

1MDB: No control over RM7 bil in Cayman Islands
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The directors of 1Malaysia Development Bhd (1MDB) have admitted the state-owned strategic investment fund has little to no control over some RM7.18 billion in offshore investments.

In the company's latest audited accounts for the financial year ended March 2013, 1MDB's directors conceded they were "unable to exercise control or significant influence" over financial investments in an unnamed Cayman Islands fund manager.

Under the Malaysian Financial Reporting Standards (MFRS), control is defined as power over the investee, exposure or rights to variable returns from involvement with the investee or the ability to use power over the investee to affect the amount of returns.

1MDB became a "participating shareholder" of the Cayman Islands fund manager, itself a specific type of structured investment company called a Segregated Portfolio Company (SPC), in September 2012 with an investment of US\$2.32 billion (approximately RM7 billion at September 2012 exchange rates)

The only clue to the identity of the fund manager in 1MDB's audited accounts is that it is a "licensed financial institution with good credit ratings."

The audited accounts, submitted more than a year late, show 1MDB's investments in the Cayman Islands SPC paid out a US\$133 million (RM435 million) cash dividend in September 2013 or a 5.76% annual return on the initial investment amount.

In the past year, the strategic investment fund has been surrounded by controversy for making questionable investment choices, among them expatriating the proceeds of a government guaranteed bond sale to the Cayman Islands, a known tax haven.

No financial sense

1MDB's most vocal critic, DAP MP Tony Pua, questioned the financial sense of 1MDB's Cayman Islands investments, especially when the "cost of borrowing is higher than the returns on investment."

According to Pua, 1MDB is "borrowing money at an effective interest rate of 6.71% to invest in an anonymous Cayman Islands fund which gave a return of 5.76%." He added derisively: "What a fantastic investment strategy!"

"The reason why the US\$2.32 billion (approximately RM7 billion) was invested in Cayman Islands in the first place was because 1MDB terminated and redeemed its 11-year loan to PetroSaudi International Limited in 2012," Pua explained.

The earlier loan to PetroSaudi, in the form of murabaha notes "commanded a guaranteed fixed interest of 8.67% per annum," Pua added. "Hence it must be asked, why did 1MDB redeem its loan earning a guaranteed fixed return of 8.67% and invest in a fund manager in Cayman Islands... giving a return of only 5.76%?"

In April 2013, KiniBiz investigated the complex paper trail of 1MDB's mysterious loans to PetroSaudi and later, with the same cash, its investments in the Cayman Islands SPC and found more questions than answers in 1MDB's shady dealings.

Under Cayman Islands company law, the concept of the SPC allows a single entity to create segregated portfolios such that the assets and liabilities of each portfolio are legally separate from the assets and liabilities of any other portfolios.

On face value, investments into an SPC could prove risky because if 1MDB's investment into a particular class of assets in the segregated portfolio goes wrong for whatever reason, it does not have a claim on the other assets that the SPC has.

The investments in the Cayman Island SPC have been classified in the audited accounts as available-for-sale (AFS) financial assets, meaning they were purchased with the intent to sell before maturity as opposed to assets held to maturity or held for trading.

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