LBMA

Fair & Effective Markets Review
Bank of England
Threadneedle Street
London EC2R 8AH

30th January, 2015

Dear Sir/Madam

Fair and Effective Markets Review (FEMR)

The London Bullion Market Association (LBMA) welcomes the opportunity to submit this letter in response to the consultation document "How fair and effective are the fixed income, foreign exchange and commodities markets?" The LBMA would also like to submit its broad support for the response submitted by the International Swap Derivatives Association (ISDA) and FIA Europe (FIA).

In this submission we have provided information on:

- the role of the LBMA within the market;
- how the bullion market operates currently; and
- direct comments on some of the questions that the review is asking.

The main purpose of our submission is to provide enough information for the Review to take some informed decisions on the proposals it will be putting forward later in the year. We would welcome providing support and further advice on the precious metals markets.

Summary of key points:

The role of the LBMA in the bullion market is key to ensure the market operate against a fair and effective framework. The LBMA plays a fundamental role in accrediting both members and refiners in order to provide quality assurance on market participants as well as the metal which is traded. This quality assurance is done through Membership accreditation, Refiner accreditation on the Good Delivery List, the Responsible Gold Guidance, and the ownership of the precious metals benchmarks. Additionally, the LBMA provides a quasi-regulatory role through its various programmes and is able to enforce its policies and procedures successfully. Failure to comply would lead to de-authorisation of the Member and or removal from the Good Delivery List. Loss of LBMA Membership status would result in the company being unable to trade gold directly with a VAT zero rating. Loss of refiner Good Delivery accreditation would seriously limit a refiner's ability to sell gold not just in London but worldwide.

In order to be a member of the LBMA, market participants must demonstrate that they actively trade spot, options or forwards in the London Bullion Market, pass KYC procedures and declare conformance with the Non-Investment Products Code (NIPs Code). This accreditation process is open to all institutions which meet these objective criteria. The existing NIPs code that the industry has in place provides a good framework for the LBMA members to operate within. We would welcome the opportunity to update this code and make it mandatory across the industry.

The LBMA would also welcome further transparency through post trade reporting, providing the industry with data that at the moment does not exist for the bullion market.

Finally, it is important that the Review does not implement any new measures which will impact the liquidity of the markets. We would like to reinforce the message presented by the FIA that the Review should prioritise liquidity, as greater liquidity results in markets which are less easily manipulated and consequently regulators should afford market participants the tools with which to foster liquidity.

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About the London Bullion Market Association and its role in the bullion market

The LBMA is the international trade association that represents the market for gold and silver bullion, which is centred in London but has a global client base, including the majority of the central banks that hold gold, private sector investors, mining companies, producers, refiners and fabricators. The current membership includes 144 companies, which are either actively involved in the loco London bullion market or which provide services to the market, such as supervising and assaying.

The London Bullion Market is a truly international market, in that although dealers in other bullion trading centres may trade in their local markets and commodity exchanges, they also deal extensively in "Loco London" metal. This term means that the gold or silver will be settled in London by the LBMA Member, either by way of book transfer or physically. Hence membership of the LBMA is vital to the London Bullion Market. The location of the underlying metal will be referred to within the contract with the customer, whether the trade is on an unallocated or allocated basis, but at all times, the metals remain under the physical control of the LBMA Member.

The on-going work of the Association covers quality assurance regarding market participants and refiners, setting and monitoring refining standards, creating trading documentation and fostering the development of good trading practices. The LBMA's main role is acting as the voice of the London Market as well as a contact point for regulators, investors and clients. It ensures the continued evolution and health of a marketplace for gold and silver in which all participants can operate with confidence. Further it co-ordinates market clearing and vaulting, promotes good trading practices and develops standard documentation. It also sets objective criteria for institutions wishing to enter the market as traders and as custodians. Additionally, during times of crisis, the LBMA is a key player to help avoid any potential market disruption. This was recently demonstrated during the Silver Fix crisis, when the LBMA co-ordinated a market response in order to make sure that the market still had a silver price.

Central to the LBMA's quality assurance work is the maintenance and publication of the Good Delivery Lists for gold and silver, which are universally acknowledged as the de facto international standard for bullion. In the refining industry, accreditation on the LBMA Good Delivery List is globally recognised as the benchmark standard for the quality of gold and silver bars, due to the stringent criteria that an applicant must satisfy. The List is used by many precious metals exchanges around the world to define in whole, or in part, the refiners whose gold and silver bars are accepted in their own markets. Total refined gold production by the refiners on the List was 4,695.8 tonnes in 2011, well above world mine production of 2,818. For silver, refined production by listed refiners of 28,395.1 tonnes was greater than the 23,689 tonnes of mine production in the same year. The gold refined by the refiners on the Good Delivery List make up about 85-90% of total world gold production.

Additionally, in order to respond to US Conflict Mineral legislation, the LBMA took its role as accreditor of the world's gold refiners and expanded the scope of its requirements, to include corporate social responsibility, by the creation of the Responsible Gold Guidance. This framework, based on the OECD Due Diligence Guidance, gives assurance to investors and consumers that all London gold stocks are conflict-free as well as compliant with international anti-money laundering laws. Without these efforts, there would have been serious disruption to the international gold market when US laws came into force.

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Background on Gold and Silver as a Unique Asset Class

Gold is traded widely, and provides many banks, trading houses, refiners, and investors with the opportunity to invest confidently. Gold demonstrates many of the attributes common to assets of high liquidity values including price stability, tight bid/ask spreads, transparent pricing and transferability and, importantly, is a run-to asset in periods of stress. When national and global economies are going through times of distress, investors rely on purchasing gold as a safe haven option and as an alternate to cash.

Loco London – a Unique Marketplace for Precious Metals

As previously mentioned **Loco London** is a concept that is perhaps the most important aspect of the London bullion market as it represents the basis for international trading and settlement in gold and silver and has evolved over time since its creation in the second half of the nineteenth century. London developed as the centre through which gold from the mines of California, South Africa and Australia was refined and then sold. With this business as a base, and supported by the increasing acceptance of the London Good Delivery List, London bullion dealing houses established global client relationships. These clients opened bullion accounts with individual London trading houses. It soon became evident that these "loco London" accounts, while used to settle transactions between the bullion dealer and client, could also be used to settle transactions with other parties by transfers of bullion in London. Today, all such third party transfers on behalf of clients of the London bullion market are effected through the London Bullion Clearing which is organised and administered by the London Precious Metals Clearing Limited.

As a result, the loco London price has become the common denominator amongst dealers around the world. The settlement process can be likened to that in international foreign exchange markets, where settlement is effected by debits and credits over currency *nostro* accounts in the relevant banking systems. A credit balance on a loco London account with an LBMA member represents a holding of gold or silver in the same way that a credit balance in the relevant currency represents a holding of dollars on account with a New York bank or yen with a Tokyo bank. In fact, because of these advantages, nearly all global OTC gold and silver trading is cleared through the London bullion market clearing system. Clients of the market include investors, ETFs, funds, miners, refiners, manufacturers as well as, of course, central banks.

An OTC Market

Members of the London bullion market trade with each other and with their clients on a principal-to-principal basis, which means that all risks, including those of credit, are between the two parties to a transaction. This is known as an "Over the Counter" (OTC) market as opposed to an exchange traded environment. While transactions between members tend to be in standard dealing amounts, when dealing with clients, a dealer will provide a tailor-made service – offering quotes for variable quantities, qualities and types of material as well as for various value dates and delivery destinations.

Unlike a futures exchange, where trading is based around standard contract units, settlement dates and delivery specifications, the OTC market allows flexibility. It also provides confidentiality, as transactions are conducted solely between the two principals involved. This is particularly important for central banks activity in the market.

Market microstructure

Dealing Basics

Market Making members of the LBMA provide two-way bid and offer quotations in gold and silver for spot, swap, forwards and options. Business is generally conducted via electronic communications such as Bloomberg or Thomson Reuters, phone or electronic dealing systems. Dealings may be conducted either via the two way bid and offer market which is available from Market Makers throughout the London trading day or at the daily auctions for the LBMA Silver Price and the LBMA Gold Price.

The Loco London Spot Price

This is the basis for many transactions in gold and silver. It is a quotation made by dealers based on US dollars per fine ounce for gold and US dollars per ounce for silver. From this basis price, dealers can offer material of varying fineness, bar size or form (for example grain) at premia to cover the costs of producing smaller, exact weight bars, or bars of a fineness above the minimum 995 fine. Metal can then be shipped to destinations around the world at prices inclusive of freight and insurance subject to negotiation. Dealers also offer quotations for gold and silver in other currencies, based on the US dollar price and currency cross-rates. Prices in some local markets for some products may be at a discount to London – reflecting demand and supply dynamics.

Quotations

Market Makers offer a two-way spread in gold and silver to their clients and to other Market Makers during the trading day. They thus provide the dealing liquidity upon which the market is based and through which client trades are absorbed into the market.

Borrowing, Lending and Forward Transactions

Three types of transaction provide the basic tools for risk management of bullion liquidity: loans and deposits, forward swaps and outright forwards. These also represent the building blocks for a variety of additional products. Just like currency, bullion may be placed on deposit to earn interest. In the bullion market, such transactions are sometimes referred to as loan transactions, and generically the interest rates applied to such lending of bullion are often referred to as loan rates.

The terms lending and borrowing are naturally applied to loans and deposits. However, as is explained below, they are also, somewhat confusingly, used when discussing forward swap transactions. Quotations for outright forward purchases or sales are sought by investors or speculators seeking exposure to bullion prices, or by producers and consumers seeking protection from adverse price movements. Forward swaps, on the other hand, tend to be the transactions of professional dealers laying off outright forward, loan and deposit risk.

Bullion Loans and Deposits

In value terms, most leasing business is conducted in gold. The lending of gold by central banks and other long-term holders provides the liquidity for operations such as hedging structures and inventory loans. In silver, where there is little or no such source of liquidity, loan demand must be satisfied from the forward swap market or other reserves.

Market convention is for the interest payable on loans of gold or silver to be calculated in terms of ounces of metal. These ounces are then generally converted to US dollars, based upon a US dollar price for the metal agreed at the inception of the loan transaction.

Swaps or Forward Swaps

In the conventions of the bullion market, the word “swap”, unless otherwise qualified, refers to a buy metal spot/sell metal forward transaction from the borrower’s perspective. From the lender’s perspective, it is a sell metal spot/buy metal forward deal. Thus metal is lent or borrowed against currency, which some participants refer to as lending on the swap or borrowing on the swap to differentiate from loans and deposits. Swaps may be transacted with both legs of the deal for value dates beyond spot. Such transactions are termed forward/forward swaps.

Cash-settled swaps are outright forward transactions conducted with the intention that the deal will not be settled by delivery of bullion and settlement of currency countervalue, but by the payment of the difference between the countervalue of the contract and the value of the contract at maturity. In other words the difference in value is “cash-settled”.

Outright Forward

This term refers to a simple purchase or sale of metal for settlement on a value date further into the future than spot. The way in which a dealer covers an outright forward deal in an OTC market provides a useful illustration of how the forward market works.

When dealing forward with a counterpart, dealers generally cover the spot exposure first and then adjust the trade to the required forward date. In the case of the counterpart wishing to make a forward purchase, the dealer will purchase spot metal in the market, generally financing the purchase by borrowing US dollars. The forward sale to the counterpart is then made on the basis of the cost of financing the transaction, less any benefit accruing to the dealer as a result of the bullion liquidity created for the period as a result of the spot purchase.

The net effect is that the dealer will have purchased metal in the market on a spot basis and sold metal to his counterpart for the forward date. In other words, the dealer will have created metal liquidity for the period on his book; in market parlance, he will have “borrowed” it.

Options in the Gold and Silver Markets

Many LBMA members offer quotations in OTC options in gold and silver. While the market provides quotations for standard, month-end maturities for convenience, in the OTC environment dealers may provide prices for other maturities subject to negotiation. A gold or silver option represents the purchase or sale of the right to buy or sell bullion, rather than an outright purchase or sale. The bullion that is the subject of the option is referred to as the underlying asset.

Support Facilities

The London bullion market is supported by a number of essential facilities:

Vaulting

Certain members of the London bullion market offer clearing services. They either use their own vaults for the storage of physical bullion or have the dedicated use of storage facilities with another party. Additionally, for gold, account facilities for allocated metal at the Bank of England are used.

Clearing

London Bullion Clearing is at the heart of the loco London system, supporting the most widely traded market for bullion dealing globally. It is a daily matching system of paper transfers whereby members offering clearing services utilise the unallocated gold and silver accounts they maintain between each other, not only for the settlement of mutual trades, but for third party transfers. These transfers are conducted on behalf of clients and other members of the London bullion market in settlement of their own loco London bullion activities. This system avoids the security risks and costs involved in the physical movement of bullion.

The Clearing system operates on the basis of a code of market practice encapsulated in a “Letter of Understanding” to which each member offering clearing services is a signatory. The Letter sets out the framework under which the signatories operate the clearing. To complement the Letter of Understanding, a Market Practice Agreement between the clearers enhances the financial security of the Clearing by enabling the “netting” of clearing activities to be set off with all other obligations between any two members of the Clearing. These netting facilities encapsulate both gold and silver. Since 1996, the LBMA has collated and distributed clearing statistics for the market on a monthly basis. These are net figures and include the number and value of ounces transferred each month as well as the number of transfers for both gold & silver. These are available on the LBMA website (www.lbma.org.uk/clearing-statistics).

Standard Documentation

Given the variety of products provided by members of the market and in order to avoid the problems and costs inherent in a multiplicity of bilateral agreements to cover the transactions involved, the LBMA has developed and introduced a number of standard agreements. These cover the terms and conditions for operating allocated and unallocated accounts as well as forward, option and gold interest rate derivative transactions in the OTC market. These agreements include: Allocated and Unallocated Accounts Agreements, the 1994 International Bullion Master Agreement (IBMA) and the 2005 ISDA Commodity Definitions, Exhibits Annexes and Confirmations (including Bullion).

The major advantage of standard documentation is that it defines market practice. Its utilisation by members of the LBMA avoids the need to continually check the terms involved in bilateral agreements and its broad acceptance also provides comfort to clients of the market. By its nature it sets standards for the terms under which transactions are conducted and so provides confidence to users of market products.

What does 'Fair and Effective' mean for FICC markets?

Q1: The Review would welcome respondents' views on the definition of 'fair and effective' FICC markets proposed in Section 3. Does it strike the right balance between safeguarding the interests of end-users without unnecessarily impeding the effectiveness of FICC markets? Are the concepts of transparency, openness and equality of opportunity appropriately specified? And how does the definition compare with those used in other markets, jurisdictions, organisations or legislation?

Overall, we support the definition of fair and effective and welcome the requirements for a robust infrastructure, competitive prices, clear standards of market practice, transparency, open access, competition on the basis of merit and integrity. However, we also draw attention to the comments made by the FIA, who rightly highlight the need to make sure that all this is balanced with existing and forthcoming regulation within the financial services sector. If regulation becomes too onerous, it may result in participants and liquidity providers withdrawing from the markets, resulting in less liquidity and thus less effective markets. This is a key concern for a cross range of market participants, and especially our members, majority of who are already structured according to the existing regulations. If these participants ended up exiting the market, market liquidity would take a severe hit and then it will be the end users who would be the ones affected the most. Getting this balance right is absolutely key to the key success of the Review's proposals.

In the last 12 months, the bullion market has seen changes which have helped to further enhance the transparency within these markets. This has been in relation to the precious metals benchmarks, which the LBMA in conjunction with the relevant fixing companies, has transitioned onto an electronic auction based platform. This has allowed for an increase in participation as well as the opportunity for interested parties to view the auction live globally, through various data providers, therefore improving transparency.

However, the Review can assist in providing for further transparency, by encouraging the precious metals market to report anonymised unique transactional data, through mandatory reporting obligations and potential clearing. The LBMA has endeavoured to conduct annual gold trading surveys since its one-off Q1 survey in 2012. The survey was conducted in order to give further clarity as to size of daily turnover in the London market. Unfortunately, the LBMA was unable to make this an annual requirement unless requested by the regulator. The organised collection of this data would give regulators a better understanding of the market and would further demonstrate the size and importance of the London Precious Metals Market.

However, we would like to suggest, that criteria for the data collected must be selected carefully in order to accurately reflect the size of the market and eliminate double counting. Additionally, the reporting regime should be tailored to the nature of the market. We appreciate (by way of example), REMIT was introduced for the wholesale gas and power markets, which introduced mandatory reporting requirements, and therefore was tailored to these markets. We would welcome a regime that is also tailored for the physical precious metals markets, rather than having existing regimes extended to apply to our market practices. Furthermore, if the Review was to consider mandatory clearing for the precious metals markets, we would want to work closely with the market and identify a sensible approach and agenda to implement such requirements. Mandatory clearing needs to be driven by market requirements. The LBMA would welcome the opportunity to have further discussion on both reporting and clearing requirements. However, please note, we would not be suggesting to impose additional reporting requirements for financial settled precious metals products, as these are already subject to derivative reforms.

Market Regulation

Since the passage of the Financial Markets Act 2012, responsibility for the regulation of the major participants in the London bullion market lies with the Prudential Regulation Authority ("PRA") at the Bank of England. The PRA is now responsible for prudential banking regulation of most of the firms active in the bullion market. The PRA works closely with the Financial Conduct Authority (FCA) which is responsible for consumer and competition issues. Trading in spot, forwards and wholesale deposits in the bullion market is underpinned by the Non-Investment Products (NIPs) Code, which has been drawn up by participants in the UK foreign exchange, money and bullion markets.

The NIPS code

This code has been drawn up by market practitioners representing the foreign exchange, money and bullion markets in conjunction with the Bank of England. It sets out the standards of conduct and professionalism expected between market practitioners with each other and with their clients. The provisions under the NIPs code are intended only as guidance on what is currently believed to constitute good practice in these markets. Although compliance with the NIPs code is voluntary, the LBMA requires all Members to comply with it on a mandatory basis.

Responsible Gold

As previously mentioned, the LBMA's Responsible Gold Guidance, consolidates and formalises already existing high standards of refiners' due diligence. The Guidance is based on the OECD Due Diligence Guidance as well as Swiss and US KYC, Anti-Money Laundering and Combating Terrorist Financing regulations.

Since January 2012, all LBMA accredited gold Good Delivery refiners have accepted and implemented the Guidance. Under this, all refiners have to establish strong management systems that deals with the issues outlined in the Guidance; identify and assess risks in the supply chain; design and implement a management system to respond to identified risks; arrange for an independent third-party audit of the supply chain due diligence; and to publicly report on the supply chain due diligence.

The LBMA's work in this area has focused on addressing the money laundering, corruption and bribery issues across the jurisdictions where physical gold is sourced and transported. This has helped to regulate the underlying asset of the market. Where the refiner does not comply with this Guidance, this would result in the refiner being removed from the Good Delivery List. If a refiner was ever removed from the Good Delivery list, this would have serious commercial and reputational issues for the refiner and their ability to sell material in the international market.

Benchmarks

Since November 2014, the LBMA's wholly owned subsidiary Precious Metals Prices Ltd has owned the daily spot price benchmarks for the precious metals markets (it will own the intellectual property right in Gold in due course). Prior to this, the LBMA had no formal role in the precious metals benchmarks as the administration and distribution was overseen by three separate Fixing Companies. In May 2014, the LBMA was tasked with the ultimate responsibility for ensuring there was no market disruption when the Silver Fixing Company announced they would wind down their administration of the 'Silver Fix' on 14th August 2014. The LBMA worked with the market, The Silver Fixing Company Limited, as well as the FCA, updating the regulator on the progress of the launch of the new LBMA Silver Price. Since the successful launch, the London Platinum and Palladium Fixing Company also announced their intention to wind down and move the administration over to a third party. The LBMA worked closely with the newly appointed Administrator, and successfully launched the LBMA Platinum and Palladium Price on 1st December 2014. More recently, the LBMA has gone through the same process for Gold as it did for Silver, with a view for the LBMA Gold Price to launch in Q1 2015. The market has welcomed the changes and the shift to the electronic platform, which has increased transparency and also opened up the ability for direct participation. This has resulted in double the number of direct participants in the Silver Price and will ultimately mean an increase for gold participants as well.

Q4: Does the market microstructure of specific FICC markets — including trading structures, transparency, asset heterogeneity or market access — enhance or diminish fairness and effectiveness? Where there are deficiencies, will recent or in-train regulatory or technological changes improve the situation, or are further steps needed? How do these answers vary across jurisdictions, or specific markets within FICC?

The current microstructure of the bullion markets helps to enhance the effectiveness of the markets. To summarise the above:

- The NIPs code, which although voluntary across the industry, is made mandatory by the LBMA for all its members, provides a good framework for the members to implement
- The Responsible Gold Guidance is a way for the LBMA to provide further quality assurance. It helps to assure the market that the Gold entering the London market is free from conflict, and that AML controls are in place.
- Benchmarks, although the precious benchmarks were traditionally dealt by different market institutions, the LBMA lead a market consultation and was instrumental in making sure market disruption was avoided as well as an improved process was put in place. This helped to demonstrate that where there are issues in the market, the LBMA is the first point of call to help with managing the issues and to ensure fairness in the conduct of the market.

Q10: Are there any material barriers preventing greater transparency in OTC commodity derivatives markets? If so, what could be done to remove them?

The OTC market has proved to be extremely beneficial over time for the precious metals industry. Not least in that it has allowed participants to trade in non-standardised sizes in a confidential manner. For example a manufacturer that needs a specific quantity of metal is able to buy that amount from the wholesale market as it is possible to trade to three decimal places of an ounce.

However, while the majority of precious metals transactions take place under a bilateral agreement between the two counterparts involved, there is likely to be a growing push for all transactions to be cleared. Post trade reporting, as already highlighted above in question one, is the material barrier preventing greater transparency in the bullion market. Unlike other commodity exchanges, the London Bullion Market does not operate as a commodities exchange with a clearing house as a central counterparty, but instead operates on an Over-the-Counter (OTC) or principal-to-principal basis, which enables participants throughout the world to trade with Members of the London market. Six of the Market Making Members provide a clearing service for both paper gold and silver (based on unallocated accounts) and physical gold and silver in the form of allocated metal. As the London Bullion Market is an OTC market, no comprehensive data is published as to the amount of metal that is traded in the London market.

An obligation to trade report would create greater price discovery and also allow market users to deal with a wider range of institutions due to simplifying the credit system. The current system means that any organisations that are transacting with each other require mutual credit lines. For financial institutions the need for large lines is mitigated, to a certain extent, by ISDA and CSA documentation. Also, it is noted that the financial cash-settled derivatives market within commodities is already subject to derivatives reform, ensuring transparency for end users. Reporting in the physical market, which currently does not happen, will need to consider market pricing factors such as premiums, shipping/storage, taxes and duties.

However, it is worth noting, that the role of the central banks in the bullion market may preclude 'total' transparency, at least at public level, but that transparency could be increased via post-trade anonymised statistical analysis of nominal volumes, provided by the clearing banks.

Q11: Are there any areas of FICC markets where regulatory measures or internationally co-ordinated regulatory action are necessary to address fundamental structural problems that exist? Can members please provide comments?

In summary, there are different regulations currently in the pipeline which will impact the types of dealing in the bullion market. The LBMA would propose that before the Review considers the introduction of any further regulation, time is given to see the impact that the current proposed regulation would have and then seek to introduce any additional enhancements if necessary.

Benchmarks

Q21: Do current domestic and international initiatives by industry and regulators to improve the robustness of benchmarks go far enough, or are further measures required?

The IOSCO principles for benchmarks have been well received and are cross referenced by both Administrators and participants. The LBMA recognised that it was very important to the market that the LBMA Silver Price was compliant with the IOSCO Principles and all the supporting governance under the LBMA Silver Price was based on the IOSCO Principles. Similarly with Gold, we have had the same responses from the market. An IOSCO compliant solution was actually a specific request in the Request For Proposal that we launched for both silver and gold. Additionally, the UK's approach to benchmarks, which has involved a separate consultation after identifying a small population of relevant benchmarks to regulate, has also been welcomed. However, at this point, there is still much clarity required on the FCA rules implementing the HM Treasury proposals to regulate the seven benchmarks. However, based on the UK process, the EU also needs to take a tailored approach to regulating benchmarks, because otherwise benchmarks will end up moving to other jurisdictions (namely Asia). It is very important that the authorities show support for the IOSCO Principles which have received a lot of acceptance from across the industry.

Standard Market practices

Can the industry help to establish better standards of market practice?
Q32: What role can market codes of practice play in establishing, or reinforcing existing, standards of acceptable market conduct across international FICC markets?

The LBMA would certainly welcome the opportunity to work closer with members of the Review team to help further enhance existing practices. We support the potential for further developing an industry code of conduct, but believe that there are existing practices and codes that can be enhanced as opposed to replaced. For example for the bullion market, this would mean furthering the development of the NIPs code and making it mandatory across the market, rather than it being made mandatory only upon LBMA members. Also, it is crucial that the industry codes and standards are applied consistently across the industry and also that they encourage liquidity providers to work against a fair and effective market. As highlighted above, it is vital that the role of the liquidity provider is not diminished, but in fact strengthened to make sure the markets remain fair and effective.

In addition, we would like to emphasise that it is very important for the Review to make sure that any industry codes are aligned with global standards, and they do not go over and beyond so to make London an uncompetitive market. We would again, draw your attention to the Good Delivery List, the Responsible Gold Guidance; both are in compliance with the global standards. In fact the Responsible Gold Guidance is very much based on the OECD Supply Chain due diligence guidance, and therefore has been easily accepted by the Good Delivery List Refiners. Furthermore the benchmarks, the LBMA Silver Price, the LBMA Platinum and Palladium Price and what will also be the LBMA Gold Price are all aligned with the IOSCO Principles, again standards that are accepted globally. It is very important for London to remain a leader in the precious metals markets that the standards do not go over and beyond the global standards.

However, we would welcome the opportunity to discuss further the potential for a single code for across the industry, if that is the approach that the Review would prefer to take. Global alignment, consistency, and enhancing the role of the liquidity provider are the key requirements for any potential industry code.

Responsibilities, governance and incentives

Q39: Are there other regulatory measures the authorities could take to strengthen personal accountability or otherwise improve the way firms manage incentives and governance? In particular, should any or all of the measures in the Senior Managers and Certification regime be extended to non-bank firms active in FICC markets?

A lot of work already has been done in the non-banking world to help improve governance. This can be demonstrated through the LBMA Responsible Gold Guidance, which places a significant amount of responsibility on management systems and controls to deal with the risk or conflict minerals and corruption. Additionally, the transition of the benchmarks to an electronic auction based platform has helped to open up participation to non-banks. There is still work to be done in developing the system further against the backdrop of proposed regulation, but the potential for non-banks to participate is certainly a positive key development. By imposing further regulation on non-banks, it would inhibit the effectiveness of the market.

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Surveillance and penalties

Q40: What role can more effective surveillance and penalties for wrongdoing play in improving the fairness and effectiveness of FICC markets globally. How can firms and the industry as a whole set up their efforts in this area? And are there areas where regulatory supervision, surveillance or enforcement in FICC markets could be further strengthened.

As highlighted above, the LBMA membership is made up of banks and trading houses actively involved in the loco London bullion market or which provide services to the market, such as supervising and assaying. All of our members who are UK financial institutions are also registered with the PRA and FCA and therefore we rely on their registration with the regulators as a way of making sure they have systems and controls in place to avoid any wrongdoing. For our accredited refiners on the Good Delivery List, we ask them all to undergo a third party audit, which would highlight their systems and controls in place to manage issues like conflict minerals, anti-money laundering and anti-terrorist financing. Any adverse findings will see them removed from our membership and therefore not only will that have a huge reputational impact but also commercial impact (as already described under the summary of key points section).

Additionally, LBMA does annual reviews for high-risk Members and requires a reapplication in case of change of ownership. Also the LBMA acts a mediator for conflicts between our members and refiners. The LBMA is seen as the neutral mediator so in the event of a dispute we are asked to provide an independent view on the issues presented.

Conclusion

As previously stated, the role of the LBMA in the bullion market is key to ensure the market operate against a fair and effective framework. The LBMA plays a fundamental role in accrediting both members and refiners in order to provide quality assurance on market participants as well as the metal which is traded. In our view, the existing NIPs code provides a good framework for the LBMA members to operate within. We would welcome the opportunity to update this code and make it mandatory across the industry. The LBMA would also welcome further transparency through post trade reporting, providing the industry with data that at the moment does not exist for the bullion market. We have worked to do this over the past five years and believe it can only be achieved with regulator support.

Finally, we would strongly encourage the Review to carefully consider any new measures which would negatively impact the liquidity of the London Bullion Market and thereby diminish this unique international marketplace for precious metals.

Further information

Finally, if we can be of further assistance, we would be pleased to respond to any questions or requests that you may have.

Yours sincerely

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