

## **Session 6: Future of London PM Market**

**Stephen Branton-Speak, Chairman**

**Goldman Sachs**

### **US Presidential Style Debate**

**Philip Clewes-Garner, HSBC, LPPM Chairman**

Thank you, Stewart. Stevie. It's always nice to work with you. As you say, we've known each other a long time. I remember Stevie as kid coming onto the sugar futures market to see his dad, who worked in the box next to me, so it has been a long relationship. I would like to thank Jim Steel for inadvertently doing most of my job in the session before this. I think he did a great job for me. I have a few apologies to make. Repetition is something that you are going to hear a lot of here today. We're all on the same wavelength, so you will hear things again and my second apology to the other two guys on the panel because they're speaking after me. So whatever I say takes a little bit of the sting out of the tail.

I've arranged my short speech into three parts –the past, the present and the future – as I feel it would be a value to understand how the markets have evolved.

### **The Past**

Let's just look at the major points that put London on the map. The Bank of England's bullion office handled Brazilian and Russian gold production from the 18<sup>th</sup> century until around 1848. It was at this time when the structure of the market changed and the bullion office, the only route for precious metals, opened the purchase for sale of gold and silver on tender to any sworn broker. Moccatta and Goldschmidt were joined by Sharps and Wilkins and NM Rothschilds. In 1852, to cope with the flood of gold from the Australian gold rush, Johnson & Matthey were appointed assayers to the Bank of England. In the same year, Stewart Pixley, a senior clerk at the Bank, opened a brokerage house, and Samuel Montague (son of the Liverpool silver smith) set up a bullion and exchange business in Leadenhall Street. Incidentally, at this time, the Bank of England's Good Delivery List comprised of only four refiners, and the specification was a bar of 200 ounces with a minimum fineness of 22 carat, i.e. 916.7. So for the next 120 years or so, the London precious metals market was Moccatta, Sharps who joined with Pixley and Montague as brokers with Rothschilds as bankers and refiners, and Johnson Matthey as refiners later also to become bankers. The London silver fixing was established in 1897 and the gold fix in 1919, providing much needed benchmarks for the industry, which are still as important today as they were then. This continued until the late 1970s when, with the gold price moving higher fuelled by high inflation, high oil prices and global tension, an influx of international players were attracted to the market. The introduction of the Financial Services Act in 1987 encouraged the formation of the London Bullion Market Association, the trade organisation set up to provide a formal framework for the gold and silver markets. Undoubtedly, the London market owes its establishment and its strength as the leading bullion market in the world to the Bank of England, which has maintained

its support over the years. The 'Old Lady' has been a unique asset and ally to the market, providing storage facilities for other central banks, supernationals and market participants, and often acting as a go-between. Indeed, I still believe that there is no other central bank with such close ties to the bullion business. The market remained very vanilla until the early 1980s, but with the development of gold loans came an explosion in structure products and, as it grew, there was an ever-growing need to maintain extra vaulting and clearing facilities.

## **The Present**

The LBMA has grown in stature to become recognised as the number one gold and silver trade body globally. Clearing now operates via electronic systems. Fragmentation is a question raised on a regular basis as more and more local markets have evolved, but London has not suffered. The pie has actually grown dramatically and, if anything, London's share has grown proportionately with a dramatic change in product appetite over the last five years. ETFs have significantly increased the physical attributes of the Good Delivery bars backing the product – the enormous benefit to London being the ability to demonstrate the highest levels of credibility. London has shown its adaptability, its ability to adapt to an ever-changing environment. The growth in change has been remarkable, particularly with the enormous uptake in gold as an investment asset class mainly through the development of precious metals ETFs and the desire to hold physical. ETF holdings at present are around 57 million ounces of gold and 360 million ounces of silver, the majority of metal held in London in Good Delivery form on an allocated basis. Credit concerns particularly over the last 18 months have meant a move away from unallocated clearing accounts to allocations, mitigating credit exposure. This does not create any tax implications in the UK, whereas in some countries, this is still an issue. The same global financial concerns have also added more momentum to physical ownership and, in so doing, have inadvertently created a greater depth of public knowledge and understanding of precious metals, particularly gold.

## **The Future**

The phenomenal growth in the ETF market will continue. Precious metals as an asset class will never return to the days of 'maybe', when only the Swiss banks understood its importance. The mitigation of credit exposure will undoubtedly continue, cleared forwards will become the norm, creating even greater comfort in the London market. This will attract extra business, which will by definition mean that again the mainstay clearers will see additional requirements for more vaulting facilities. The Good Delivery List of approved brands now forms the backbone of nearly all gold and silver markets, and has been strengthened in the recent past with the initiation of proactive monitoring and its focus to maintain the highest standards. This will continue to maintain London's position in the number one spot. Custodial services will need to grow as products backed by physical become the norm. I have focused here really on gold and silver, but with the eminent start of loco London platinum and palladium clearing, it will mean London becomes a full one-stop shop. This is really prerequisite to both total credit mitigation and a future tie-in to cleared forwards. There will be a united London front to the global precious metals market. It may be called the London Precious Metals Market Limited, an umbrella organisation, overseeing all precious metals, trade, clearing and fixing companies. Each organisation, the LBMA, the LPPM, the LPMCL and the three fixing companies would hold equal shares. Besides acting as the voice of the market, it would also manage the intellectual rights to all important historical data, fixings, turnover, Good Delivery List, mark-to-market platforms, etc., which will be provided to global precious metals and newswire fraternity at a cost, with the revenue stream utilised for the good of London. So London's strength has evolved over 250 years around physical, maintaining quality, custodial facilities and, of

course, the experience that we've all achieved over that period of time will mean that London will continue to adapt to any change needed to maintain our number one position in the bullion market. The future of the London precious metals market? What a silly question! Thank you very much.

### **Neil Clift, Managing Director, JP Morgan Chase**

Good morning everybody. I think the unique thing about our industry is that a lot of us started out in various other places. I started out in foreign exchange, moved into gold 15 years ago, and have never wanted to leave and I don't think ever will leave. I think that's true of a lot of people I see here in the audience. Once people find this market, it's a very interesting market, has many facets to it. I think people find that it fulfils a lot of their personal requirements. We are living in very exciting times in the precious metals market, times of great change that we are seeing at the moment, probably unprecedented in terms of the scope of the changes. We have had new participants enter into this market, we have seen the sovereign wealth funds coming in, we have seen private clients coming through, pension funds, and also we are seeing central banks buying gold. Against that, on the supply side, we've got the falling production with falling grades and also this recent credit crisis that we have had has led to a constraining of capital, where the mines have not necessarily had the capital to put into practice their future production needs that they would otherwise have, so there is a supply environment that is also constraining. I want to talk about three things really this morning.

I used to head up our trading arm, but now I am much more our 'look after new business and new business development', and what I see a lot of in that role is physical. Physical pretty much takes over maybe 70% of my life. Everything that I seem to be doing has some form of physical back to it and that's very true for gold, obviously the growth of the ETF and the expansiveness of our vaulting facility. I remember going down to our vault probably 12 years ago and seeing in our vault literally one pallet of gold, which was all we had in the vault. If you go to our vault now or your go to HSBC's vault or certainly the Bank of England's vault, you will see a very, very different story now. It has substantially changed. So I think what we have seen, as Phil alluded to, is a move away from this unallocated gold into allocated gold. So a far greater proportion of what is stored in our vaulting system is allocated, meaning that the gold belongs to that client, it's their gold and they can come and take it when they want. We've seen this across a broad spectrum of commodities, not just the precious metals. We have seen that the gold market and most of the other commodities markets have moved to what I would term 'full contango', whereby the curve effectively for forward dates reflects the cost of storage and the cost of financing. This has happened in base metals and also in precious metals such that there is effectively a zero yield for commodities. I think that that is something we've seen and probably will continue to see. The reason for this is it dissuades somebody from going further up the curve and getting a gold price at effectively a discount, and people have wanted to do that, in particular investors, because it has delayed their need of settlement of gold. So you've got this curve that is pretty much flat all the way out in terms of financing and storage. Also, obviously the credit concerns of this market are outweighed and we are seeing this move recently to be able to use gold as collateral, which I think is very positive for the gold market.

Secondly, is this move towards credit mitigation and diversification? Obviously, last year, cost of credit dramatically increased for a number of counterparts and the move towards cleared contracts is a direct consequence of that. I think we'll also see that people will not want to have their exposure in the same place. One of the developments that I see with the ETFs potentially happening

is you develop various liquidity pools of ETFs as the market moves away from having it all in one place and, particularly for London, I think this is relevant because as the economies particularly of Asia develop, you will see those economies wanting ETFs based in their local constituencies. So I think there will be a threat to the London market from the storage side of things if ETF grows as we think it will do. I suppose the other thought is the new exchanges we're starting to trade with, new exchanges opening up in Asia, Singapore, Hong Kong and China, and whether or not that has some threat for the London market and how things potentially pan out. So a potential fragmentation of liquidity is something that London just needs to pay attention to and think about.

Thirdly, and this is possibly the most controversial one, I see ultimately a return to hedging. I know the producers in the room will be saying, "what the hell is he talking about, we just told him that we're not going to be hedging", but I think the new producer in the room is your sovereign wealth fund, he's your hedge fund – he's your ETF holder. They are effectively surrogate mines in my view, they hold a large portion of the reserves of the above-ground stocks and I think that this will lead to, and it's not going to happen just yet, but a lot of these guys are looking for excess return on their investment. They are not looking for just a passive investment, they are looking for risk overlay, and so when you look at the market and you take into account the fact that we've got this forward curve that is already significantly higher. If you go out 10 years, forwards are \$400 higher than the current spot market, and then you look at the volatility curve, and out in the volatility market, the long date volatility is significantly higher than the short date volatility. For instance, a one-year volatility at the moment is 10 volatilities higher at 27.0 than the one month, which is at 17.0, and I think what that will do is attract the new hedgers into the market because they will be able to earn that excess return. So, a one-year 25 delta option is a 1400 strike call option, you could earn \$45 for selling that at the moment. So, I think we will see a return to hedging. Now, what does all this mean? I think basically, I've heard a lot of very bullish comments on gold in this conference. I myself am very bullish too for the short term but I think, ultimately, there will be a return to slightly more normal markets where people do try to generate excess returns from these curves. There is a Pithy saying in the trading market that goes, "When they're crying you should be buying, and when they're yelling you should be selling". So the yelling isn't deafening yet, but it's certainly getting louder. Thank you.

### **Raymond Key, Managing Director, Deutsche Bank**

Well, I guess my job is to quickly wrap up so we get to the fun part of this morning's session. I think the main point I would want to make is that we're at crossroads here, and you look through history and in any industry or any country and you have two choices. There is a threat and an opportunity. I think that's why this is such a controversial topic because there has been huge changes going on in the bullion market for some time, but I think we're actually at a very critical point for a lot of reasons. Really it's up to the London market now – which I do believe has a great future – to start being a lot more proactive and owning the destination of where we want to go to. I think we are all aware that there is a lot to be won and lost, and we look through those changes whether it be regulatory changes, the electronics, the ETF product, which is truly astounding. We now talk to clients who are telling us that they get better option liquidity on gold by trading the ETF option. That is phenomenal. The OTC options market has been in existence for at least 15 to 20 years and, then within probably two years, the options side was launched, and then for hedge funds to be telling us that they get better liquidity there, we need to wake up and look at what we're going to do about that. I think that on the positive side, the reason I'm so positive about the London market is the only reason these products are successful is because you've got a foundation of a very good system that people can trust. And what is that? A lot is wrapped up in the LBMA and the people here today, where you have a very good clearing system, you have a vaulting system that

works and you have a Good Delivery List. People around the world use that and rely on that. I think in some ways they've taken that for granted because it has been a service that has been provided over the years. We are really at a point now where we need to look where we think this market is changing. I think we need to embrace the ETFs but also look where we want to move forward with that. I think it's important that these few changes are going on. I'm very supportive of it. The talk of moving even the PGM clearing into London, whilst part of it is controversial, and you could take either side of it, the reason why in the long term I'm quite positive on that is that I think it really sends a message that there is one desirable for the thought process. The monitoring and the future needs to be controlled under one umbrella, and certainly as Philip was saying, it is where the experience and expertise has been for well over 100 years. When I look at some of the challenges we need to be aware of, certainly in the space of the market makers, for example, I think we need to look at ourselves and make sure we are not just doing what we've always done but seeing how we can improve upon that. I think it's really important that where there is huge competition from the ETF space that we don't let that just engulf this market on the market making. Then we have a real commitment to providing that liquidity to the market because now we are seeing so many competing windows, whether it's the electronic trading or the ETF product. It is really up to us to actually continue to provide that liquidity in the market, and I think it is a challenge on the banks as well to make sure they are providing the products around that ETF, the added benefit ones, which I think Neil was alluding to, that if we were talking about this 12 years ago, the main focus of the banking community was the producer community and as a result of that, the central banks. Now I don't think that there are many banks here today that would say, probably except for some of the physical houses, that their major client now is the investor space. So I think Neil's point is pretty pertinent around the future product offering is going to be how do you actually create benchmarks on investing. With more passive people to begin with and their benchmarking approach to investing in gold, I look at how you can actually provide excess returns or facilities around that. I am going to leave that there, but I feel over the last year that there has been a lot more conservative thought about how we move this forward and I think just the very fact that we are having this debate today is a very positive way of making sure that all parties head in the right direction. Going back to the original comment, it is a threat but is also very much an opportunity. Thank you.

**Steve Branton-Speak:** Thank you Ray. Now in terms of format here, there are plenty of questions coming in. We have some that were prepared beforehand, which we would rather not use, but I would like to give priority to questions from the floor. I think it is a bolder question if you stand up and say it yourself rather than text it in, but I am happy to kick off with one of the texted in questions and we might as well get straight at it if you like.

**Question:** What impact will the CME's cleared OTC gold product have on our market?

**Neil Clift:** I think it is definitely an interesting development. We as banks, with a number of our counterparts, effectively cross-collateralise all of our trades so we would, when we trade with each other, post collateral to each other to mitigate the credit risk that we see. So the CME cleared forwards contract is important, but possibly not so important for us. More important for us is being able to trade with our clients and people who maybe aren't such great credit risks or maybe tenor-wise can't get out the curve. Generally, I think markets tend to optimise the cost of doing business and I think this will probably be the optimum solution, the cheapest cost solution for doing business with other counterparts.

**Raymond Key:** I think that there is a bit of a 'wait and see' approach to see how many people will take up the facility that is getting offered. I'm thinking we have no doubt that it is going to be successful in the medium term, but I think there's still a wait and see approach. The one thing that

I'm probably in some ways more bullish on and why I think it's great for the gold market is their announcement to offer gold as collateral. I think that's a huge statement, when we look at the future of gold and the reason why people are holding gold at the moment or a large number of people are: it's the safe haven and the security, it's a real statement that's going out to financial markets at the moment saying, 'when we can post dollars and euros and T bonds and other such things, why can't we place gold?'. I think that's fantastic for the bullion market because I think as a result of them being the leaders in that, I think that in a year's time that there's going to be all of the large exchanges that will move to that. It is a different part of that question, but I think it's a fantastic development for the business.

**Philip Clewes-Garner:** I'd like to turn it on its head and say, first of all, I'm not 100% sure that it will be the CME, so that will shock a few people. I think the regulatory environment in the States is such that it may cause great concern to a lot of people in Europe and I think that has to be looked at before you even go down that route. So should we have cleared forwards? Undoubtedly, it will add depth to the market and I also think the idea of collateral in the form of precious metals is great as initial or variation margin; it's fantastic for the market. I'm sure that it will add depth to the market and there will be more gold cleared in London, there will be more gold in all the vaults and it's a great thing, but I'm not convinced it will be only one company that has a cleared forward platform.

**Steve Branton-Speak:** I'm going to keep taking questions from the text here unless anyone's got something to stand up and ask.

**Question (Tim Wilson):** What is London's position vis-à-vis the rest of the world? We saw the LME make a bold statement two weeks ago at the dinner by declaring an open office out in Singapore, and I just wondered whether the London market has plans to become more integrated and more involved with the Asian market – if we see that is where business continues to grow and to develop.

**Steve Branton-Speak:** My interpretation of that question is what is the LBMA doing in terms of Asia. Clearly, Asia is the hot space for commodities, and we are blessed and cursed with the title of the London Bullion Market Association and what actually that mean in terms of what is quite clearly an international market now. Ray sits on the Management Committee of the LBMA and would be best positioned to kick off the answering of that question.

**Raymond Key:** Your point's very valid. I think as much we're talking about the future of the LBMA and the London market, and where does that go. I think your point is that that is fine but you can't look local, you also need to look global. Where are the future buyers going to be? I think that part of an initiative in London has to be not just insular but global as well. You've seen that through the ETF product offering alone. You're starting to get a lot more platforms where the ETF securities are listing: in Japan recently, they are putting products in the US, there's talk of all of these ETFs providing the next level of service, which will be more regional, different currencies. The point around that is that's all stone, it's still falling under the London Good Delivery List so it still comes back to London, but I think the point is that we still need to own it so we need to, as an industry, look at where the developments are going to come from and which regions. It's a good point that we need to have representation in those areas; as this expands, it is very difficult to manage just from London.

**Neil Clift:** I think the GDL is an exceptionally important quality to this market and I think no matter where liquidity is around the world, the London GDL and rules of the LBMA that are enforced will be applied globally. I do think that we will see new pools of liquidity opening up in

various other localities, as Ray said, ETFs, but also just other physical holdings as well. I don't think it's a bad thing. I think London will maintain its position as the place for delivery and the place where the price is quoted for, but that's not to say that you can't have location swaps quoted between various centres and that market become a lot more liquid so that people can easily move gold between various centres.

**Philip Clewes-Garner:** The market already has quite a depth to the location of swap physical business. If you talk to most dealers in Hong Kong, Japan, they've always got an interest in doing something or other against loco London, so I think that's there already. I will say that before London takes the edge, it may be an idea that the Asian participants in this market create their own environment, which they may do by talking to the LBMA or the London Precious Metals Markets Ltd in the future. If you consider as I said that the actual physical held in London is phenomenal. I think there's something like 250 million ounces of gold in London and 600 million ounces of silver. When you consider that on a global basis, it is phenomenal. We do need to think more about where our customer base is going to be in the future; there is no doubt about that. The Far East is more focused on physical, so there is always going to be this link between London and the Far East, one way or the other where there is physical coming in or going out to the Far East. It's a good question and I think Asia has to take the first step and create its own environment where there is some other organisation to talk to.

**Question (Tim Wilson):** Should the LBMA be proactive. I agree with you entirely, the Asian market should be cohesive, but should the LBMA be proactive going into that space?

**Steve Branton-Speak:** I think it's a bit of an issue of logistics, one of the good things in gold is that it is such a broad, deeper and higher turnover marketplace and, logistically, can the LBMA and its Membership and its Executive control all aspects of a vast market? It can't control the ETF, the ETF is equity. A lot of the metals trading businesses can't even trade ETFs because they can't trade equities. In my institution, ETFs are trading in the equity department, it's not even traded in the commodities business. We can't really control the Shanghai Futures Market, the Tokyo Market. There are lots and lots of aspects that the LBMA really can play a role in but can't control. As we debate this more and more, we come back to the conclusion that our crown jewel is the Good Delivery List and that is what is used in pretty well every instance of serious credible gold trading, the GDL is used some form or another. Asking the LBMA, we want to fashion and shape, but there is frankly a limit to what we can do. If someone wants to set up a Sydney gold futures market, they don't necessarily have to come to the LBMA, but what I do like is that if they set it up, I bet you they use the LBMA GDL as their contract spec. So we are challenged with what are we doing to fashion, shape and stay involved, but there are some sort of logistical questions as to how much control one group of people can have over what is a truly huge global business that is receiving so much media attention, so much interest. I think you just have to figure out what your role is – and it's a role and not control.

**Raymond Key:** Maybe the point there is that the LBMA should look at putting a resource in Asia, and that's not a controlling resource, that's more like information dissemination. Promoting what the London market does through all of these various services. So not controlling, more like just having a sales rep out there in terms of disseminating the information more locally perhaps.

**Neil Clift:** We've also got a fairly unique commodity here as well that actually to transport this commodity costs you less or about the same as it does for a spread on the spot price. It's a pretty unique commodity in that sense, so the transportability of it to move to other centres is relatively easy and probably will happen.

**Question (Ross Norman):** I fear that we're being a bit timid here. The issue as I see it is actually as was mentioned earlier on that the legacy problem is the 'London' in the LBMA. Maybe also the problem is the 'A' in the Association. The structure is not perhaps entirely appropriate for what we're looking to do here. This is less a question and more a statement if you like, and please feel free to challenge it. Ten years ago, you invited Sir John Harvey Jones to come here to talk to us about the market and he said: "Well, I fear it won't happen to you chaps because you're too fragmented." Ten years on, we still have a fragmented market. We have LPMCL; we have any number of institutions that need to be consolidated. We know that we should kick on with that. We have also a fragmented market in terms of the number of institutions that trade globally. I don't think we've challenged that and I don't think we've consolidated that level either. I would suggest that perhaps the association is the issue and that we need to create a structure appropriate for achieving an end. Perhaps defining what that end is, much like the LME, they have gone forward and very successfully dominated a market – as an association, it's a representation of Members. It doesn't have the clear remit of the LME, which is to grow globally in the way that they have. Perhaps the answer is to look at the structure of the LBMA, make it a for profit entity, and to rather more vigorously promote ourselves globally and to consolidate the market in the way that it needs to.

**Steve Branton-Speak:** This statement is a representation of a number of questions being texted in – variations on a theme. The LBMA is an association, it is not an exchange. Historically, it has not been a for profit business, it's been a trade organisation. I guess the question is, 'can the current structure of the LBMA and the Executive and the Committees best position itself to take this market to whatever the next phase is?'. That is a reoccurring theme during this conference and previously, and one of those burning issues if you like. So, who would like to start – Philip?

**Philip Clewes-Garner:** Fragmentation in the market is an issue. There is no doubt about that. I don't think you should focus on the LBMA, because you could say the same thing to the LPPM, the LPMCL, the three fixing members. Unless it becomes one organised company under one umbrella, you're 100% correct that the LBMA on its own is not going to be the one that does it. And there has already been one meeting between the Chairmen of all these organisations to try and focus on how we bring together all of these companies under one umbrella. That is the only way to take it forward.

**Ray:** I agree. When I said before it's a threat and an opportunity, I think if we do nothing, it's quite frankly worrying how this market could develop in terms of if we don't own it, we lose it. I agree with most of your points. It is good to know that those discussions are going on and I think ultimately for London, the LBMA and these other organisations really to own their future, they need to move ahead with it. I guess one of the challenges, because it is so fragmented, is actually putting a time line and getting the right people committed to making it happen. It is such a small industry, it's easy for people to become conflicted very quickly. I think you need to have the right people, and hopefully events like this motivate people to see that they need to own it and you get those conversations happening now, and there is a clear agenda to move things forward.

**Neil Clift:** I echo those comments. I think there is a perceived benefit in having a much more cohesive environment in which to trade in, and I think as I mentioned in my opening remarks, the fact that there are other exchanges going to be trading gold for locations other than London I think is something that we need to be cognisant of, and therefore having a London market that trades London cleared gold contract traded for here I think is important for us.

**Steve Branton-Speak:** I think there's also an issue of do we want a total solution, which I think you were inferring towards there Ross, or do we go for a piece-by-piece solution and more organic evolution. If you want a total solution, getting agreement amongst such a diverse collective is really hard. I mean selection of the location for a conference can take six months – can you imagine how long it would take to get everybody on board for a total solution. The total solution in the form of an LME solution, I think they have an 80-person Executive, we have a five-person Executive and five is a contract high in terms of staff. So you're changing it into a very different beast. I don't think anything is off the agenda, I think that is where we stand right now. Opinion is one thing, but execution is something very different. All of us have day jobs and none of us are going to get paid by the LBMA, so you have prioritise things so the execution of these ideas is perhaps more difficult than thinking them up. But there is a process in hand and I think the LBMA is probably having the most thorough reassessment of the path it's on, where it wants to get to, should it expand, should it joint venture somehow. I think that's all ongoing and I think a lot of that should be debated in this sort of forum, which is an open forum. I don't think the LBMA has ever been upset by people asking it questions about where it's going. There might be a timely point to answer things and inappropriate times to answer things, but I've seen a reasonable amount of openness from the LBMA.

**Steve Branton-Speak:** Can we throw that question back out to the floor? I think this is something that we can actually vote on. Should the LBMA go for a total solution which I think would mean a significant JV venture with somebody or should we go for something more organic? Yes or no.

**Voting Results: 60% Yes, 40% No**

**Steve Branton-Speak:** Well, that's good feedback. We'll try and change the theme a little bit, and remembering that this is a precious metals conference, one of the questions scrolling up and down here is:

**Question:** When is PGMs clearing ready for lift off in London and what about the PGM fix?

**Philip Clewes-Garner:** At my speech in the Platinum Dinner in May, I did say that we intended to look at loco London platinum and palladium clearing in the fourth quarter of 2009. That has been extended a bit because, in consultation with the fixing members, one of the fixing members needed more time to make sure that his company was prepared for a loco London fix and one of the issues from his side was the fact that a lot of his physical contracts were deliveries loco Zurich. The date that we intend to start having a loco London platinum and palladium clearing is 1<sup>st</sup> February. Apologies that it has been extended, but the target date now is 1<sup>st</sup> February and everybody hopefully will be on side.

**Steve Branton-Speak:** I think that given that Philip is Chairman of the LPPM and one of the four platinum fixing members, there probably isn't too much to add on that subject.

I would like to touch upon how the panel sees the role of electronic trading given that there has been an incredible rise in market share as to how much gold is transacted electronically, be it ETFs or futures, and what that means for the LBMA, what that means for relationships and how we see that progressing, going forward?

**Raymond Key:** I don't have a very strong opinion on that; I think the most important thing is making sure the system works and what I mean by that is that everything that the London market

does allow that to function because it's a very seamless process of delivering into physical. Electronically, where we're at, it's not in isolation. If you look at all markets, electronic trading is unequivocally going to grow and grow. I think what's going to be difficult is that over the next few years is when we will see so many products getting offered and I think there's a plethora of ETFs going to continue getting listed, like I said before, regionally, currency, other types of physical, ability to deliver. I think that we are going to get a lot more exchanges given the push to cleared forwards. I think that one of our difficulties is trying to work out the winners and losers. I think there's going to be a lot of noise in this space, but my view on electronic trading is that as long as it's set up correctly and it's promoting liquidity then that's where we're going. The obvious lesson is foreign exchange. In some ways, it's interesting in foreign exchange; what we'll see here is more consolidation in the industry. You now really have a few main players that really dominate that space, particularly on the electronic offering. You get a lot more look-through systems where all the second-tier participants can offer product but they are really streaming from the major players in that market. I think that's probably what will happen on the electronic trading side of it, but it can't work unless you have the experts on the physical side that allow that trade to settle.

**Neil Clift:** I think the role of market maker for the London market is insignificant in allowing our market to develop. We as a group of traders, market makers, agree that we will each quote each other a price when called and pretty much we agree on the kind of spread that we will quote each other as well. That has been a significant driver in allowing the London market to be the liquidity pool. As markets become more developed and liquidity moves onto the exchange, it's really about liquidity. If the electronic platforms have the liquidity pools then there is no need for the market making function. However, that will take a while to get to. I think the other thing to possibly say about this is that other platforms that have moved to this more electronic, maybe at the LME, there are issues thrown up in the fact that they can then be somewhat played around with in terms of what price is actually printed on the electronic system, where maybe there has really been a sweep by a trader or another maker moves the market very quickly, which you don't normally get in an OTC market. I think there are things you need to be aware of when you move into this electronic platform, but like Ray says, FX has gone there and I think that it is somewhat inevitable that we continue down that path.

**Philip Clewes-Garner:** I think FX is a completely different market. You trade dollars, they clear in the States. You can trade gold and you can clear it in 20 or 30 countries around the world. You can trade physical gold in Singapore, Hong Kong, New York, London or wherever, so it is a completely different environment. I think it would be highly dangerous to contemplate a market that was across platforms purely for two-day value or whatever. I think you really do need the underlying market making in the spot markets, which is when you think about it, where everybody goes first. You are going to trade forwards – where do you go first? You go to the spot market. If you want to hedge something? You go first to the spot market. There is obviously a place for all platforms, and today it's very rare for one market maker to actually ring up another one and ask him for a quote. I'm sure that that will continue. But you do need that natural hub, but given that it is physical and products backed by physical that are the flavour of the month.

**Steve Branton-Speak:** Adding a little bit to that, the market making role in spot, interbank, will always have a role. I don't think Goldman has been asked the spot gold price of another bank in a few years, which is actually a good thing. It suggests that the market has grown up; you don't need a pricing infrastructure that is there to provide liquidity, the fact that the gold market on a spot basis provides pretty good liquidity way above what the market makers can collectively provide. If you look at the position then it's amongst the market makers and the size of the gold market. The VAR capability isn't there for servicing some of the enormous interests that are in the market. The thing

now is that customers, their VAR in metals absolutely dwarfs the Bank's VARs. There are plenty of very high profile – a transaction last night of 200 tonnes is an example. So I don't think the interbank spot market – the demise of it – keep it there as an emergency when someone turns the power off or the fuse blows, but for day-to-day operations in terms of delta hedging, the electronic platforms are where it's at. I don't think anyone would be in denial about that.

**Phil:** Can I just add to that Steve? London always prides itself on the basis that you will get a gold price in London, and that was the same in Hong Kong because basically they followed the way London works. That will continue. I am not being detrimental to the New York market, but there was a problem on Comex or Nymex, they wouldn't quote the market. So the ability to have a cohesive spot market between the members of the market in London has always been beneficial to the customers of the bullion market. I think today it's a back stop; it's not needed every day of the week, maybe once a year. You never know when the platform is going to go down and, unfortunately, platform-orientated business means that you breed dealers who don't have the ability to quote on a spot basis if they're not careful.

**Steve Branton-Speak:** He is very old school!

**Question:** Does the panel believe the rise in demand in investment precious metals and the rise in price volatility will damage demand from physical end users in the medium and long term.

**Neil Clift:** I think as we heard from some speakers yesterday, the jewellery market is suffering somewhat in this high price environment. I think it is important that that market is focused on and built up, and that people do feel that gold jewellery is as important at a higher price as at a lower price. I think, initially, this higher price environment is somewhat impacting that. I think ultimately the ETF build-up will lead to further hedging. I don't think it will lead to a market that just continues ad infinitum so, yes, there are tectonic plates shifting what is going on, but I think the market is self-normalising in some degrees and, at some point, we'll not only see the jewellery demand picking back up as people become accustomed to the higher price, but we'll also see the market looking to sell into what is quite a high-priced commodity. I do think the miners at some point will come back to this market. They'll see the value; they have a strong competing product in the ETF space out there. It is a pure play in gold, as opposed to their product, which has very much got a lot of other risks wrapped into it. So therefore I think that they will also at some point look to come back into this market.

**Steve Branton-Speak:** Does the audience think that investor demand in the medium to long term can continue to more than offset lower physical and consumer demand in the precious metals space?

**Voting Results:** 61% Yes, 39% No

**Steve Branton-Speak:** Well, we've sat here for a couple of days and I've only actually heard one bearish comment, which was in respect of the silver price. We seem to have some consensus.

**Philip Clewes-Garner:** Just on that subject again, I think sensitivity to the gold price in its natural markets, which is basically India, the Middle East, Far East has diluted dramatically over the last 18 months. You only have to look at who bought 200 tonnes of gold in the last 10 to 20 days. India was so sensitive to the price of gold, if it went up \$2-£3 they would sell, and if it came back down, they would be buying. On any dip today of \$20 or \$30, you see physical interest in the market. So there is a definite change in the mentality towards the gold price. Who would have believed that

India of all countries would come out and pay \$1,045 for 200 tonnes of gold? So it is a change in sentiment, in the environment.

**Steve Branton-Speak:** Hopefully, this has been of some benefit. We've touched on some of the issues. I don't think we have entirely sat on the fence, but we'll try to be a little less timid.

**Raymond Key:** Ask the audience – who would prefer a cleared forwards solution in London versus the US?

**Steve Branton-Speak:** So (1) US-based / (2) Non US-based / (3) Both – a competitive marketplace.

***Voting Results: 9% US, 34% London, 57% Both***

**Steve Branton-Speak:** Thank you for the questions. It's been a pleasure and I'll pass over to Ruth and Stewart.