MAKING THE ITALIAN MARKET FOR ‘INVESTMENT DIAMONDS’ MORE TRANSPARENT: THE IDB AND DPI CASES

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1. INTRODUCTION

The financial crisis prompted many consumers to seek alternative investments able to keep the value of their savings. Buying goods whose value is expected to increase over time but that are relatively easy to sell without incurring in large capital losses may appear as a suitable form of alternative investment. The purchase of goods that can increase their value cannot be considered an ‘investment’ in a technical sense and therefore is not regulated by financial institutions and bodies. In this context, traders are expected to be particularly diligent in communicating how the selling price is calculated and how the value of goods is expected to evolve over time, in order to make consumers aware of the economic advantages and the risks of using these goods as a store of savings’ value. The Italian Competition Authority (hereinafter ‘ICA’) had the chance to deal with these issues in 2017, in two proceedings regarding the sale of polished ‘investment diamonds’ through the bank channel.

The investigation started at the end of January 2017, after a complaint filed by a consumer’s association (Altroconsumo), prompted by an investigative report broadcasted by Italian public television questioning the fairness of the commercial practices followed by Intermarket Diamond Business SpA.

1 Italian Competition Authority.

2 The Italian Financial Regulator (CONSOB, Commissione Nazionale per le Società e la Borsa – The National Commission for Companies and the Stock Exchange) stated in 2013 that laws and regulations on investment do not apply to retail selling of ‘investment diamonds’, to which criteria already used for other goods apply. However, CONSOB also considered that diamonds may be appreciated by consumers not only as stores of value but also as physical goods. CONSOB therefore explained that the trading of diamonds does not show to possess any of the typical characteristic of investments of a financial nature, which are the assurance and realization of profit or limited usability of the goods. Moreover, CONSOB also stated that trading of ‘investment diamonds’ is not linked to the trading of bonds or derivatives, and therefore cannot be considered as a financial activity.

('IDB') and Diamond Private Investments SpA ('DPI'), which are the leading Italian sellers of investment diamonds.

Documents seized in ‘dawn raids’ at IDB and DPI offices showed that both firms had made almost all of their ‘investment diamonds’ sales through the banking system and that banks had offered select group of their customers to buy diamonds as a an alternative form of investment. Therefore, the proceedings were later extended to the four banks\(^4\) which accounted for most of DPI’s and IDB’s sales.

Both proceedings were closed in September 2017. ICA found that the commercial practices put in place by IDB and DPI in the sale of investment diamonds were unfair and misleading because of their being deceitful of consumers with regard to the price of diamonds, the market conditions and the profitability of their purchase, in breach of Art. 20 and Art. 21, para. 1 letters b), c), d) and f), as well as Art. 23, letter f), of the Italian Consumer Code\(^5\).

DPI, IDB and the banks involved were all sanctioned with fines, for a total of more than euros 15 million.

2. **Some Characteristics of the Diamond Market**

‘Investment diamonds’ are diamonds of the most valuable quality in terms of carats, clarity, cut and colour – the so called ‘4Cs’\(^6\) - and are very rare to find (they represent only 2% of the worldwide diamonds production). These stones are usually not intended for jewellery, but proposed as beautiful goods that can be used as ‘store of value’ due to their rarity - which is expected to increase in the future because of a reduction of the natural supply of diamonds - and tradability.

\(^4\) The banks involved were Unicredit S.p.A. and Banco BPM S.p.A. for PS 10677 proceedings, and Intesa Sanpaolo S.p.A. and Monte dei Paschi di Siena S.p.A. for PS 10678 proceedings. This activity is not regulated by Banca d’Italia (Bank of Italy, the Italian Banking Regulator), which considers it to be merely ‘connected’ to strictly ‘bank related’ ones and therefore considers operators free to undertake it, provided that they pay attention to its reputational effects and provide adequate protection to customers.

\(^5\) The Consumer Code describes unfair commercial practices on the basis of the definitions contained in Directive 2005/29/EC, concerning unfair business-to-consumer commercial practices in the internal market and amending various other directives. The Articles referred to by the ICA correspond (also in their wording) to Art. 5, Art. 6 para. 1, letters c), d) and f), and Art. 18 of Annex I of Directive 2005/29/EC.

\(^6\) Investment diamonds range from 0.5 and 2 carats, have high clarity levels (FL, IF, VVS), are brilliant cut and their color ranges between River D and Top Crystal I. Other important characteristics are fluorescence, cut symmetry and their certified compliance with the ethical criteria of the ‘Kimberly Process’.
Each diamond is different from any other and therefore, the ‘price’ for diamonds cannot be determined in the same way as it is set for precious metals such as gold or silver.

Over time, several price references have been developed based on the 4Cs, which are currently used for setting wholesale transaction prices in the main international exchanges (e.g., New York, Antwerp and Mumbai). The most used reference is the Rapaport Price List, published weekly since the 1970s. It indicates the values of diamonds - classified according to the ‘4Cs’ – estimated with reference to the highest prices recorded in wholesale transaction for all the different grades of diamonds. Since 2004 average prices have also been available based on real wholesale transaction prices paid in transactions occurred on IDEX - International Diamond Exchange, an online exchange platform. On a monthly basis, IDEX publishes the Diamond Retail Benchmark, a report containing an estimate of retail diamond prices, which is obtained by adding the full-service retail mark-up applied by high-end retailers to the highest prices recorded on the wholesale platform for the different types of diamond. The Benchmark is intended as a guide for consumers to assess the retail price for a given type of diamond, also taking into account the services provided by the retailer.

Investment diamonds are retailed through several different channels. In Italy, most diamonds are sold through specialist companies like DPI and IDB, which have collaboration agreements in place with a large number of banks.

3. **THE MISLEADING COMMERCIAL PRACTICES ASCERTAINED BY THE ICA**

The ICA found that the information provided to consumers – through DPI’s and IDB’s websites, brochures and leaflets available in bank branches and the material provided to banks to illustrate the advantages of purchasing diamonds to their customers – on the advantages of buying investment diamonds, on their prices and on the liquidity of their ‘investment’ was severely misleading.

First of all, diamonds were indicated as particularly convenient stores of values, immune to inflation and other economic fluctuations. To this end, DPI and IDB used to publish on the most important Italian financial newspaper (*Il Sole 24 Ore*), a chart showing the trend of ‘diamond price quotes’ and comparing it to the inflation rate and the price indexes set in regulated markets, namely the Eurostooxx50\(^7\) for IDB and the gold fixing on the London market for DPI. This chart has been found to be misleading in many ways: (i) the ‘diamond price quotes’ were nothing else than the list prices of DPI and IDB, presented in such a way to suggest that they were ‘market prices’ and that purchasing

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\(^7\) The Eurostoxx50 index represents the performance of the 50 largest companies in terms of free-floating market capitalization in 11 Eurozone countries. It is designed by the index provider STOXX.
diamonds was substantially a financial investment in a real good; (ii) the diamond prices were shown as increasing at a stable rate, while the trend reported by Rapaport and IDEX as it has emerged during the proceedings showed several periods marked by a decrease in prices, even though their average long-run trend was increasing; the trend represented in the comparison chart gave therefore a false impression of price stability and of steadily increasing returns, meant to back the claim that diamonds could be a convenient ‘store of value’, also due to the expected drop in their production.

This chart could be easily accessed by bank officer and was largely used to show and explain the advantages of purchasing diamonds, according to consumers’ complaints received by both traders and the ICA.

Its being published on the most important Italian financial newspaper lent credibility to the misleading information contained in the chart.

Secondly, most consumers - with the partial and late exception of Intesa San Paolo’s customers – were not made aware that the prices they were required to pay included substantial commissions for the banks and significant mark-ups, and therefore the wholesale cost of the diamond was about half of the price paid by the consumer – an unexpected difference for a purchase that was presented as a form of financial investment. Actually, prices charged by DPI and IDB were much higher than the IDEX Retail Benchmark.

Such a difference between the wholesale value of the diamond and price paid by the consumer – while legitimate in itself – meant that consumers selling their diamonds on the market (at prices based on IDEX or Rapaport wholesale prices) could not realize the returns expected on the basis of the comparison chart nor, more importantly, recover the capital invested in purchasing the diamonds – except in specific circumstances, such as a long-run increase in the wholesale prices sufficient to compensate for commissions and mark-ups legitimately charged by IDB and DPI. Therefore, the claim that ‘investment diamonds’ sold by IDB and DPI were a store of value was substantially false, as it was very difficult that consumers selling their diamonds on the market (through jewellers, etc.) could recover their capital without losses.

The misleading nature of this claim emerges even stronger when considering that the consumers were unaware of the swings in the market price of diamonds and that therefore were completely exposed to the risk of suffering even larger capital losses had them decided to sell their diamonds when the price cycle was low.

IDB and DPI actually offered a ‘resale service’, consisting in attempting to find a consumer, within a specified time frame, willing to buy the diamonds at their list price. As long as demand for diamonds sold by IDB and DPI largely exceeded resale requests, resale was relatively easy and most consumers got the return expected on the basis of the comparison chart, as the resale occurred at those inflated prices. However, after the broadcasting of the investigative report, the ratio between demand and resale request inverted, neither IDB nor DPI were any longer able to satisfy resale request. This clearly
showed that resale mechanism could not work if consumers were aware of the sizable difference between the price asked by DPI and IDB and the wholesale value of the gemstones, as very few consumers would have been willing to buy diamonds that could not be easily resold without incurring in large capital losses.

IDB and DPI omitted therefore to inform consumers about the actual risks surrounding their diamond purchases and the conditions under which IDB’s and DPI’s diamonds could actually represent a ‘store of value’.

As to the role of the banks, their engagement in the commercial practice at issue emerges from several elements. The investigation showed that the banks identified a ‘target’ of customers to whom to propose the purchase of IDB’s and DPI’s diamonds, also setting a ceiling on the proportion of assets that a customers could have invested in diamonds. Banks earned high commissions on the sale of diamonds made by DPI and IDB through them. Moreover, banks saw the sale of DPI’s and IDB’s diamonds as an opportunity to widen the range of services offered to their customers and to increase customer loyalty.

Bank officers had to illustrate the characteristics of the ‘investment’ - in particular, its advantages - using the material provided by IDB/DPI or internal elaboration of such material, which contained the same claims as above. Most of the procedure of placing the order, confirming the purchase, consigning the diamonds and making the payment occurred at bank branches in the presence of bank officers.

The product being offered in their banks, the advice received by their trusted financial advisors, the involvement of their banks in all the steps of the purchasing procedure led many customers to regard investment in IDB’s and DPI’s diamonds as trustworthy, and induced them to neglect those cautions they would otherwise have exerted before making such a poorly-known alternative investment.

Moreover, the banks used the material received from IDB and DPI in a mostly uncritical manner. They did not abide by the expected professional diligence, as they did not carry out an independent assessment – based on their specialist knowledge – of the actual riskiness inherent in purchasing the investment diamonds offered by IDB and DPI, an investment that some of the banks judged not liquid.

4. OTHER VIOLATIONS OF THE CONSUMER CODE BY IDB AND DPI

The ICA found that IDB and DPI had also breached some of the rules applicable to distance and off-premises contracts added to the Consumer Code by Legislative Decree no. 21/2014 (implementing EU Consumer Rights Directive). These rules were applicable due to the fact that the banks used to send their acquisition proposals via the Internet and the diamonds were delivered either to the bank or to the customers’ homes, and in any case off IDB’s and DPI’s premises.
The contract terms drafted by the traders restricted consumers to communicate their will to exercise their right of withdrawal via registered mail only and did not provide any form for such a communication. This constitutes breach of Articles 49, 50, 52 and 54 of the Italian Consumer Code, according to which the consumer can inform the trader of his/her decision to withdraw from the contract using a form made available by the trader or making an unequivocal statement of withdrawal in any other form.

IDB also violated the rule of the Consumer Code concerning the place of jurisdiction for litigations between business and consumers (article 66-bis). In fact, according to the agreement concluded with customers, these disputes should have been submitted to the court of the place where IDB had its registered office, and therefore not to the court of the place of residence of the consumer.

5. CONCLUSIONS

Transparency, accuracy and completeness of information on price and risks are essential to faithful and correct communication. The ICA’s intervention has revealed DPI’s and IDB’s commercial practices to be unlawful and unfair. The intervention was meant to create the conditions for a more transparent market for investment diamonds, by forcing the firms operating in it to disclose complete and correct information to the consumers, in order to create the basis for a trustworthy business. Moreover, the ICA, by extending the proceedings to the banks, also aimed to emphasize that professional diligence requires even greater care when the bank channel is used to propose non-regulated and innovative forms of investment.