprises. Selling of some of its shares in SOE to private investors through the stock market can improve the generally unsatisfactory performance of these entities by the discipline of private ownership. In addition, companies listed on the stock market are exposed to the rules and regulation of the

The objective of this method is to involve small shareholders and larger institutional shareholders in the purchase of state owned assets

stock exchange which can act as a guiding force towards attaining effective financial and management disciplines in the company.

The Capital Markets Development Authority (CMDA) will continue to engage in more discussions with both the government and public enterprises on this initiative. A workshop targeted for executives of all responsible government ministries and state owned entities will be hosted by the Authority in February 2009 to discuss the in-depth details of the process. Contact the CMDA office on phone (679) 3304944 or info@cma.com.fj for more information.

Global Financial Crisis in a Nutshell

The Global Financial Crisis of 2008 is a major financial crisis described by many as one of the worst in the global financial history. Former chairman of the United States Federal Reserve, Dr Alan Greenspan, during his testimony before the US Committee of Government Oversight and Reform - labeled the crisis as "a once-in-a-century credit tsunami."

The crisis which originated in the US sub prime mortgage market in 2007, snowballed and came to fore in September 2008 with the failure, merger and conservatorship of several large United States-based financial firms.

Beginning with failures of large financial institutions in the United States, it rapidly evolved into a global crisis resulting in a number of European bank failures and declines in various stock indexes, and large reductions in the market value of equities (stock) and commodities worldwide. The crisis continues to have implications that go far beyond the financial and economic sectors.

Around the world, stock markets have fallen, large financial institutions have collapsed or been bought out, and governments in even the wealthiest nations have had to come up with rescue packages to bail out their financial systems.

On the one hand many people are concerned that those responsible for the financial problems are the ones being bailed out, while on the other hand, a global financial meltdown will affect the livelihoods of almost everyone in an increasingly inter-connected world, including Fiji and the greater Pacific region.

While the domestic financial system has successfully weathered the most immediate effects of the financial crisis, Fiji is far from immune from the effects of the unfolding crisis.

The recent Pacific Islands Forum Economic Ministers meeting (FEMM) held in October 2008 highlighted the likely impacts of the

global crisis on island countries like Fiji, which include:

- the fall in value of trust funds, and superannuation schemes – particularly those exposed through off-shore investments;
- the adverse impact on export prices for commodities due to the falling world commodity prices;
- the difficulty in accessing capital; and
- the pass through effects on the economy from the expected slowdown in tourism and decline in remittances due to low international competitiveness of exchange rates.

The difficulties faced by economies in the region and around the world kept mounting and to repair the financial system, increase demand and restore confidence is a challenge that all policy makers face.

2008 – Capital Markets Investment in Review

A review of the 2008 performance of capital markets investments reveals mixed returns. Some asset classes performed remarkably well when compared against previous years' results, while others plunged as the specific market segments were hurtled by the various global and domestic factors. The three market segments under review include the stock market, unit trust and bond market.

Stock Market

According to the SPSE's 2008 stock market report, the overall trading pattern in 2008 improved as investors, including both institutional and retail continued to invest in the stock market. Out of the 16 companies listed, 11 recorded a positive capital growth compared to only 1 company in the year 2007. ATH recorded the highest total returns of 60.76% with Rice Company recording the second highest total return of 26.8%. Fijian Holdings Limited, Kontiki Growth Fund and Pacific Green were the only three company stocks that recorded negative total returns for the year.

Amongst the actively traded stocks for the year was RB Patel Group Limited (RBG), Fijian Holdings Limited (FHL), Flour Mills of Fiji Limited (FMF) and the Amalgamated Telecom Holdings Limited (ATH). Trades in these four companies accounted for 94.6% of the total value traded during the year. Yaqara Group Limited (YGL) was the most inactive stock in 2008 with no trades recorded during the year. Table 1 next column provides a summary of the 2008 stock market trading.

Summary of Share Trading:	2007	2008	% Change
Market Capitalisation (\$)	809,958,464	1,002,334,603	23.8
Number of Trades	613	757	23.5
Volume of Shares Traded	2,692,658	18,401,339	583.4
Value Traded (\$)	3,642,255	26,051,091	615.2

Source: Stock Market Report, 2008: SPSE

Unit Trust

Total returns recorded for the managed funds industry in 2008 ranges from (1.89%) to 3.33%. Compared to previous years, 2008 was a very difficult year for unit trust companies, following the removal of tax benefits for investors in early 2007. Although the number of unit holders increased for most entities, growth returns recorded were generally negative. However this is expected to improve in 2009 given the announcement of the removal of unit trust dividend tax by the interim government.

Total returns recorded for the managed funds industry in 2008 ranges from (1.89%) to 3.33%. Compared to previous years, 2008 was a very difficult year for unit trust companies, following the removal of tax benefits for investors in early 2007



“On Regulatory Matters, during the quarter, the CMDA received no complaints, undertook no new investigation, and made 1 inquiry into the potential breach of the financial limits rule. Various enquiries into renewal of licenses were undertaken also during the quarter in preparation for the changes to the continuing licensing requirements.”

Licensing

New License

- Mr Sowani Tuidrola to act as a broker/ dealer for the Fijian Holdings Securities Limited from 14 October 2008 to 31 December 2008.

Renewals:

- PricewaterhouseCoopers Corporate Finance Limited (PWCCFL) to conduct the business of providing corporate finance and securities investment advisory services from 30th November 2008 to 31 December 2009.
- Mr Nitin Gandhi to act as an investment advisor representative for the Pricewaterhouse Coopers Finance Limited (PWCCFL) from 30th November 2008 to 31st December 2009.
- Ms Jenny Seeto to act as an investment advisor representative for the Pricewaterhouse Coopers Finance Limited (PWCCFL) from 30th November 2008 to 31st December 2009.
- Mr Chirk Yam to act as an investment advisor representative for the Pricewaterhouse Coopers Finance Limited (PWCCFL) from 30th November 2008 to 31st December 2009.
- Mr Jerome Kado to act as an investment advisor representative for the Pricewaterhouse Coopers Finance Limited (PWCCFL) from 30th November 2008 to 31st December 2009.
- Mr David Oliver to act as an investment advisor representative for the Kontiki Capital Limited (KCL) and broker/dealer representative for the Kontiki Stockbrokers Limited (KSL) from 12th November 2008 to 31st December 2009.

Bond Market

The domestic bond market recorded a very weak performance in the 2008 financial year, with total returns ranging from as low as (13.77%) for 15 years bond to only 2.04% for 3 year bonds. This is substantially lower when compared against the 2007 figures.

However, investors should note that in assessing investment returns - past performance is not necessarily an indicator of future performance. The focus in selecting investments should be on the future earning potential of the company/investment, and that past performance is only an indicator of what has been achieved so far.

New in Brief

Unit Trust Tax Exemptions Reinstated

Unit trust investors can breathe a sigh of relief with the reinstatement of the tax exemptions on dividends for unit trust investments. The dividend exemption has been reinstated for the following entities: Unit Trust of Fiji, Fijian Holdings Unit Trust, Fijian Holdings Property Trust Fund, Colonial First State Income and Growth Fund and Colonial First State Income Fund. The reinstatement was effective from 1st January 2009.

CMDA to Host SOE Workshop

The Capital Markets Development Authority will host an awareness workshop specifically targeted for public enterprise including, government commercial companies, commercial statutory authorities and reorganised enterprises. The objective of this workshop will be to promote awareness on the options available in the capital markets as an exit strategy for public enterprises restructure and reform efforts. The main focus will be on share-issue privatisation and public listing processes. The full day workshop is scheduled for Thursday, 19th February 2009.

Serua Provincial Meeting

CMDA was invited to conduct an awareness presentation at the Serua Provincial Council meeting on 27 November 2008 at the Serua provincial office in Naitata, Navua. The presentation, which briefly highlights the development and regulatory role of CMDA and the various capital raising opportunities available in the capital markets, was well received by the 30 or so members present. The importance of the demarcation between traditional and commercial obligations were also highlighted, particularly the Board of Director's fiduciary role owed to both the company and shareholders.

FHL Acquired BP Oil's Pacific Operations

FHL Energy Ltd, a wholly owned subsidiary of one of Fiji's prominent listed company, Fijian Holdings Ltd (FHL), has entered into an agreement to acquire the operations of BP Oil South West Pacific Ltd. The acquisition valued at around F\$190 million was the largest investment ever undertaken by the FHL group. FHL has also announced its engagement with the Hindustani Petroleum Company Ltd

to manage the operations in the region. The newly-acquired business includes 67 retail outlets and related operations in American Samoa, Cook Islands, Fiji, Tonga, Tuvalu and Vanuatu. The deal is expected to be finalized by the end of February 2009.

Securities Licensing Examination Course

The CMDA has successfully administered the 2008 Securities Licensing Examination Course, a program offered for the fifth year in Fiji by the Securities & Investments Institute Asia-Pacific (SiiA), formerly by the Financial Services Institute of Australasia ("FINSIA"). The three-month self-study program comprises of two modules, (1) Financial and Investment Analysis and (2) Securities Law and Regulation in Fiji, with exams for both modules held on 5th December 2008. Successful completion of the program will satisfy the minimum educational requirements for a broker/dealer representative license or a unit trust representative license from the CMDA. Registration for the 2009 program will commenced soon and interested applicants are advised to contact the CMDA office for more information.

Quarter 4 2008 Trading on the South Pacific Stock Exchange

Company	Total No. of Shares Traded	Total Value of Shares Traded (\$)	No. of Trades	Last Price Traded this Qtr (\$)	Qtr 4-Qtr 3 (% Change)	Earnings Per Share Traded (cents)	Price/Earning Ratio (times)	Divided Yield (%)	Market Capitalisation (\$m)
Atlantic & Pacific Packaging	0	0	0	0.88	0.00	2.97	29.60	2.84	7.04
Amalgamated Telecom Holdings	82,360	96,500	35	1.18	6.31	10.93	10.79	7.63	498.08
Communications (Fiji)	43,500	78,300	3	1.80	0.00	12.39	14.53	3.89	6.40
Fosters Group Pacific	1,213	16,739	5	13.80	1.47	96.95	14.23	3.62	143.63
FijiCare Insurance	250,000	167,500	1	0.67	3.08	9.21	7.28	5.97	4.16
Flour Mills of Fiji	220,000	187,704	11	0.85	13.33	2.58	32.91	2.35	127.50
Fiji Sugar Corporation	1,371	494	1	0.36	0.00	n/a	n/a	0.00	15.98
Fiji Television	3,277	11,366	4	3.50	4.17	26.56	13.18	5.14	36.05
Kontiki Growth Fund	4,400	3,448	7	0.77	(11.49)	n/a	n/a	0.00	2.72
Pacific Green Industries	0	0	0	2.10	0.00	5.43	38.70	0.00	16.00
R B Patel Group	320,227	563,639	11	1.76	3.53	14.26	12.34	7.95	52.80
The Rice Company of Fiji	7,500	22,500	1	3.00	21.95	36.07	8.32	5.67	18.00
Toyota Tsusho	0	0	0	1.96	0.00	8.82	22.23	2.55	27.50
VB Holdings	0	0	0	3.00	0.00	16.08	18.66	0.00	4.70
Yaqara Group	0	0	0	1.18	0.00	n/a	n/a	0.00	17.99
Fijian Holdings	93,312	204,345	133	2.27	4.61	89.34	2.54	8.81	23.75
TOTAL	1,027,160	1,352,535	212	Market Capitalisation as at 31 December 2008					\$1,002.33