BANKING AND FISCALITY

It is no secret that diamond trading involves vast amounts of monetary transactions. In an industry trading high-value goods, the financial needs are enormous. Having a steady supply of banking services, and a clear regulatory framework regarding banking and fiscality are of crucial importance to the industry.

BANKING

Aside from a loupe, a bank account is the most valuable tool of the diamond trader, allowing him to purchase and sell diamonds on a daily basis in a transparent, compliant way. Diamonds are a very high-value product, which makes it challenging for traders to operate entirely on their own equity. Many companies use external (bank) financing to optimize cash flow, especially when they purchase from large mining companies that demand an upfront pre-payment before shipping the goods to the buyer.

The banking framework has always been one of the main pillars underpinning the leading position of the Antwerp diamond industry globally. Institutions such as the Antwerp Diamond Bank and ABN AMRO Diamond & Jewellery Clients have provided specialist services tailor made to the needs of the diamond companies. The availability of banking services and financing has been a fertile soil to cultivate and grow the vibrant market that we have now.

This framework has been under severe stress in the past decade, to the point that it puts the sustainability and viability of the Antwerp diamond industry in peril. The biggest issue is the absence of sustainable access to basic banking services, such as bank accounts and payments.

The comparative study of diamond trading centres by PWC confirms this risk, stating that financing is one of the biggest challenges Antwerp is being faced with to maintain its position. Antwerp scores very low on ease of opening a bank account as well as financing potential. According to a stakeholder in this study, “the diamond industry has been extremely slow to respond to financing issues in the local market.”

Our stakeholders also acknowledge the problem:

"Bankability is an ongoing issue. It is not being solved so far. Banks are leaving the sector. Why? Because there is not enough transparency in the sector and a lot of bankruptcy still happens. So, we need to bring our sector in line with a 21st century company profile: more accountability, more transparency." - Stakeholder interviews

The stance of the financial sector is definitely influenced by negative media coverage on the diamond industry and a persistent negative perception about the industry as a whole. It is a two-sided story. Many diamond companies have been lagging behind in transforming their business practices. They still run their business in an old-fashioned way and are unable to provide the level of transparency regarding their business, customers, financials, inventory and so on, that banks often expect. The negative perception about the industry is also regularly fueled by fraud cases. Most of them are old or unrelated to the Antwerp diamond industry – such as the recent Nirav Modi fraud case – but nevertheless affect the perception that financial institutions have about our industry.

There is no doubt that the diamond industry as such bears a high inherent risk, given the high value and the ease of transporting these small goods. But the controlled risk – after application of legislation, regulation and compliance measures – in the Belgian diamond industry is much lower and should fall within the boundaries of most banks' risk appetite. This has been acknowledged by the government and the banks, which have – in collaboration with the AWDC – developed a comprehensive risk-analysis of the diamond industry (see "Compliance").

The attitude of the banks is part of a bigger picture. Confronted with rather vague government regulation and sky-high penalties, banks themselves have chosen an overly prudent approach. Instead of adopting a case-by-case approach, assessing every individual client on its merits, banks have chosen to completely disengage from a number of activities or jurisdictions seen to be high-risk regarding money laundering and terrorism financing. This happened despite the clear rejection and disapproval of such "blanket de-risking" approach by the Financial Action Task Force, the leading intergovernmental body on anti-money laundering and terrorism financing.

Hence, bankability is a concern for the global diamond industry. It is related to rebuilding trust and proving honesty.

The departure of the Antwerp Diamond Bank in 2015 – as a consequence of a European Commission state-aid agreement required to support its mother bank KBC – was a major blow to the Antwerp diamond industry. Within a year, about 500 diamond traders lost their bank account at ADB. Many of them didn't have a second bank account and needed to find an alternative to continue their business. ADB was also financing the diamond industry for an amount that exceeded 1 billion USD. This source of funding will be completely drained away by the end of 2019, when the last remaining credit agreements with the former ADB customers will be terminated.

Despite the efforts of the AWDC, only one new bank has entered the Antwerp diamond industry since our last Sustainability Report – the National Bank of Fujairah (NBF) from UAE, which opened a representative office in Antwerp. As a result of intense collaboration with the AWDC, however, a payment institution called Ebury has managed to successfully deploy activities in the diamond industry, now providing payment services to more than 200 companies.

What is more, Antwerp is the only relevant diamond trading center that is entirely isolated from access to its domestic banks. There is not a single Belgian bank that currently provides services to diamond companies. All Belgian banks have adopted the "blanket de-risking" approach as mentioned above, and have completely withdrawn from the diamond industry. The industry fully relies on a handful of banks that have their decision centre abroad – ABN AMRO, State Bank of India, Bank of India, the NBF and Société Générale. The fragility of this situation was recently demonstrated by the closure of the Union Bank of India (UBI) and ICICI offices in Antwerp, which happened in the past 12 months. The closures were not directly linked to the exposure of these banks in the diamond industry, but nevertheless, it again forced many diamond traders (37 UBI; 50-60 ICICI) to look for another provider for basic banking services.

As a consequence, no new companies can set up shop in our industry, which leads inevitably to a decline in the number of active companies and threatens the sustainability of our industry. This also puts pressure on the future sustainability of diamond financing. The fact that overall profit margins in the diamond midstream have been low in the past decade and are not likely to increase in the near future (1%-3%, Bain 2018) does not make the diamond industry an attractive target for financial institutions. A shortage in financing would primarily affect the medium-sized companies, as the larger corporations often have their own structured financing and the smaller ones often operate on their own equity.

These are a few examples of AWDC's endeavors to increase bankability:

- The risk-analysis of the diamond industry has been developed by all government actors involved in the diamond business (e.g., Ministry of Economy, Customs, Police, etc.), the Federation of Belgian Banks (Febelfin) and the AWDC. It contains a comprehensive overview of all risks related to money laundering and terrorism financing in our industry, the existing mitigating measures and all additional measures that could be taken to further lower these risks.
- Setting up a Bank Account Helpdesk that, by means of active intervention by the AWDC, guides diamond traders through the process of finding a new bank (account).
- Creating new solutions by working together with FinTech companies. For instance, in 2018, the AWDC guided the activities in the diamond industry of a company called Ebury. Together we created a compliance and business framework in which Ebury - including their stakeholders such as the banks backing their services - as well as the diamond industry, feel comfortable. After a year of working in the diamond industry, Ebury now provides bank accounts and payment services for more than 200 diamond traders. The compliance framework applied is stronger than what most banks – even outside of the industry – apply. Every diamond payment, for example, needs to be supported by documents such as the invoice, the customs document or a certified copy of the KP Certificate if applicable.
- Diamonds are traded in US dollars. Large American banks that process international payments in USD play a significant role in these transactions. Over the course of the last few years, the AWDC has directed targeted information campaigns and briefings toward these banks so they perform their compliance check in an objective, thorough and effective way.
- Developing an intensive collaboration with Febelfin - the umbrella organization for Belgian banks -, the National Bank of Belgium and the federal government to establish a framework protocol in which Belgian banks should once again feel comfortable offering basic banking services to diamond traders. To this point, it is still not clear whether and when Belgian banks would be ready to apply this protocol. However, it could be the first step to rebuild the essential trust between the banking sector and the diamond sector.
- Financing is always a key to the successful implementation of sustainable sourcing projects. The AWDC will use its knowledge, network and experience related to financial services to find the right partners that can provide sustainable services supporting these projects - like the new initiative in Guinee explained in the Chapter on economic impacts.

By means of the above-mentioned initiatives, the AWDC tries to contribute to SDG 8: "Promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all", and especially to:

• **Target 8.3:** Promote development-oriented policies that support productive activities, decent job creation, entrepreneurship, creativity and innovation, and encourage the formalization and growth of micro-, small- and medium-sized enterprises, including through access to financial services and

• **Target 8.10**: Strengthen the capacity of domestic financial institutions to encourage and expand access to banking, insurance and financial services for all.

FISCALITY

Belgium claims a legitimate share from any economic activity on its territory for its public expenses. The diamond industry makes substantial contributions to the Belgian GDP, estimated at about 5%. While specific figures are not available, the AWDC has initiated a study to determine the added value the diamond industry generates for the Belgian economy. Knowing that the industry benefits from a special tax regime, the general public expects clear data about the financial results and revenues coming from luxury goods and demands a "fair level of taxation".

As a trading center in an international context, the Antwerp diamond industry is highly susceptible to tax competition. The high value per weight unit of diamond and the fact that this product is so easy to transport makes it possible for a diamond company to easily relocate its business activities to a competitive trading centre such as Dubai, Mumbai, Tel Aviv or New York. This is why it is extremely important to strike the right balance between fair taxation and maintaining enough competitiveness to reap the benefits, enabling the diamond industry to generate sufficient economic added value for the government. The introduction of the Diamond Regime, also called "Carat Tax", must been seen in the light of achieving this precarious balance.

Since 2016, this tax system introduces a lump sum taxation for registered diamond traders in Belgium selling from their own diamond stock. The Diamond Regime replaces the actual cost price of sold goods with a fixed calculated amount of 97.9% of turnover from diamond trading. This substitution occurs irrespectively of the actual gross margin reflected in the financial statements of the traders. As a secondary rule, the diamond dealers' minimal taxable basis can, in principle, never be less than 0.55% on turnover. This secondary rule functions as a so-called 'de minimis' clause to determine the minimal taxable basis for registered diamond traders.

This tax system, approved by the European Commission and considered as non-state aid, provides diamond dealers with the competitiveness, stability and predictability they require. In the past, lengthy and robust discussions were frequently held with the Belgian tax authorities regarding the valuation and monitoring of diamond stocks. In exchange for this legal security, diamond dealers are currently paying more tax than before. For the AWDC, the Diamond Regime constitutes a clear example of good governance and creates a win-win situation between the authorities and the private sector.

The Diamond Regime was applicable as of tax year 2017 and it is already clear that the system is extremely successful. Based on a high-level statistical study of publicly available information, the total tax contribution of the diamond industry during 2016 was estimated at €58 million, which means an additional yield of €34 million compared to the year before. The AWDC is convinced that the current system will provide the best possible tax regulation for our diamond industry in the coming years and advocates the continued application of the Diamond Regime.