

Gold and Silver Clearing

“Loco London” Through the Central Hub Developed by London Precious Metal Clearing Ltd

By Peter L. Smith, Executive Director, JPMorgan Chase Bank NA

The LBMA has requested that I provide some additional clarity on the methodology employed to develop the monthly clearing statistics. Since my original article about London bullion clearing for the Alchemist (issue number 6) written a distant 13 years ago, much has changed, but much has also remained the same.

For example, I said back then that not everyone would be familiar with what was behind the phrase “Loco London” or its significance in comparison to the volume of bullion business worldwide. It was a phrase added routinely at the conclusion of a bullion transaction, or used by commentators when analysing the importance of the London bullion markets.

The then reality of London being the global clearing centre for OTC traded gold and silver remains as true today as ever and, perhaps even more so, with the rising establishment and growth of several new exchange traded bullion markets and platforms around the globe impacting upon London OTC bullion trading volumes. In fact, OTC Loco London is usually the preferred market to use when squaring off any exchange positions, and the general level of bullion cleared “Loco London” remains very robust. To date, in 2009, the average value of gold and silver cleared is in excess of \$20 billion each business day (see graph

or for detailed bullion clearing statistics, please visit the LBMA website, which publishes the data each month under “Market Statistics”).

On the other hand, back in 1996, there were eight Clearing Members but, with some painful realignment of priorities, two members have since decided to exit the Loco London gold and silver clearing business.

Today, the remaining six bullion clearers, each a major bank, are the joint shareholders who created “London Precious Metals Clearing Ltd” (LPMCL), which owns and runs the central clearing system for the daily settlement of gold and silver transfers.

These six members of LPMCL are:

- Barclays Bank PLC,
- Deutsche Bank AG – London Branch,
- HSBC Bank USA National Association – London Branch,
- JP Morgan Chase Bank NA – London Branch,
- The Bank of Nova Scotia – ScotiaMocatta,
- UBS AG.

Thirteen years ago, the bullion clearers were exchanging transfers between themselves by telephone instructions – a

situation that was causing considerable problems in the control and audit departments within those banks.

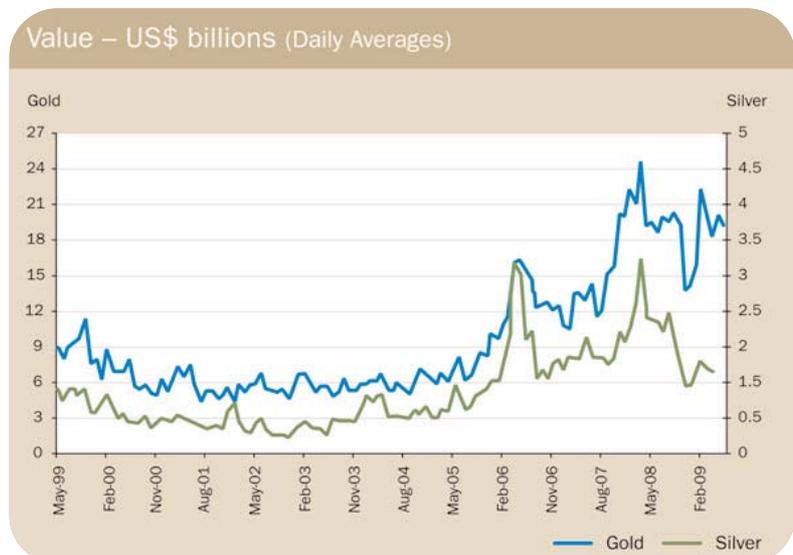
Because of those concerns, the clearers realised that the only sensible and secure solution was to develop a central clearing hub, where transfer instructions could be up loaded and matched. This resulted in the establishment of LPMCL in April 2001.

For more detailed information regarding LPMCL, please visit its website – www.lpmcl.com. The six bullion clearers provide the LBMA with figures for amounts cleared each month, taking three measures for each of gold and silver:

Volume: The amount of metal transferred on average each day measured in millions of troy ounces.

Value: The value measured in USD, calculated by multiplying the volume figure by the monthly average London pm fixing price for gold and the average London fixing price for silver.

Number of Transfers: The average number recorded each day.



For these figures to be correctly understood, it is necessary to give some definitions. The figures contain:

- a) Loco London book transfers from one party in a Clearing Member's books to another party in the same member's books or in the books of another Clearing Member
- b) Physical transfers and shipments by a Clearing member, both for its own account and on behalf of a client.
- c) Transfers between a clearing member and the Bank of England, all such transfers involving the Bank of England are "physical" and may also be for either the account of the clearing member itself or on behalf of a client.

Most importantly, when collating these statistics, in order to eliminate "double counting", only the debit side of each transfer transaction is recorded by each clearing member.

Accordingly, we are confident that the reported statistics are not over-inflated.

However, it should be pointed out that as virtually all gold and silver wholesale traders net all their trades for the same value date, with each of their counterparties, the clearing statistics mask the actual underlying value of daily Loco London OTC trading. In my opinion, the numbers are probably understated by as much as a factor of three times, or possibly even more during busy market periods / periods of high volatility in the market.

Excluded completely from the statistics are: allocated and unallocated balance transfers between clearing members, where the sole purpose is to reduce or eliminate overnight credit risks.

Thus if clearing member "1" has an unallocated gold and/or silver balance at clearing member "2", which when valued at current market prices creates a value in excess of the overnight risk limit, as approved by its Credit Department, then clearing member "1" has two possible options:

- a) It can either ask clearing member "2" to transfer an amount of gold and/or silver to another Clearing Member where there is some unused credit capacity sufficient to eliminate the excess credit exposure at Clearing Member "2",
- b) or alternatively, they can ask Clearing Member "2" to allocate an amount of gold and/or silver in their own vaults, or an alternative mutually acceptable vault, sufficient to extinguish the excess credit exposure.

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Physical movements arranged by Clearing Members in locations other than London; for example, a shipment of physical gold or silver bars from a Clearing Member's stock held in say Zurich or Istanbul would not be included in the statistics. This position is treated in the same way for such movements for the Clearing Member for their own account, as well as for movements effected for and on behalf of a Client of the Clearing Member.

The LPMCL Clearing hub (AURUM) has proven to be reliable and, over the last 18 months or so, has been a true boon for the Clearing Members' back office staff who had to cope with significant volume increases as the market heated up in response to the global credit crisis. Without the efficiency of the system, there would have been many more late nights and, with the heightened concentration on risk, the controls people would have been faced with would have created a much more

complex task manually trying to determine underlying exposures.

In these fast-moving times, the market through LPMCL is continuing to adapt to events and challenges. A couple of issues that will shortly impact the clearing include a request from The London Platinum and Palladium Market to provide "Loco London" clearing for later this year. Additionally, certain Exchanges are currently developing systems for "cleared gold forwards", the earliest of which is planning to launch imminently.

Fundamentally it is still true that much of the clearing methodology remains unchanged, with the main driver in today's market place being the need to achieve greater efficiency in delivery and accuracy to handle large volumes which, in turn, requires continual technological development. ■

Peter L. Smith

is an Executive Director at JPMorgan Chase Bank NA., London and Global Head of Physical Precious Metals Marketing, Clearing and Vaulting.



Peter joined JPMorgan's credit department in 1970, becoming Department Head in 1974.

Since the development of JPMorgan's bullion trading business in late 1979, Peter ran the bullion mid and back office for London. For the last nine years he has marketed JPMorgan's bullion clearing and vaulting services, and been responsible for global physical precious metal transactions.

Peter has been involved with the London Bullion Market Association, since the inauguration of the Physical Committee in 1987, and as the PC Chairman since 1992.

He is Chairman at London Precious Metals Clearing Limited, which runs the centralised system for the daily settlement of precious metals in London. He recently joined the Management Committee of the London Platinum and Palladium Market as Vice Chairman. ■