The Silver Anniversary of the LBMA

By Robert Guy, the Founder Chairman of the LBMA

Robert Guy (seated left) with the current Chairman of the LBMA, David Gornall.

To mark the silver anniversary of the LBMA, the very first chairman, Robert Guy, looks back with affection at the events which led to the formation of the LBMA in 1987.

This was not going to be the easiest meeting. It was October 1974. My boss at Rothschild's dealing room had just resigned and the bank had chosen me to be his successor. This affected not only Rothschild, but also the London Gold Market. Rothschild had chaired the Gold Fixing since it started in 1919, and had been broker to the Bank of England for more than a century. I was on my way to chair a meeting of the other members of the Fixing: Samuel Montagu, Mocatta and Goldsmid, Sharps Pixley and Johnson Matthey. Or was I? There was no alternative but to open the meeting by asking my new colleagues: "Is it your wish that Rothschild should continue to act as chairman of the Fixing?"

They knew that my dealing experience was in foreign exchange, not bullion, and I knew that my peer group was up to 20 years older than I (a mere child at 30) and that they had recently discussed the possibility of the chairmanship being rotated. Was I out of a job before I had even started?

Fortunately for me, although it was not with the greatest show of enthusiasm, the other members gave their consent that day in 1974 and I continued to chair the meetings. But only until 1993!

In those early days there was certainly a great deal to concern us. We were struggling to regain a portion of the gold sold by the South African Reserve Bank (at that time South Africa produced around 1,000 tonnes a year, now down to around 200 tonnes) which we lost completely when the British government closed the gold market for two weeks in 1968. We were also facing the threat of new competition from the US futures market, due to open in January 1975. We were beginning to take advantage of the liberalisation of the market in Hong Kong where we opened new trading subsidiaries. But the going was tough.

Gradually things got better. More subsidiaries followed in Singapore, New York and Sydney. The IMF and US Treasury gold auctions, far from depressing the gold price, stimulated fresh investor demand. Central banks returned to the market (as buyers). Gold production rose. Turnover increased and so did profits. London was back. Some years later the head of the Soviet Union central bank asked me how we had planned our recovery – no surprise in such a question from a country which lived (and died) by its five-year plans.

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But, in truth, it was not planned. Apart from the external factors, I think the success of those years can be attributed to ethos and competition. The five firms were extremely competitive and watched each other's activities like hawks. But, at the same time, they knew the importance of working together.

And that is why, whatever the state of the market, they would meet, in turn, in each other's offices, at 4pm on a Wednesday afternoon every month. Naturally we began with tea and biscuits; an hour or so later the waiter would appear with the drinks trolley.

We were an eclectic bunch. The group included Guy Field of Samuel Montagu (at that time the leading house in the market), French émigré, brought up in Liverpool, with an idiosyncratic turn of English phrase – "Don't make my goat boil" – and his young assistant, my longstanding friend Robert Beale (a fellow historian, albeit from Cambridge). There was Keith Smith of Mocatta and Goldsmid, the oldest firm in the market, for whom he had worked, man and boy, save for National Service in the RAF, and Jack Spall of Sharps Pixley, father of Jonathan (now at Barclays Capital), who, unusually for the market (but to its benefit) started his city career in the softs market and had been a broker with Merrill Lynch. Irascible might be the word for some of them; goodness knows what their word was for me.

There were occasionally some unusual issues to address (were the bars from North Korea radio active? Had the makers of counterfeit sovereigns in Beirut been working overtime?) but a typical agenda at the meetings of the fixing members would include performance at the Fixing and market making throughout the day; clearing and good delivery; imminent legislation in the UK and the EEC; VAT. And indeed all those other similar issues which face the LBMA today. Except there was no LBMA: no central secretariat. We split the work between ourselves and colleagues in our respective firms. The Bank of England did not attend our meetings but I regularly reported to it on developments. ("I expect my broker to keep me informed," said one official when I had forgotten to do so. Oh!)

One issue that we had particular need to discuss with the Bank was the application of Derby and Co (to which Guy Field had moved) to become a member of the Fixing. The Bank had granted Derby the status of 'authorised dealer' – a necessary qualification to deal in gold in the days of exchange control – and now the company wanted to enhance its status further.

What did the Bank of England itself think? "It's not within my gift" came the official reply, and Derby was denied. But later, by which time he was at JP Morgan, Guy ("too many Guys?" asked one distinguished commentator) made a very significant contribution to the creation of the LBMA, particularly in the drafting of the constitution.

The early 1980s, the rise to the then record price of $850, the explosion of western investor demand, the dramatic dishoarding from Asia, the birth of bullion banking (as we then called mine finance) – these were indeed good years for the market. As a result, a number of foreign banks sought to open their own bullion trading rooms in London – Morgan Guaranty, Credit Suisse and Nova Scotia among the earliest. Negotiations with Customs and Excise resulted in their becoming associate members of the market, which meant that their wholesale trades could benefit from exemption from VAT under the Terminal Markets Order. They were in the 'Black Box'. Yes, this meant more competition but at the same time it only enhanced the position of London in the international market. That's why we had an 'open door' policy.

In retrospect, we then got a bit carried away. After much debate and protracted discussions with the London Metal Exchange (LME), in 1982 representatives from the gold market formed their own company, the London Gold Market Ltd, which became joint owner with the LME of the London Gold Futures Market (LGFM). A trading floor was built in Plantation House and the shareholders, particularly the members of the Fixing, provided good order flow and price support. The Achilles heel, however, was the lack of domestic investor and speculator interest, without which no futures market can survive and, following an excellent report by John Wolff, the market closed within three years.

(There was a useful side-benefit from the closure of the LGFM. The market, as an entity, had enjoyed the benefit of the Terminal Markets Order and, on its closure, we negotiated with Customs and Excise the right of individual companies to become, if they so wished, associate members of the London Gold Market. The majority did so.)

In the early days of the LGFM it appeared that solid progress was being made. The marketplace generally was relatively quiet, not as exciting as earlier in the decade, but there did not seem much to worry about.

And then came the collapse of Johnson Matthey.

On Friday September 28, 1984, I flew back from Washington where I had been attending the annual meeting of the IMF. Bleary-eyed, I arrived back home in Kew on Saturday morning to be greeted by my wife Diana (a constant source of support throughout my career) with the words: “The deputy governor of the Bank of England has just rung. He wants to speak to you. But don’t ring him, he’ll ring you.”

The hours passed. I had no idea what this was about. I tried to ring my closest and most trusted colleague at Rothschild but without success. Eventually the deputy governor did indeed ring. ‘Opaque’ is, I think, the right word (and in the circumstances totally understandable) but the instruction was quite clear. I had to contact the other four members of the market and tell them to meet (accompanied by a colleague who could ‘deliver’) at the Bank of England at 9am on Sunday morning.

Easier said than done – I didn’t have all their home telephone numbers. (You didn’t in those days and, of course, there were no mobiles.) I surprised one member by suddenly and surreptitiously (another banker lived next door) appearing on his doorstep in a Chelsea square. Another I tracked down via a phone call to a pub in deepest Surrey. High drama is often accompanied by moments of sheer farce.

The simple fact of the matter was that Johnson Matthey Bankers, a Recognised Bank and supervised as such by the Bank of England, was insolvent. The cause was not JMB’s bullion trading activities but the bank’s commercial loan book. The exposure of the Fixing members to JMB was small and manageable – we had strict trading limits on each other which varied according to our relative size – but many international banks were not as prudent and had very high exposures. JMB’s failure, in my view, would threaten the whole London market, rebound very badly on the city and be particularly damaging to the Bank of England.

The full story of what happened over the next 24 hours will not be told until the Bank releases the relevant papers, but the outcome was that at 8:30 on the Monday morning the Bank announced that it had bought JMB.

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The Fixing took place, as usual, two hours later with the representative of JMB at his desk. JMB was eventually sold to Mase Westpac (which bought it only on condition that it was invited to join the Fixing) in June 1986.

Other changes were well underway by then, however. Work had already started at the Treasury on the drafting of the Financial Services Bill which led to the creation of the Securities Investment Board and the various self-regulating organisations which were later subsumed by the Financial Services Authority. (The story continues!) The members of the gold market were already concerned about the possible repercussions this would have for them.

Much more important for us, however, the Treasury, headed by a very angry Chancellor of the Exchequer (Nigel Lawson) was demanding a new approach to banking supervision following the JMB debacle. Nobody had sought his views on the rescue plan for JMB and he was not pleased. Something must be done. And, dreadful phrase, lessons must be learned.

The eventual outcome was that the Bank assumed formal supervision of the foreign exchange and bullion markets. Discussions took place with the Bank which now needed a formal body to represent the bullion market. A small group of associate members drafted their own proposals and came to discuss them. Our response was that they were pushing at an open door. The gold market had to take account of the new responsibilities of the Bank and it recognised that the market as a whole was suffering from a democratic deficit. The open door policy, our creation of associate members, had proved so successful that there were now more than 50 of them. Liaison was proving increasingly onerous and time-consuming. In October 1986 I wrote to all the associate members informing them that I had “been asked by the Bank of England to give some thought to the organisation of the market in the light of the forthcoming enactment of the Financial Services Bill”. I then formed a steering committee (drawn from associates as well as members) to assist the Bank in its drafting of a Code of Conduct. In February 1987 I wrote again to everyone: “We are now turning our minds to the creation and constitution of the London Bullion Market Association” and invited all to give us their views. The LBMA was incorporated on December 14, 1987, and we held the first Extraordinary General Meeting on May 12, 1988.

If today’s members of the LBMA look through the minutes of the early AGMs they will recognise many subjects which concern them now, just as they did the old gold market. But I perceive a greater professionalism and innovation, which reflect the strong commitment of a large number of people.

The clearing arrangements were revamped. Standard terms and conditions were published, guidelines on options were produced. Building on the initiative of a number of dealing rooms (Martin Stokes of JP Morgan and John Bishop of Rothschild to the fore), the LBMA took responsibility for developing the Gold Forward Offered Rate (GOFO), which did much to help develop mine finance. A new market agreement was made with Customs and Excise.

A public relations firm was hired and a newsletter published; it was nowhere near the standard of *the Alchemist* but at least it was a start. In it we were able to announce victory in a battle with Brussels. The EEC wanted us to go metric. We wanted to keep the troy ounce. Together with the Bank of England and the refining industry we won the day. The troy ounce was saved.

There were few arguments and a strong collegiate approach prevailed. I was particularly pleased that we kept to our original ambition and supported charitable causes such as the provision of a bursary for students from the developing world at Imperial College and the Camborne School of Mines.

We opened an office in Fredericks Place and for the first time we had an executive secretary, Inga Brereton, to support us. We tried hard not to be over-bureaucratic and to keep our costs down but it’s fair to say that we did not have the vast number of regulations, domestic and international, with which those in the market today now have to deal. As a regular reader of *the Alchemist*, I cannot fail to be impressed by the range of activities which are now undertaken.

Looking back at my time in the City and at Rothschild, I have many good memories. But my greatest satisfaction is in being one of those who created the LBMA in 1987 and I send my warmest congratulations to all of you on making it such a success today.

Robert Guy, was the Founder Chairman of the LBMA.
He read history at Balliol College, Oxford and joined N.M. Rothschild and Sons in 1967. He was a member of the Main Board for 26 years and, following his retirement in 2003 was a Non-Executive Director of the Royal Mint. He and his wife, Diana, now divide their time between Kew and Provence and their grandchildren in Sussex and New Orleans.