

LBMA – Delivering Transparency and Integrity

By Ruth Crowell, LBMA Chief Executive



vaults – as at end May, 2017 – 7,514 tonnes, valued at \$306 billion – making the London holdings second only to those at Fort Knox in Kentucky, USA.

“The amount of gold held in London vaults is the equivalent weight of 12,523 Spanish bulls or 88,400 Rafa Nadals, almost enough to fill the Nou Camp stadium (although no doubt Rafa would prefer to be at the Bernabeu).”

Building trust and firm trade reporting capacity

Publishing London’s vault holdings exemplifies how the LBMA is meeting the challenges of market structure and sensitivity. Each of the vaulting companies, including the Bank of England, had to be satisfied that the disaggregate information would be kept securely, that the data would be properly vetted and stored securely.

Vault operators were also anxious that important principles regarding client confidentiality were not compromised in any way, particularly with regard to high-profile clients, such as central banks, whose decisions around gold could move markets. For each of the vault operators, appropriate approvals had to be sought to ensure that any concerns that might be raised by compliance, legal and senior management were addressed.

Building capacity was a challenge, particularly given recent global, US and EU regulatory changes. Many firms have significant resources tied up preparing for MIFID reporting. But the work has been done, retaining confidentiality while adhering to market-leading standards.

Arguably, trade reporting is even more challenging, as it encompasses the concerns and issues of a much larger group of institutions. Once again, protecting client confidentiality and the integrity of the global market are of paramount importance.

London is the centre of the over-the-counter global gold market and home to one of the largest stockpiles of gold in the world. Ruth explains how the LBMA is taking steps to ensure that London develops and maintains its status as the leading market for precious metals.

London is the fulcrum of the over-the-counter (OTC) precious metals market, involving participants from across the world. Despite its central role, however, the precise size of the market has been hard to determine.

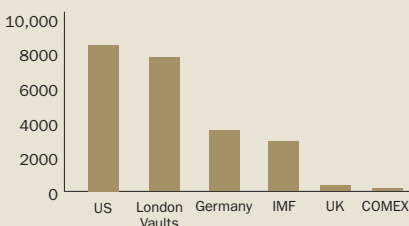
This is not just a challenge for gold but for all OTC or bilateral markets. Trades are strictly principal-to-principal and there is no central counterparty that can efficiently capture and report all trades. As a result, OTC markets have traditionally relied on surveys to gauge gross turnover.

Indeed, the LBMA is the global standard setting body for precious metals, not an exchange and consequently, neither it, nor anyone else has this information. The LBMA relies on market participants being willing and able to provide it with this information. And given the size, sensitivity and diversity of those participants, historically this has not been possible.

Now, however, the LBMA has introduced a new system under which OTC market participants will report trades. The initiative has three clear benefits: it will create an accurate picture of the size and shape of the market; it will promote transparency for existing and potential investors; and it will engender confidence in the liquidity and efficiency of the OTC market. Initial steps have been taken and the system will be fully rolled out next year.

Beyond trade reporting, steps have already been taken to improve market transparency and promote positive investor sentiment. In July this year, the LBMA published, for the first time, how much gold is held in London

Gold Holdings (tonnes)



The chart compares the amount of gold physically held in London vaults with the official reserves of the US, Germany, the IMF, the UK and COMEX.

Best-in-class service providers – Cinnober Boat

Initially, all trading members will report their OTC trades. Once the dataset is live in 2018, reporting requirements will be extended to ensure that the data ultimately reflects the size of the global OTC market.

Last year, following an exhaustive selection process, Cinnober Boat was appointed as the LBMA's trade reporting service provider. They provide solutions and services to leading trading and clearing venues, including exchanges, clearing houses, banks and brokers around the world. Boat is already used by many LBMA members for trade reporting, thus minimising disruption and cost.

The system is already capturing trades through a hub known as LBMA-i, which is powered by financial technology operator Autilla. LBMA Market-Makers have already started reporting, followed by other trading members later in 2017. Following a period of quality checking, it is expected that the first set of data will be published in 2018.

Transparent market statistics support investment

Increased transparency should prove a highly beneficial resource for existing and future OTC investors, as they seek to better understand market liquidity and depth. And a more accurate picture of the market's size and liquidity will make a vital contribution to lobbying efforts against disruptive future regulation such as Basel III's Net Stable Funding Ratio. The legislation is well intentioned, but there is an unintended consequence for investors that, in its most severe form, will dramatically increase the cost of transacting in the wholesale precious metals markets.

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Market conduct – Global Precious Metals Code

Transparency apart, client protection is a key issue for the global gold market. To address this, the LBMA published the Global Precious Metals Code in May this year. The first stand-alone code of conduct for the wholesale precious metals market, this represents an important step in market development.

The Code is intended to define a robust, fair, effective and transparent market, where all participants are able to transact following best practice guidelines. It sets out a common set of principles to promote the integrity and effective functioning of the global market covering ethics, governance, compliance and risk management, information sharing and business conduct.

Market commitment to best practice

All market participants involved in the global wholesale precious metals market are expected to act according to the principles of this Code and LBMA members will be required to sign a statement of commitment, attesting their conformance with the Code. Other participants, such as central banks, are expected to follow suit.

The Code was created after an extensive period of consultation with participants in the wider precious metals market. It was deliberately modelled on the FX Code produced by the G20 central banks, given the similarities between the OTC FX markets and the precious metals market. But considerable work had to be done to tailor the requirements to include industrial companies such as miners and refiners. Ultimately, the Code is intended to reassure clients that market participants are acting with high levels of integrity when it comes to conduct.

Metal quality control – London Good Delivery

Ethics, governance, compliance and business conduct are essential foundations for an effective market, but so too are the conventions that allow London to function fairly and efficiently, such as standard dealing amounts and physical bar requirements.

The LBMA plays a central role in this regard, setting the international standard, the London Good Delivery List (GDL), which is recognised not only by the global OTC precious metals market, but also by exchanges, central banks, refiners, investors, mints, jewellery and electronics companies across the world.

It is the *de facto* international gold standard, ensuring that when professional investors buy gold, they get what it says on the tin. And that label has changed in recent years. Now the gold does not only have to be pure, it has to be responsibly sourced.

Maintaining integrity

For Good Delivery standards, the key word is enforcement. Our high standards and the large market we represent mean that losing LBMA accreditation has serious commercial implications. We have therefore adopted an Incident Management Process (IMP), under which we review various allegations and issues that are brought to our attention in relation to any of the GDL refiners. Earlier this year, and following a review carried out according to the IMP, we removed a refiner from the GDL,

which received a lot of media and market attention. This, however, was not the first time we have removed refiners from the GDL. Failing to comply with the requirements of the Responsible Gold Guidance has led to several other removals in the past. Once removed, a refiner cannot apply for accreditation for a minimum of five years.

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Raising the bar – continuous improvement of standards

Removing the refiner this year was a serious step but it followed logically from a decision made in 2016, when we decided that all GDL refiners could no longer choose the relevant industry programme they wished to implement, but must undergo a LBMA Responsible Gold Audit, given its broader scope. This ensures the LBMA has a full line of sight on all of its accredited refiners.

Removing a refiner from the Good Delivery List may sound harsh – and it does not happen often – but the chain of integrity in the gold market is too important to jeopardise the Good Delivery standards. If those standards are compromised, the participants who are actively involved in the market that rely on us would all suffer commercially. They would also incur significant costs and considerable difficulties trying to individually manage the quality of the metal they use or produce. There has to be confidence in the global OTC gold market. And that's what the LBMA brand must provide.

Conclusion

The LBMA's transparency and integrity work has taken big steps forward this year with the publication of the Global Precious Metals Code and the vault holdings statistics. We continue to develop and maintain standards regarding Good Delivery and we challenge ourselves and the Market we represent to become increasingly transparent. The LBMA will soon be publishing an Annual Review to document achievements and challenges faced throughout each year, including on Responsible Gold. And we look forward to the next chapter in our transparency initiatives with the publication of Trade Reporting in 2018.