ÆGIS journal

Addressing threats that affect your bottom line

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This month's features:

- **Special Announcements:**

- **November 03, 2009 Webinar - OnsiteConference.com Intellectual Property and Critical Information Risks for the Financial Services Professional**

- **January 8th and 9th 2010 George Town, Grand Cayman. International Funds Conference, Global Transparency - Meeting the Challenge. Panel Discussion - Cross Boarder Discovery and Litigation Issues. http://www.caymanfundsconference.ky/about_cayman.html**

The LUBRINCO Group, in conjunction with the International Bodyguard Association, will be hosting a ten day SEI certification course in mid-2010. This certification will allow executive protection professionals to legally work in the EU.

1. Asset Location and Due Diligence — What the meaning of "is" is

We have, sadly reached the point where you must conduct some level of due diligence on everything. This is because people tell you things, and you make assumptions about what they mean, without verifying your assumptions. Let us give you some examples.

Investment Grade Securities

Part of our current financial problems (which largely can be attributed to greed and stupidity) were caused by giving investment grade (AAA) ratings to securities which, at best, were crap. While we have discussed the problems with rating agencies in these pages, the fact is that if you are investing, you had best know what you are investing in, and make an informed decision as to whether the investment makes sense. If mortgage backed securities are paying some given percentage, and an AAA rated CSO or CDO is paying significantly more, you should both understand what a CSO and CDO are, and why it could be paying more (higher risk), and whether or not *you* really believe it is investment grade. If you don't understand swaps and derivatives – and most investors don't – then they are probably not a good investment choice for you.

Organic Food

A study by *Newcastle University* and the *Danish Institute of Agricultural Research*, published in the British *Journal of the Science of Food and Agriculture*, which analyzed produce from 25 farms, found that organic milk contained 67 per cent more antioxidants and vitamins than ordinary milk. Scientists at Newcastle University also found organic milk contained 60 per cent more of a healthy fatty acid called conjugated linoleic acid, or CLA9, which tests have shown can shrink tumors.

Similar levels of vaccenic acid, which has been linked to a reduced risk of heart disease, diabetes and obesity, were also found.

Organic milk contained 39 per cent more of the fatty acid Omega-3, which has been shown to cut the risk of heart disease, and 32 per cent the levels of the less healthy Omega-6. Oddly, the benefit of this study was not that it confirmed the benefits of organic milk, but that it gives hints as to what to study about feed during non-grazing season.

So does this mean that you should buy organic milk? Well, it depends what you mean by organic. When most of us think of organic we think no antibiotics or hormones and no pesticides, and cattle allowed to graze naturally, as intended by Muktar, the cow God, but according to a sign we saw in a farmer's market, the USDA has changed the rules and calls a diet half of silage grass fed. And Wal-Mart is selling organic milk. Their milk is made from largely non-grazing corn fed cattle, barn raised. While organic by *their* definition, the resulting milk was deemed by Whole Foods to be "unacceptable" and "not up to our standards."

So if you want organic food, you have to dig a bit deeper to find out what the producer means when they say "organic."

Can you hear me now?

A year ago we had the misfortune to end up in New York Presbyterian Hospital, where we spent, off an on, about twenty weeks, with more to come. Putting aside the whole annoying life-threatening disease thing, it immediately became clear that there was no usable T-Mobile reception. This is not to say that there was no signal: Indeed, the signal would bounce back and forth from full to none, so that you could not reliable make or receive a call, nor even send a text message on the first try.

Now, we don't claim to know a lot about GSM technology. On the other hand, for quite a number of years we did the daily intel report first for

OmniPoint, then for VoiceStream, then for T-Mobile, and have learned at least something about the technology. So we called tech support and told them they seemed to have an antenna balancing issue. They said the problem was that the electrical discharges of the hospital interrupted the signal. This might have seemed reasonable if we knew a little less, or if we ignored all the ATT, Sprint, and Verizon users chatting away,

Were-the T-Mobile support people deliberately lying? No. They were simply reading a script, and there was too much inertia to bounce it up the tech-support food chain. Had that happened, a technician would have eventually been dispatched and the problem resolved. As it was, the situation balanced itself by hospital employees using other service providers, and at least one long-term patient switching providers.

When you have reception problems in a place that is important to you, you may well get an unsatisfactory technical explanation, and have to switch service provider until you find one that gives you coverage in the places where you need it.

Read the Label

We have a confession to make: We love sweets. On the one hand, this is not really a problem because we largely prepare our own meals, and rarely have fast or convenience food. On the other hand, we know that sugar is bad for us. A compelling case can be made that heart disease in the United States was an outcome of the introduction of massive amounts of sugar into our diet with the introduction of Coca Cola. When you add in the cost of obesity, diabetes, and other related diseases, the health care costs associated with sugar consumption are enormous, second only to those associated with smoking.

But what if you don't cook for yourself, and instead, as with smoking, choose to self-select consuming fast foods and convenience foods?

The U. S. Department of Agriculture recommends that a person who consumes a 2,000 calorie diet should not consume more than about 40 grams of refined sugar per day, while others recommend consuming no more than 20 grams of refined sugar daily. The following shows the sugar content for a twelve ounce can of various sodas:

- 7Up = 39 grams
- Coca-Cola Classic = 39 grams
- Dr Pepper = 40 grams
- Minute Maid Orange Soda = 48 grams

- Mountain Dew = 46 grams
- Pepsi = 41 grams
- Sprite = 38 grams

While a simple solution is to stop drinking soda and stop eating food with added sugar, eliminating sugar requires careful scrutiny of labels. As an example, someone recently brought us what they thought was Ruby Red grapefruit juice. The label announced that the first ingredient was filtered water and the second was high fructose corn syrup.

While we expect sugar in sodas and deserts, the same holds true for virtually every food, because so many foods contain sugar or high fructose corn syrup. Buying peanut butter? You can get Smuckers peanut butter (peanuts, salt, 210 calories, 1 gram sugar) or Jif, which is also made by Smuckers, (peanuts and sugar. contains 2 percent or less of: molasses, fully hydrogenated vegetable oils (rapeseed and soybean), mono- and diglycerides and salt, 190 calories, 3 grams sugar). It is a safe guess that your pre-diabetic tyke will prefer the sweeter Jif. Making your kid a bologna sandwich? 4 grams sugar. Quarter Pounder with cheese? 9 grams sugar.

The bottom line is that in every aspect of our lives we make assumptions, some of which are correct, and some of which are not. We need to more actively verify these assumptions.

2. OPSEC, Economic Espionage, and Competitive Intelligence — Spying in the British milk industry

According to the Leicester Mercury, a dairy paid a competitor's employee £40,000 to steal sales records from its rival so it could steal its customers. (http://www.thisisleicestershire.co.uk/news/Dairy-paid-man-steal-rival/article-1088281-detail/article.html).

The issue here is not that this is a cow-eat-cow world, but that every industry has critical information that would be of value to competitors. And like the dairy in question, virtually nobody ever bothers to identify this information or to protect it.

How can you better identify and protect your intellectual property and critical information? Contact us.

3. Executive Protection — Are ASRs obsolete?

Recently someone asked us whether the pepper-bases personal defense spray – generally referred to as the ASR, was dead, effectively replaced by the Taser™ and other emergency safety tools. It has been over twenty years since we introduced capsaicin-based sprays at the 1988 conference of the American Society of Law Enforcement Trainers, and we have not had any financial interest in them for over a decade, it was and interesting question.

The first ASR was an oleoresin capsicum in alcohol solution, and contained one tenth of one percent capsaicin. It had a near-zero failure-to-control rate in the hands of a trained user. As it happens, capsaicin is extremely soluble in alcohol and virtually insoluble in water, making alcohol the ideal carrier. While some have noted that alcohol is as flammable as hair spray, if you avoid using it on anyone whose hair is on fire, there is no issue. We note that there was an incident here in New York City, using a sample we had given ESU (though they declined training in its use), we note that nobody was injured, and that the incident could not be replicated.

The ASR was designed to be used by a line officer on pain resistant subjects at field interrogation distance or closer: In practical terms, from five feet to six inches. How did it work? When the atomized ester containing the capsaicin was inhaled, it dilated the capillaries of the trachea, producing uncontrollable coughing. In order to simulate pain-resistant subjects, the ASR Instructors Council recommended that subjects in dynamic simulations wear glasses, and slather their face, hands, and all exposed skin with DermaShield™ or DermaPlus™ to eliminate any dermal discomfort.

The big disadvantage of ASRs was that the mist would float in the air, and cause everyone to cough. Even this wouldn't be incapacitating, it was certainly annoying.

The FBI felt that a spray containing one half of one percent capsaicin was a better choice, as it decreased the failure-to-control rate marginally, and did not increase recovery time. They believed that above one half of one percent capsaicin there was no increase in effectiveness, that recovery time increased, and that if pain-sensitive subjects were sprayed it constituted cruel and unusual punishment. So we ended up with two strengths.

Subsequently, other manufacturers entered the field. One of the first things they did was to change from an alcohol carrier to other carriers, which often did not mist well. Second, they wanted greater reach for the products, even though the products would, in fact, be used at field interrogation distance or closer. Finally, some move to stream units, which, since they didn't mist and wouldn't be inhaled, didn't work well. To compensate for this some manufacturers made their products much stronger, hoping that pain-compliance would work on pain-resistant subjects. In some cases we say the failure-to-control rate go fro near-zero to seventy percent.

Is the ASR obsolete? If I were an officer I would still want a misting alcohol-based ASR on my belt, backed by appropriate training.

4. Technical Issues — Cambio de California

Q&A on California and the IOUs, or Much ado about what to do with an IOU

The State of California intends to issue IOUs.

This really is an interesting event. In theory only the US Treasury can issue currency. The issuance of exchangeable or negotiable IOUs is monetizing the debt and creating a *defacto* currency. A second problem is that under state laws "due bills" can be issued - but only by banks. So is California breaking Federal Law, or it now required to become a licensed and regulated bank, or most it now be licensed as a money service business? W can see the marquee: Cambio de California.

However, this current "IOU" plan is not without precedent. In 1992 California issued interest-bearing warrants, which are not currency but a temporary debt form that is accepted by participating bank and other financial institutions, usually at a discounted price to their maturity value. The current California plan describes warrants that will mature on October 1, 2009. What is interesting is that they have gone from a 30 day maturity to the limit of maturities for commercial paper at 90 days. Just short of running afoul of the Securities Laws and the MSRB (Municipal Securities Regulatory Board).

If California is like most other governments, they will be issuing warrants. Warrants are payable upon presentment items, where the first person in line to present their warrant for payment has first claim upon any funds available in the account, and are drawn on the government itself rather than on their bank. If the first person in line to be paid has a warrant for more than is available in the account to pay them, all others in line behind have to wait until the first person is paid before they can present their claim for payment --even if their warrant is for less and there is enough in the account to satisfy their claim. FIFP (First In First Paid). This is a historic hangover from the West's mining days when a local city continued operating even though the treasury didn't have sufficient funds to pay all the bills. People would literally line up at the city hall (or bank) and wait to be paid based in accordance of preference denoted by their place in line. What's old is new again...

More than $1 billion of the so-called warrants will be issued to the elderly, to the disabled, and to welfare recipients that are due checks, according to the controller. Another $565 million will be sent to businesses that hold contracts with the state, while $159 million will be given to students.

How do you deal with a warrant? According to one California bank if an IOU/warrant is received in a lockbox, the bank will send it to you as an unprocessed item. The recipient gets to hold the IOU until October 1st, at which time they should be able to collect funds. Banks will not pay the face value or give cash. The last time this happened the bank would have paid a discount amount for the items, but those were 30 day warrants, not 90 day warrants.

Banks handle warrants just as they handle checks, but hate them because they are drawn on the issuer and not a bank. The bank only acts as the agent of the issuer in the handling of the warrants. Warrants are obligations of the issuer and require the issuer to tell the bank whether or not to pay any warrants presented; this is an inefficient process at best and painful at worst. According to most banks we have spoken to, they will not be accepting them. Those that are willing to accept them are looking at discounting them.

It will be very interesting to watch how this plays out. If California does sufficient damage to the reputation of warrants it might motivate state legislatures to update their laws.

It is unprecedented, considering California may soon default on its "official" IOUs, which are their municipal bonds. Where in the chain of bankruptcy claims would the IOU-2 holders stand? It is getting more bizarre by the day...

What are the warrants worth and what do they mean to the financial institutions? Will banks accept the warrants based upon the debt grade of California? What discount would they need to apply to the debt not to suffer a haircut on reserves parked in these instruments? And would the warrants have to be written down to zero, (our friend mark to market) if the State defaults on it bonds, or begins to pay the interest on the bonds with warrants?

As for the banks, we cannot speak to reserve requirements. But as to the discounting factor, that would be essentially the same as what the municipal bond market will be applying in pricing California debt, plus a little more yield spread for the less-liquid nature of the warrants. For those of you who have access to a Bloomberg terminal, you can compare California yields to other states and general market rates to see what risk premium is being assigned to California debt. We can tell you that California paper has long been treated as less desirable than that of other state issuers, even those carrying identical ratings. And now, California is the lowest rated of all fifty states and will probably be rated even lower soon.

Some banks may elect to traffic in warrants while others may not. We would like to emphasize here that there is no empirical or even statistical way of forecasting the outcome of all this or what prices will be. In the world of municipal bond prices, there is no such thing as a central quotation system, and the reality for all markets is that prices are nothing more than what a buyer has paid.

As for the question of default and its impact on the warrants, we can only say that the ratings agencies seem to believe that the State has adequate capital and resources to pay its debt, since it is not currently rated as junk, though more downgrades could be in the offing if the State doesn't reach a legislative compromise. Warrants maturing October 1 buy some negotiation time.

California contributes between 10 and 15% to the nation's GDP. If a real crisis ensues, California will jump the TARP line at the Fed. The Treasury has already seen fit to subsidize municipal borrowing by rebating to state and local issuers 35% of the interest cost associated with Build America Bonds, so there seems to be an inclination to help.

So what will they be worth?

In the discussions we have had with managers in California, it is their intent to offer no more than ninety cents on the dollar, and send them to the State or municipalities in California, at full face value, for the payment of their taxes and other municipal obligations such as water and sewer. There could develop a brisk market in state warrants with buyers who have to pay state taxes and invoices buying warrants at a discount and delivering them to the State at full face value. Some have even thought of sending them to the Fed for their tax payments, but we are sure that was more fiscal bravado than substance.

The following are a few useful ways to benchmark how the warrants will be discounted.

The first useful idea for benchmarking California warrants is the Credit Default Swap rate for one year California G.O. bonds, currently at 245 basis points. So, that may be a handy discounting rate to apply to Cal warrants, but keep an eye on the CDS rate – it was over 300 bps in March, a region one source calls "Lehman Brothers territory!" Since virtually nobody buying or selling CDSs, the reliability of this is roughly what you would expect.

The second is to look at the market price for California G.O. bonds due this year. At 3.2% they are about 2.5 above treasury and are selling at 98 cents on the dollar. This implies a discount to cash of about 4.5% for a liquid instrument.

The reality is that some expect the discount that will be offered will be more like 9% to 12% by reputable financial institutions.

We also expect the state to become indignant about how the incredible script is being treated, and discounted and sue those who are providing the cash for excessive discounting.

5. Real Stories from the Field — Vegan Chinese food

We recently got a call from a friend who said that his favorite Chinese restaurant in New York's Chinatown was Buddha Bodai (http://www.chinatownvegetarian.com/), a Buddhist/Kosher Chinese restaurant at 5 Mott Street. Since we are trying to cut the amount of red meat we eat to under half a pound a week – one third of a normal 24 ounce steak – it seemed worth trying. Particularly because it was not merely an *interesting* Chinese restaurant, of a *good* Chinese restaurant, but his *favorite* restaurant.

Since we had to be in Chinatown anyway (it is next door to City Hall and the courts), we arrived at the restaurant around 2pm. It was quite full, with roughly half the patrons being Chinese.

I had expected that the menu would largely consist of vegetable dishes, and, in fact, had my heart set on eggplant in garlic sauce, or perhaps bean curd country style. In fact, of the twenty dishes in the luncheon special (http://www.chinatownvegetarian.com/lunch%20special.htm), fourteen of them were mock rotting-flesh-of-long-dead-animals dishes. Since they had neither eggplant in garlic sauce, or bean curd country style, I decided to throw all caution to the wind and try the Lamb with Mixed Vegetable in Garlic Sauce. Afterwars, we raced to a nearby restaurant to get mock tofu dumplings, aka pan fried pork dumplings, to cleanse our palate.

There seem to be several target groups for this restaurant. The first is Buddhists, and people whose diet is kosher or halal, who want Chinese food. A second would be vegetarians and vegans. A third might be carnivores humoring vegetarian friends, but who know that real meat tastes better than faux meat.

In fact, however, the real target audience appears to be people who want to eat meat, but, for whatever reason feel disinclined to do so. And that, gentle reader, brings us to the purpose of this story. There are a number of vegetarian restaurants in Chinatown, and even more in Gotham as a whole. Many of them appear to be way less successful, because they are aimed at people who want to eat vegetables. This restaurant, however, has apparently realized that virtually everyone with canine incisors is, underneath, a carnivore. They have offered these people the opportunity to come close to eating meat, yet still allowing them to not have eaten meat.

There is a lesson for marketers here…

6. Book and Product Reviews

Financial Regulatory Reform
Department of the Treasury 89 pages
http://www.financialstability.gov/docs/regs/FinalReport_web.pdf

The Treasury Department has released its document on what it would like to do in the future, which encompasses the following five areas:

1. Promote robust supervision and regulation of financial firms.
2. Establish comprehensive supervision of financial markets.
3. Protect consumers and investors from financial abuse.
4. Provide the government with the tools it needs to manage financial crises.
5. Raise international regulatory standards and improve international cooperation.

Obviously, their intentions and Congress' willingness to pass legislation in these areas. That said, if you have any involvement in the financial markets you should download and read this.

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