LBMA

Alchemist

The London Bullion Market Association ISSUE 63 August 2011

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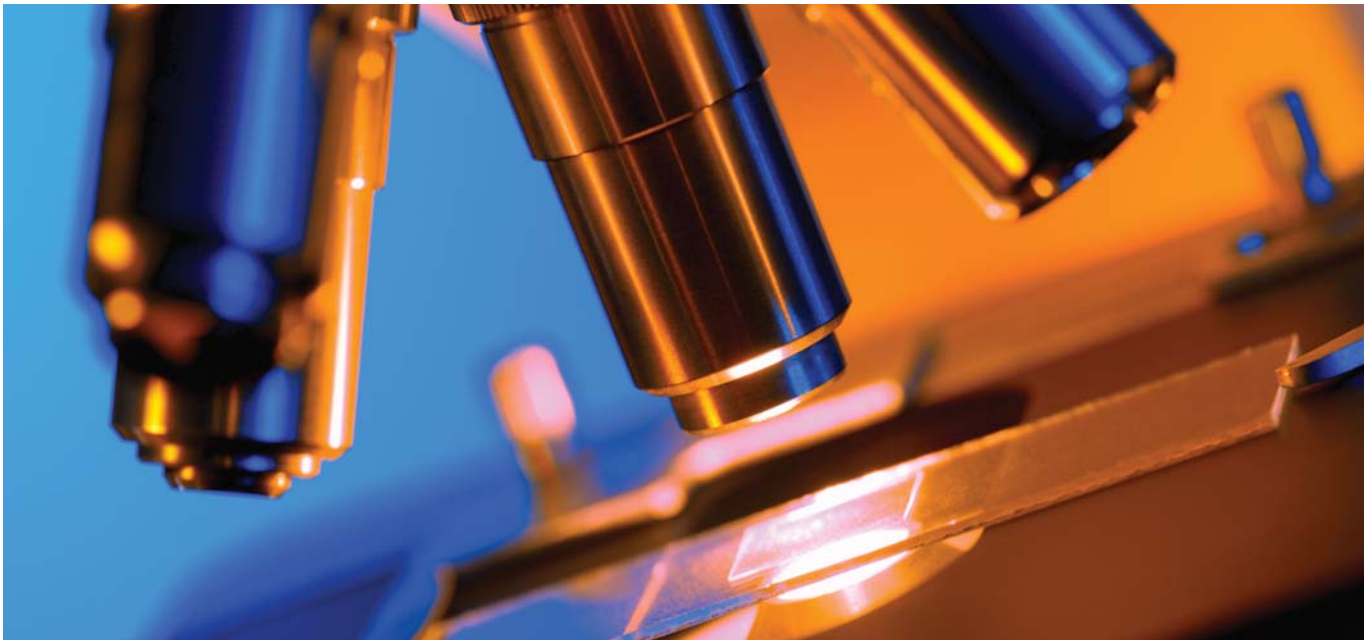
Banro Corporation's Gold Mine Project – Legitimate Mining in the DRC

The issue of conflict minerals, including gold, in the Democratic Republic of Congo is being hotly debated in the wake of the US Dodd-Frank Act. Most discussions focus on illegal mining operations. But there is another side to gold production in the DRC. The photograph shows Banro Corporation's gold mine project at Twangiza in the east of the country which is expected to start commercial production in the fourth quarter of 2011. For further information see the Regulation Update – Supply Chain Due Diligence article on page 23.

REACH Challenges

- *Past, Present and Future*

By Violaine Verougstraete, Health and Alloy Manager, Eurometaux



A review of the challenges faced by industry and regulators with regards to REACH. REACH is the European Community Regulation on chemicals and their safe use. It deals with the Registration, Evaluation, Authorisation and Restriction of Chemical substances.

The entry into force of the REACH Regulation (EU Regulation No 1907/2006) has given significant impetus to non-ferrous metals science and to the development of tools, so as to be able to address its chemicals management requirements.

The need to maintain 'access to the EU REACH market' and the obligation to demonstrate 'responsible care' within a fixed timeframe have forced us to acquire a better understanding of the hazards and risks of our materials along their lifecycle, and across the exposures, uses and forms of the substances. Moreover, we had to take over the duty of ensuring the proper risk management of a substance, from cradle to grave, thereby going beyond the usual management area, e.g. a production site.

These obligations have prompted a huge effort to generate data since 2006; prompting industry to go back to existing knowledge – either publicly available or available as grey literature lying around in drawers – in an attempt to fill in the holes in the somewhat frightening 'data gap analysis' exercise. Strategies to make the best use of available data, to generate the missing information, and to develop methodologies and tools had to be agreed by groups of people sharing interests in one and the same substance, but who did not *per se* know each other. This all had to be done within a limited timeframe, which triggered some animated discussions on technical, cost-sharing and resource aspects.

Besides being an 'information generator', REACH has actually proven to be an incredible communication challenge, forcing the actors within the same supply chain to establish work and communication procedures, to exchange information on what constitutes the reality of the one and the other, and to ensure rapid and joint familiarisation with the subtleties of both the legal context of REACH and its implementation.

A significant number of metals and metal compounds had to be registered before the first REACH deadline (1 December 2010), which added considerable time pressure to these knowledge and communication challenges, resulting in some exhausted looks from consortia managers when we as Eurometaux – conveniently not registering – had to announce changes in guidance documents or in the tools.

All in all, the sector was able proudly to announce on 1 December that the non-ferrous metals industry had successfully

reached the first REACH registration deadline, and even to add, in the same enthusiastic sentence, that we were aware that this first deadline was only a first step and that other challenges would follow.

The post-2010 registration recovery period has actually been short. Not only because the sector had to get down to the business of preparing the registration of lower tonnage substances, but also because some of the challenges that we had foreseen in December soon began to show their faces, during "post-registration debriefings" organised by industry and in meetings with the REACH enforcement regulatory authorities.

Future Challenges

At this point, let me mention some of the challenges I see in the follow-up to registration at consortia, regulatory and site level. The focus will deliberately be on some of the technical challenges, which may in my opinion have an impact on the overall valuation of the data collection effort for registration.

To start with, the fact of having submitted a dossier for a substance on 1 December did not mean that the 'R' ('Registration') page of REACH could be turned. It remains an active process, requiring further attention and resources from consortia – not always planned for at the time when the consortia were set up. There will be the necessary updates of the submitted files linked to for example new information becoming available, or triggered by ECHA guidance changes and/or future reviews of REACH. In addition, some cosmetic updates of certain files are necessary. As a matter of fact, it should be realised that despite the general willingness and considerable efforts made, the dossiers submitted in 2010 have often only been "as good as possible" and could still have some weak spots when it comes to evaluating their completeness and defending a substance. Even in the non-ferrous metals sector, which has a solid tradition of co-operative work and is skilled at working together on multi-metallic risk assessment and classification projects, some differences among the dossiers can be detected. The approaches used are broadly similar, but the devil is lurking in the detail behind missing justifications, overly brief explanations, and sometimes inconsistencies between one compound and another. These flaws are a visible sign of the lack of time before the 2010 deadline, which did not enable all the metals to move together, at the same speed, towards complying with all the information requirements. Work has begun on addressing these shortcomings, but it will take time and will involve further resources that will have to be accounted for in consortia work programmes.

Within the last four years, industry has of necessity built up significant expertise in chemicals management and in 'thinking in applied mode'. We have been driven by the need to find pragmatic solutions to conceptual issues. Some examples are: a) how to deal with the aspects of 'data-rich substances' in a system designed for 'data-poor' and 'safety factor' approaches; b) the management of uncertainty versus precaution; and c) the consideration of aspects such as the massive form of the material or its 'complex composition'. To overcome defaults in guidance documents or overly predictive estimations generated by models that did not take account of metal-specific aspects such as natural occurrence, certain biological mechanisms and essentiality, we had to go back to the sector data and develop metal-specific tools and approaches. These 'solutions' have required discussions, exchanges of information, workshops and significant volumes of 'guidance notes' spread throughout all the consortia. Interestingly, this essential move to pragmatism has enabled more industry people to be involved in the technical discussions, previously left up to the metals science professionals. Compared with three years ago, both in associations and companies, many more industry people are now used to finding their way around the jungle of acronyms used in metals science; they understand what risk assessment means and question the practical implications of classifications, Derived No Effect Levels (DNELs) and Exposure Scenarios. The situation naturally still leaves room for improvement, but overall, knowledge has increased and been brought right up to date.

All in all, the sector was able proudly to announce on 1 December that the non-ferrous metals industry had successfully reached the first REACH registration deadline, and even to add, in the same enthusiastic sentence, that we were aware that this first deadline was only a first step and that other challenges would follow.

Regulators and Industry Experts – Communication Challenges

What about the regulatory bodies' experts? The setting up of REACH and its sequential implementation (focusing first on registration, then evaluation and finally authorisation) seem to have put certain regulators on hold to some extent. They had to prioritise the organisation of enforcement activities and resources for the further REACH processes. They also had to wait for the dossiers to become available, rather than being actively involved in brainstorming on technical issues in the dossiers as they may have been in the past. Regulators seem to have been somewhat out of the technical information circuit. On the other hand, several regulators seem to have made use of that registration time to better qualify what they are expecting from the REACH process and to identify the shortcomings of REACH that need to be addressed (e.g. combined effects).

There is an unfortunate timing incompatibility here: while we as industry are now awaiting their evaluation and would now be in a position to communicate on lessons learnt from registration, the REACH Regulators are now themselves faced with a huge amount of information, are subject to time pressure and are propelled towards 'learning by doing' within newly set-up committees, with new fields to address. 'Breaking in' the system and limited timeframes do not give regulators much opportunity either to familiarise themselves with the recent science and techniques built up for REACH by the various sectors, or to communicate on their registration period reflections.

This mismatch in schedules and priorities now leaves us with a kind of gulf between authorities and industry. For as long as both sides cannot meet and find means and dialogue on their respectively acquired expertise, this gulf could, in my opinion, adversely affect the discussions on the REACH dossiers and substances:

- First of all, despite the fact that we have never had as much information as now, the word 'precautionary' again seems to be

actively part of the debates. Without becoming familiarised with this mass of data, how to handle the latter and their limitations, the 'unknown' remains a barrier, whatever the amount of information that may impel regulators to remain precautionary or not to fully consider the data collected.

- There is a normal human tendency to go back to what is known rather than diving into the unknown, particularly when there is pressure to deliver a certain amount of work. This can now be observed in the choice of some substances to be scrutinised through REACH processes: some of these have already been extensively and exhaustively discussed in earlier or other Chemical Management systems, and the question then arises as to whether this will enable the objective of REACH to be achieved, i.e. to streamline and improve the former legislative framework.

Going Forward

It is imperative to avoid discussions hampering the added value of the efforts made by both industry and regulators. Although the roles and rules for the REACH actors are well outlined in the legal text and guidance documents, this does not prevent emotion and/or frustration from bubbling up. I believe that it is even more vital to overcome this communication challenge when considering that it was not possible to solve all the technical issues in risk assessment and classification before December 2010. In the metals sector, we still have ahead of us a number of important questions to solve, related for example to the characteristics of "complex materials", to testing difficulties and/or to data generation. We need a platform where we can discuss methodological proposals with experts involved in REACH committees and regulators involved in enforcement, so as to be able to propose the most appropriate safe use solutions to industry. Such platforms would allow us to discuss also forthcoming scientific challenges that are currently not covered by the scope of the REACH, such as the importance of diffuse emissions, mixture toxicity, etc.

Finally, we need to address the challenge of making the best use of the data generated at all levels, thinking beyond just the REACH-related steps. This is true for the EU, where companies are still exposed to legislation and regulatory 'hints' other than REACH. While efforts are being made at legislative level to solve some potential overlaps and to streamline the overall framework, responses should be found in the meantime to the practical questions that companies may pose: how to evaluate the REACH data, how to make the best use of the 'core tools' of REACH, such as Exposure Scenarios and DNELs, how these should be incorporated into day-to-day practice versus older references or tools proposed by other pieces of legislation. To address this could avoid filling cupboards once again with piles of unread papers.

It is imperative to avoid discussions hampering the added value of the efforts made by both industry and regulators. Although the roles and rules for the REACH actors are well outlined in the legal text and guidance documents, this does not prevent emotion and/or frustration from bubbling up.

Outside the EU, several jurisdictions are following with interest what is ongoing in the REACH scene, in order to both draw lessons and get information. This is an opportunity for some harmonisation of datasets and of technical aspects; and the OECD definitely plays a key role in this field.

Conclusion

REACH does not end with the successful submission of a completed registration dossier. This is only the beginning, in fact. A number of challenges and difficulties arise that could impact on the further process and its success. While these challenges seem to weigh preferentially either on the industry side or on the regulatory side, they concern all the REACH actors involved, and it is by solving them together that we shall guarantee the functioning and valuation of the efforts made up to now.

Violaine Verougstraete
Eurometaux

Violaine Verougstraete studied medicine and toxicology at the Catholic University of Louvain, did a DEA in Public Health and obtained her PhD in Public Health in 2005 from the Catholic University of Louvain (Belgium).

She worked as a researcher at the Industrial Toxicology and Occupational Medicine Unit of the Catholic University of Louvain for eight years. She collaborated in the EU Risk Assessment "Cadmium and Cadmium Oxide". Since May 2005, she has been working for Eurometaux as Health and Alloys Manager. She is currently co-ordinating the scientific activities and projects of Eurometaux, such as for example the HERAG and MERAG (risk assessment) projects, classification projects, and human toxicology and ecotoxicology-related activities.

LBMA Executive's Visit to Brink's New Vault

By Varsha Peiris and Collett Roberts, LBMA

In April 2011, the LBMA Executive embarked on a visit to Brink's UK's new bullion vault, located within the M25.

About Brink's

Brink's is a secure logistic organisation involved in various sectors including the transportation, handling and vaulting of precious metals, with over 150 years of experience. It is the third-largest bullion vaulting organisation yet the only one which is not a banking institution and the largest bullion carrier in the UK. Brink's Ltd (UK), headquartered in London, has been an Ordinary Member of the LBMA since April 1988.

First Impressions

We arrived at the secret location; Brink's new above-ground vault. Instantly, there was a distinction compared to its other vaults that we have visited when attending bar inspections. The new vault had a distinguished interior and exterior primarily due to the apparent massive investment in external security. This vault joins the ranks of Fort Knox, which also has above-ground vaulting facilities.

Once through security, we were met by Simon Churchill, Sales Executive. Simon introduced us to various senior members of staff, including Ms Orit Eyal-Fibeesh, Managing Director, and Phil Wright, Head of Security, who gave us the LBMA's exclusive tour.

The Need for Expansion

Before the long-awaited tour started, we were given an informative briefing as to why Brink's had taken this huge step to expand and build a new vault. Due to the uncertainty in the financial market, investors keen to invest their funds in a secure commodity had turned to the precious metals markets. In light of this perception, they had begun investing in gold because it was seen as a 'safe haven', and retail as well as wholesale transactions caused the demand for supply to rise significantly. Consequently, the transportation and storage of physical bullion had increased in line with this demand for physical stock. Having a vault above ground made dealing with the higher volumes and physical movement easier, due to the good access points.

Security

The vault took nearly two years to build, using impeccable security skills and materials to make it the highest European CEN grade that currently exists. Given its unique status of one of the first above-ground vaults in London, additional security was required. Layers upon layers of structural security precautions were included in the build. These were to prevent lorries from being able to ram the vault as well as to prevent intruders approaching by helicopter or catapult. This new vault actually has higher than the maximum security rating required, which leads us to think that it should be nominated for a scene in a James Bond movie.

The Tour

The Executive began their journey around the labyrinth of steel and high-tech security; it was like walking around a showroom. However, we were instantly reminded that we were in a bullion vault when we reached the stacks of silver bars. These bars were stacked on pallets to almost full capacity of the floor, which felt like the size of half a football pitch. The sheer depth and volume of the vault was very overwhelming.

After travelling through the silver and coin vaults, we finally reached one of the gold vaults. Working at the LBMA, we were

particularly excited to see the London Good Delivery bars. However, security at this point was of course extremely high. It was an amazing feeling to be standing so close to these gold bars that were locked up behind bars. So close, but yet so far!

During the tour, it was interesting to see both new and old machinery being used, such as the electronic weighing scales and the traditional beam balances. It was clear that although vault staff were keen to use the new electronic scales introduced in 2010, they were not quite ready to let go of the tried and trusted way of weighing bullion on the traditional beam balances.

Future Plans

After our exclusive morning tour, we were treated to a lovely lunch with all of our Brink's hosts and were given the background of Brink's Ltd as well as the opportunity to ask questions. It was interesting to learn about the importance for Brink's to maintain a perfect balance between storage volume and liability/security. We were surprised to learn that although this new vault had only been open for a very short period, it was already nearly full. Due to the continued demand for secure vaulting space, Brink's was already considering expanding by building another new vault.

The LBMA would like to thank all the staff at Brink's involved in arranging this visit and we are looking forward to our tour of their next vault!

Loco London Liquidity Survey

LBMA Gold Turnover Survey for Q1 2011

By Stewart Murray, Chief Executive, LBMA

Background

At its meeting in April, the Management Committee agreed that the Executive should carry out a survey of Members' trading turnover in the loco London gold market. All members were asked to volunteer data, by providing, on a confidential basis, their turnover figures for spot, forwards and other transactions in the first quarter of 2011, with the data to be divided, if possible, between trades with other members and trades with non-members. As most readers will be aware, the LBMA is not an exchange and it does not require its members to report on turnover. The only statistics which are produced on a regular basis by the LBMA are the monthly clearing statistics, based on returns from the six clearing members which together form the London Precious Metals Clearing company. The only previous surveys of trading turnover were those carried out by the Bank of England in 1991, 1994 and 1996, and these were restricted to the LBMA's market makers.

So, why did the Management Committee decide to authorise a survey of members' gold trading? The answer lies in Europe or, more precisely, in the discussions within the Basel Committee on Banking Supervision on the new liquidity regulations for banks. The issue is whether gold should be considered as a "high-quality liquid asset" so that it can be included in the liquidity buffers that banks must meet. Although the Basel Committee did not recommend the inclusion of gold in these liquidity buffers, the implementation of the Basel guidance by national legislators and the European Union legislators may still allow gold to be included if they can be persuaded that gold is, indeed, a high-quality liquid asset. The World Gold Council has been pursuing this goal over the past two years and it requested the LBMA to carry out a survey of turnover in order to strengthen its argument that the gold market is sufficiently deep and liquid to justify gold's characterisation as both high quality and liquid.

Conduct of the Survey

All Members were sent the reporting form at the end of April, which asked for the data on spot and forward transactions to be divided into sales and purchases, and between members and with other counterparties. The third catch-all category of "other transactions" was also included to cover, for instance, options and bullion-related commodity swaps. The data to be included in the survey did not include deposits or loans.

From the outset, great care was taken to ensure the confidentiality of the data submitted. All Members were given an identifying code and asked to use that on the reporting form rather than their company name. The list of identifying codes was maintained in an encrypted file that only two members of staff had the password for. All members were given two data delivery points, which were the LBMA or the Bank of England.

Results of the Survey

Ultimately, 36 of the 56 Full Members involved in trading gold submitted returns. These included all of the LBMA's spot and forward market makers.

The results of the survey are summarised below in terms of daily averages during the period (Figure 1). Also shown for comparison are the clearing turnover statistics. It should be noted that the figures provided for trade between members were divided by two in order to avoid double counting. This is rather conservative in that many of the trades reported with members would be with members that were not themselves reporting. The figures for sales and purchases should be added to get an idea of the total trading turnover.

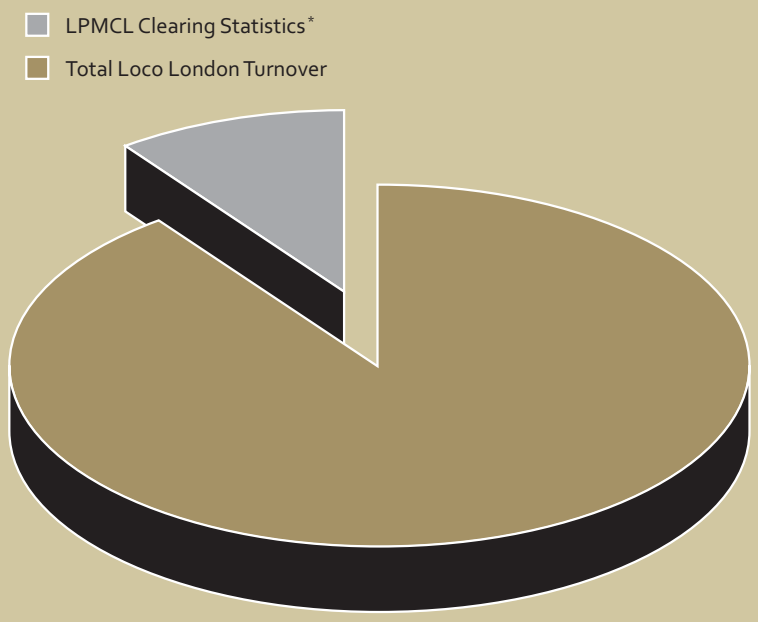
Figure 1 - LBMA Survey of Loco London Gold Turnover

	Q1 2011 Turnover*					
	'ooo ounces		Number of trades		Total Value (Sales)	Total Value (Purchases)
	'Sales	'Purchases	Sales	Purchases		
London Turnover	5,593,743	5,350,183	201,713	184,140	$7,754,438,081,578	$7,416,798,373,170
Total Loco London Turnover	10,943,926		385,852		$15,171,236,454,748	
LPMCL Clearing Statistics	1,183,459		122,303		$1,640,689,519,546	
London Daily Avg	173,713		6,125		$240,813,277,059	
Spot	89%	91%				
Forwards	5%	4%				
Other	6%	5%				

*Source: LBMA, Comprised of data from 36 LBMA Members, including all spot and forward Market Makers, for spot and forward Loco London transactions

Figure 2 - LBMA Survey of Loco London Gold Turnover - Q1 2011

Loco London Q1 2011 Turnover compared to Q1 LPMCL Clearing Statistics



LPMCL Clearing Statistics*

These figures contain:

- Loco London book transfers from one party in a clearing member's books to another party in the same member's books or in the books of another clearing member
- Physical transfers and shipments by clearing members
- Transfers over clearing members' accounts at the Bank of England.

Excluded from these statistics are:

- Allocated and unallocated balance transfers where the sole purpose is for overnight credit
- Physical movements arranged by clearing members in locations other than London.

It can also be seen that there is an approximately ten to one ratio between the turnover figures and the clearing statistics (Figure 2). It can be seen that spot transactions form the large majority of the total (around 90%), with forwards and other transactions each representing around 5%. The average daily trading volume in the London market in this period was 173,713,000 ounces or $240.8 billion (Figure 1).

Basel III Implementation –European Parliament Update

In July, the European Parliament voted unanimously to recommend that central counterparties accept gold as collateral, under the European Market Infrastructure Regulation (EMIR).

It is very significant that the European Parliament is putting its weight behind the argument that the unique characteristics of gold make it an ideal form of high-quality liquid collateral. We now look forward to the European Parliament and Council of the European Union upholding the inclusion of gold in the next stage of negotiations around EMIR, which will take place in September.

Natalie Dempster, Director of Government Affairs at the World Gold Council, commented on the vote:

"It is very significant that the European Parliament is putting its weight behind the argument that the unique characteristics of gold make it an ideal form of high-quality liquid collateral. We now look forward to the European Parliament and Council of the European Union upholding the inclusion of gold in the next stage of negotiations around EMIR, which will take place in September. The ratification would mark a significant step forward in redefining what constitutes a highly liquid asset under the Capital Requirements IV Directive too.

Market demand for gold to be used as a high-quality liquid asset and as collateral has been building for some time. In late 2010, ICE Clear Europe, a leading European derivatives clearing house, became the first clearing house in Europe to accept gold as collateral. In February 2011, JP Morgan became the first bank to accept gold bullion as collateral via its tri-party collateral management arm. Exchanges across the world, such as the Chicago Mercantile Exchange, are now accepting gold as collateral for certain trades and London-based clearing house LCH Clearnet has said that it also plans to start accepting gold as collateral later this year, subject to regulatory approval. As regulators from G20 countries demand that more OTC trading is centrally cleared and with the on-going world economic difficulties further eroding the creditworthiness of other forms of collateral, we expect to see increasing demand by clearing houses, exchanges and investment banks to use gold as collateral".

LBMA Summer Secondment

Emma Attridge, Bank of England

By Emma Attridge, who works on the Custody team at the Bank of England, recently completed a secondment to the LBMA in June 2011.

The major focus of my work as an LBMA Secondee was related to the LBMA Good Delivery system. This was particularly interesting to me, given my role in the Custody team at the Bank of England. The major projects I worked on were in relation to the development of the LBMA visual guide, including management of images and submission of images from the London vaults.

Internal Image Management of Good Delivery Images

The goal was to install, set up and customise software for use by the LBMA in the management and organisation of its image database, specifically Good Delivery related images. I learned about the types of defects and imperfections that can occur on GD bars, and was introduced to the administration interface of the GDL website. Using the defects section of the website as a reference point, I customised the Zoner software for future use by the Executive. I also worked with Rebecca Adamson, LBMA GDL Assistant, to formulate a system for accepting new images from vaults, processing them using Zoner and subsequently adding relevant images to the GDL website.

Vault Submission Process

I was given a brief to produce an Adobe format form to be used by vaults when submitting images of defects and imperfections to the LBMA. I liaised with the Bank of England (Barry Gull) during a trial period, to ensure the efficiency of the new submission form. The form is now in full use by all London vaults. The collection of these images assists the LBMA Executive in creating best practice guides for the Good Delivery system.

Loco London Survey of Turnover

The LBMA recently conducted a Survey of OTC Gold Turnover to assist with the WGC lobbying efforts to ensure that gold is treated as a high-quality liquid asset by the EU. I assisted by collating data as well as calling outstanding senior management level contacts at more than 30 companies to chase up their submissions. This resulted in a sizable submission from the LBMA Membership. For further details on the LBMA Survey of Turnover, please see the article on page 9-10.

Meetings Attended

I attended the Physical Committee meeting, the Referees' Meeting and the LBMA AGM, which greatly assisted my understanding of the importance of the work I was doing. I also participated in the team's weekly staff meeting, where I gave a confident and clear summary of the work I had been doing to date.

My Time at the LBMA

I am grateful to have been given the opportunity to work at the LBMA for a month. The experience was valuable in terms of consolidating all previous knowledge I had of the LBMA's work and building upon it. I learnt a lot from all LBMA Executive members and appreciate the time that they gave up to share their knowledge with me and answer my questions. It amazes me that such a small team copes with such huge work volumes, especially when there are international conferences and meetings to attend. It has been great to meet so many market members and finally match names to faces! I would recommend the LBMA Secondment programme to anyone involved in precious metals trading who wants to delve into the complex issues challenging the London market and become engrossed in the Good Delivery List.

I am grateful to have been given the opportunity to work at the LBMA for a month. The experience was valuable in terms of consolidating all previous knowledge I had of the LBMA's work and building upon it.

LBMA Secondments – Going Forward

Given the positive experience of Emma's secondment to the LBMA, both institutions have agreed to continue this successful programme. The LBMA is delighted to be welcoming Aelred Connelly of the Bank of England to be the next participant in the programme beginning in September 2011. Thanks to all involved, particularly Trevor Stone, Louise Lee, and of course Emma Attridge and Aelred Connelly at the Bank of England, for making this programme possible.

The Real Price of Gold

By Fergal O'Connor, LBMA Bursar and Dr Brian Lucey, Associate Professor of Finance, School of Business Studies, Trinity College, Dublin

The extraordinary flows into gold, from investors seeking safe haven or just prudent diversification coverage, have contributed to a sustained increase in its price to new nominal highs. Inevitably, this has given rise to a significant body of discussion on whether gold is a bubble or not. It can be useful to step back from the day to day and to think a little about what exactly a bubble is and is not. From the economic perspective, a bubble is an unsustainable level (which can of course be either positive or negative) of an asset relative to its 'true value'. Gold can be viewed as one of two basic asset classes. It may be thought of as a currency or a commodity. Which is the truer representation is important if we view some of the current discussion about whether gold is currently in a bubble phase.

In addition, we must think about 'rational' and 'irrational' bubbles. Rational bubbles are situations where investors know the size of the bubble, and have only differing expectations about its duration, but share a common model of the fundamental and bubble component of prices. Again, however, we require a model of the fundamental value, as well as some heroic and unrealistic assumptions about investors' expectations. For some recent studies on rational bubbles, the reader is referred to Fukuta, 2002 or Cuoado, Gil-Alana, & de Gracia, 2005.

Many articles argue that gold is in a bubble phase by looking at its real (i.e. inflation-adjusted) value and that it is currently far above its long-run average in relation to all major currencies, e.g. The Economist blog 27 July, 2011 – *Turning gold into dross*. These turn gold's nominal dollar price into a real price using the US inflation rate. In this view, gold is a commodity that happens to be denominated in US dollars and thus whose price can be deflated in the same way as any other commodity. If gold is purely a commodity then its real value in any currency over time can be found using its US dollar price, the exchange rate between the dollar and the domestic currency along with US inflation. But that means that we cannot easily, if at all, determine the existence of a bubble in gold prices, as the bubble component can be either the exchange rate or the dollar value, or indeed the price itself. Research on commodity bubbles, such as the papers by Sornette, Woodard, & Zhou, 2009 on oil or Jirasakuldech, Campbell, & Knight, 2006 on real estate, use duration dependence models (such as that introduced by Chan, McQueen, & Thorley (1998)), which while empirically easy to implement, work on the basis that every asset must show fluctuations in price and thus runs of upward-only price movements cannot continue indefinitely.

However, if we view gold as a currency, then it should have its own inflation rate. Why should it have the same inflation rate as any other currency? Inflation is the rate at which the purchasing power of a consumer erodes over time. Merely picking the dollar's inflation rate as it is the currency that gold is generally traded through is arbitrary and a historic relic. But since gold is not in general use day to day as a method of exchange, there is no easy way to calculate an inflation rate of gold. Gold is used as a method of exchange in certain states in America (e.g. Utah), but in a way that seems to preclude measuring its inflation-adjusted value. In these states, purchases made using gold are in practice made at the goods' dollar value, not gold weight, and are paid for in gold at its market price relative to the dollar. So a purchase price of $1 for an item is worth about 1/1,700th of an ounce of gold at today's values. If the market value of gold increases by $100 dollars an ounce, only 1/1,800th of an ounce is needed to buy the item. This however does not indicate that gold has suffered a deflation, or the dollar an

inflation. It simply means that the exchange rate of the dollar and gold has changed. It could just as easily be due to a change in relative yields, or some other fundamental determinant of gold and/or the dollar's value.

If Purchasing Power Parity held in relation to the dollar/gold exchange rate then, in the medium term, the amount of gold in ounces relative to dollars would be stable when their relative rates of inflation were taken into account. But is it possible to measure the gold inflation rate? To do this, we would need to observe an area where goods prices were denominated in ounces of gold *directly*, not through another currency that will have its own rate of inflation. No such market exists to our knowledge.

Conclusion

The fact that the inflation rate of gold is not directly observed does not prove that gold is or is not in a bubble phase. But the real dollar/gold exchange rate can only be shown if we can observe changes in the relative purchasing power of gold and the dollar, using their respective rates of inflation, as well as the dollar/gold exchange rate. Part of the puzzle is missing. That is not to say that gold will always increase in price. It is to say that it may well be an inherently heroic task of measurement to determine same.

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is the 2011/2012 recipient of the LBMA Bursary and a PhD student at Trinity College Dublin.

Dr Brian Lucey
is a Professor of Finance at the School of Business at Trinity College Dublin, where he is director of the MSc finance programme. He studied at graduate level in Canada, Ireland and Scotland, and holds a PhD from the University of Stirling. His research interests include international asset market integration and contagion; financial market efficiency, particularly as measured by calendar anomalies; and the psychology of economics.

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LBMA Bullion Ma

The local forum for the globa

The LBMA Bullion Market Forum – Shanghai
With 196 delegates taking part in this one-day event, the LBMA Bullion Market Forum – Shanghai was a great success. Participants included the bullion department Managing Directors from all the major Chinese banks as well as significant international participation. Our thanks go to all speakers, delegates and exhibitors for participating in this prestigious event. As compared to the LBMA's annual conference, which focuses on issues facing the entire international bullion market, the LBMA Bullion Market Forum – Shanghai focused primarily on the local Chinese bullion market. The LBMA has held previous Bullion Market Forums in Delhi and Moscow, and is looking to hold a future event in New York.

rket Forum 2011

l industry: Shanghai

Management Committee Delegation to China
Thanks also to all those members of the LBMA Management Committee who took part in the MC Delegation to China. This delegation was made up of the following participants: Kevin Crisp of Mitsubishi Corporation International (Europe) Plc, Philip Aubertin of UBS, Simon Churchill of Brink's Limited, along with Stewart Murray and Ruth Crowell of the LBMA. The delegation was a strong group and had many successful and important meetings. These included meetings in Beijing and Shanghai with the China Gold Association, China National Gold Group Corporation, People's Bank of China Financial Markets Dept, Shanghai Futures Exchange and Shanghai Gold Exchange.

DIARY OF EVENTS

SEPTEMBER
18-20
LBMA Precious Metals Conference
Montreal, Canada
Tel: +44 (0)20 7796 3067
conference@lbma.org.uk
www.lbma.org.uk

27-28
Global Mining Investment Conference
London, UK
Tel: +44 (0)207 754 5994
ros@objectivecapitalconferences.com
www.objectivecapitalconferences.com

OCTOBER
4
LME Dinner
London
www.lme.com

25-27
World Commodities Week 2011
London
Tel: +44 (0)20 7092 1000
enquiry.uk@terrapinn.com
www.terrapinn.com

25-28
China Investment Summit 2011
London
Tel: +44 (0)20 7092 1000
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FEBRUARY 2012
6-9
Mining Indaba Conference
Cape Town, South Africa
Tel: +1 859 746 5700
info@miningindaba.com
www.miningindaba.com

23
LBMA Annual Party
London, UK
Tel: +44 (0)20 7796 3067
events@lbma.org.uk
www.lbma.org.uk

MAY
17-19
World Mining Investment Congress
London
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JUNE
9-12
IPMI Conference
Las Vegas
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The Shanghai Gold Exchange and its future development

By WANG Zhe, Chairman and President of the Shanghai Gold Exchange

The following is an edited version of a keynote speech made at the LBMA Bullion Market Forum in Shanghai on 26 May 2011.

At the 2004 LBMA Conference in Shanghai, Central Bank Governor Zhou Xiaochuan proposed a 'three transformations' strategy, which led the way for the development of the Chinese domestic gold market. It is an honour that six years later the LBMA has decided to return to Shanghai to host such a high-profile forum.

Since then, the Shanghai Gold Exchange (SGE) has embarked on a fast-paced development. Today, I am here to give you an introduction to the services of the Exchange and share our experiences. I will give a brief history of the development of the Exchange over the past six years, and mention some ideas about its future development.

History of the SGE

The Exchange was officially opened on 30 October 2002. It currently has 163 members, including major domestic commercial banks, five foreign banks, and firms involved in gold production, consumption and investment. It has nearly seven thousand institutional clients and over two million individual clients. The Exchange has twelve types of contract in gold, silver and platinum. It undertakes other business including spot physical, deferred trading, forwards and individual physical investment.

Since 2004, the Exchange has continued to develop. Its trading volume has increased at a rate of about 40% per year, increasing even more quickly in 2008 and further in 2010. In that year, trading volumes of gold and silver reached new records: 6,051 tonnes of gold at a value of RMB 1,615.78 billion, 73,615 tonnes of silver at a value of RMB 386.33 billion and 54.69 tonnes of platinum at a value of RMB 19.84 billion. In 2011, the market maintained rapid growth and the variety of silver contracts grew at an explosive rate.

By the end of April this year, the Exchange had traded 1,909 tonnes of gold, 73,569 tonnes of silver and 20.88 tonnes of platinum, a total transaction value of more than RMB 1 trillion.

From the opening of the Exchange in 2002 to the end of April this year, more than 20,000 tonnes of gold, nearly 170,000 tonnes of silver and 300 tonnes of platinum were traded. The total transaction value exceeded RMB 5 trillion.

Chairman Wang Zhe (far right) at the LBMA Bullion Market Forum - Shanghai 2011.

Market features

The Exchange can be described in terms of the following six major features.

Spot transactions and physical demand

The Exchange focuses on serving the spot market to meet the domestic market's requirement for large amounts of physical bullion. China has rapidly become the world's largest gold consumption market. In 2010, gold spot transactions grew 28% to reach 1,626 tonnes and the amount of physical gold delivery at the Exchange reached 837 tonnes, a new record, which guaranteed the leading position of the Exchange in the domestic gold spot market.

Deferred trading and derivatives

One of the important points of the 'three transformations' strategy is the transformation of the domestic gold market from a commodity market to a financial derivatives market. The Exchange strives to explore new products as well as strengthen its spot market. In 2004, the Exchange launched a gold deferred trading product, which became extremely popular. The turnover of gold deferred trading grew 36% to reach 4,423 tonnes in 2010. Gold deferred trading has accounted for over 60% of the gold market for three consecutive years. In 2010, it accounted for 73% of the market. In addition to gold, silver deferred trading has grown rapidly during the last three years. In 2010, silver deferred trading accounted for more than 96% of the total trading volume of

73,615 tonnes. All silver trading in the first four months of this year was deferred trading. As you can see, deferred trading contracts have become core products of the Exchange.

Price discovery and synchronisation

With the gradual maturity of the price discovery function and pricing mechanism, the Exchange's gold price has dominated the domestic market. Now that five further commercial banks have been awarded physical gold import and export licences, commercial banks import a substantial amount of gold. The Exchange plays a critical role in minimising the price difference between the domestic and overseas markets. Although the dramatic moves in the international gold price last year led to a surge in domestic demand, which pushed up the domestic gold price and widened the price difference, overall the domestic price now moves in synchrony with the international price. The price difference between the two markets has shown a clear seasonal pattern. In the peak season leading up to Chinese New Year, from November to January, the price difference between the two markets could be as wide as two to three yuan per gram. However, from April to August the difference was narrower, within one yuan per gram.

Members of the Exchange

Drawing on the experience of the international market, the Exchange has supported its financial members (commercial banks), benefiting from their abundant financial resources and strength. Bank members' proprietary trading grew 29% in 2010 to reach 2,094 tonnes and client trading grew 56% to reach 277 tonnes. Currently, the commercial banks account for 58% of the market and more growth is anticipated.

Apart from banks, general members also play an important part in the market. In 2010, their proprietary gold trading grew 12% to reach 1,171 tonnes and clients' gold trading reached 1,356 tonnes, a slight decrease from the previous year. Proprietary silver trading grew 104% to reach 1,562 tonnes; clients' silver trading grew 83% to reach 19,876 tonnes. Though the institutional clients are still the most important participants in the market, the market share of individual investors has soared in recent years. In 2010, individual gold trading volume reached 1,154 tonnes, an increase of 163%. The number of individual investors increased 93% to 1,778,500. The share of individual gold trading increased from 9% to 19%. The amount of individual silver transactions reached 49,738 tonnes, more than ten times as much as in 2009. During the first four months of this year, the number of individual investors kept growing rapidly and now has exceeded two million. The Exchange has become the main channel of investment of physical precious metals, fulfilling the needs of domestic residents.

The lending market is an integral part of the international gold market system. In a mature gold market, participants can lend gold and finance at the market lending rate, in order to carry out market transactions more easily.

Night trading session

The SGE was the first to offer a night trading session in the domestic financial market. The night session starts at 9pm and ends at 2.30am the next morning (Monday to Thursday). It overlaps with the afternoon session in London and the morning session in New York, which is beneficial for the synchronisation of markets and enables domestic investors to arbitrage across markets. Since the official launch in November 2005, the night session's trading volume has increased every year, particularly in 2008 when trading volume quadrupled compared to the previous year, accounting for one-third of total trading volume. In 2010, night session total gold turnover rose 24% to reach 1,943 tonnes, accounting for 32% of the total gold trading volume. 37,553 tonnes of silver were traded, an increase of 352%, accounting for 51% of total silver trading volume. The Exchange is now considering the launch of a Friday night session to fulfil market needs.

Foreign members

Over the past two years, the Exchange has admitted HSBC, Standard Chartered Bank, the Bank of Nova Scotia-ScotiaMocatta, Australia and New Zealand Bank and Credit Suisse as members. The SGE is the first and only exchange in China with foreign membership. Not long ago, applications from Barclays Bank and United Overseas Bank were approved. Very soon they will become members of the Exchange as well. Besides that, many well known international commercial banks, including JP Morgan Chase, Deutsche Bank, Standard Bank and UBS have shown an interest or are applying to become foreign members of the Exchange.

Foreign members of the Exchange play an increasingly important role in the market. From September last year, foreign banks' proprietary trading grew rapidly. In 2010, the transaction volume of foreign member banks was 168 tonnes, almost 5 times of the previous year, accounting for 8% of the total proprietary trading.

The next step

The gratifying development of the gold market presents both opportunities and challenges. It is worthwhile to think about how we can take advantage of the opportunities to innovate and sustain the growth of the market, while seeking co-operation with international markets for mutual benefit. We would like to propose the following ideas.

Further improvements in the Exchange's inter-bank price quoting system

The Exchange formally launched the price quoting system in March, allowing commercial banks to cover paper gold exposure and fulfil the specific needs of OTC forwards. The Exchange combines the trading models of price bid and price quote to nurture and support the domestic gold market makers and to attract more investors into the market to satisfy their multi-dimensional trading needs. In the future, as the price quoting system is developed and perfected, we are confident that we are forging a useful tool for the bidding market.

We have also realised that, compared to the wide variety of personalised products in the international gold market, such as spot, forward and swaps, our current price quoting system provides limited products and services, which are mainly focused on physical transactions and limited gold lending services. Therefore we need to further improve the price quoting system, enrich the variety of products, enhance their functions and gradually adopt international trading products, to meet the banks' individual needs.

Establish the gold lending market and form the lending rate.

The lending market is an integral part of the international gold market system. In a mature gold market, participants can lend gold and finance at the market lending rate, in order to carry out market transactions more easily. In the domestic market, due to the late start,

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Achieving more together

the scale of the gold lending market is still relatively small, while a market lending rate has not yet been established. However, in recent years, with the support of the Exchange, the domestic gold lending market has made great progress. Market players have gradually become more diverse. Foreign banks, domestic commercial banks and enterprises are actively involved. In 2010, the total commercial bank gold lending grew 68% to reach 112 tonnes. The potential of the lending market is very promising.

Hence, the Exchange should take the opportunity and accelerate the establishment of the gold lending market. It should support more commercial banks to provide gold lending services, attract foreign banks and refinery companies to join, and facilitate the mobility of domestic physical gold. What is more important is to establish a gold lending rate in China as soon as possible, to encourage inter-bank gold lending and assist small and medium enterprises, thus to improve market functions.

Build a gold derivatives market.
The first domestic gold ETF - Lion Global Gold Fund was launched at the end of last year, which has gained much attention at the Exchange. On the one hand, we intend to further reduce the trading hurdle and the investment threshold of existing products in response to the impact of fund companies' ETF products on the market system; on the other hand, we have accelerated the steps to study gold bonds and ETF products as an important reserve to explore new products and promote innovation.

Admit more influential international banks and gold dealers as members
The gold market is a global market. However, our gold market is not very internationalised. In recent years, we have introduced some influential foreign banks and endeavoured to communicate with foreign markets. But this is just the beginning. Next we will continue to increase the number of foreign members and introduce more powerful foreign financial institutions and gold dealers into our market.

Meanwhile, we will further improve our quality of service and provide foreign members with better market environment to stimulate their enthusiasm. The Exchange will communicate and co-ordinate with PBOC actively to address the concerns of foreign members, particularly the foreign exchange allowance and issues of importing and exporting. The Exchange will encourage our foreign members to play a greater role.

Connect the domestic physical certification system with international markets.
There is a comprehensive physical certification system in the London gold market, which is a globally recognised physical delivery criterion and plays an important role in the promotion of globe gold trading. At present, although China's gold quality certification system has met the standard of the LBMA in both specifications and standards, and some rules are even stricter than those of the LBMA, there is no common admissible mechanism of international certification which can apply to domestic physical gold. This has handicapped the development of domestic market. This fact made us realise that we should co-operate with the LBMA to connect the two physical certification systems as soon as possible, so that gold in China can be accepted in the international market and we can supply gold more efficiently to gold market players both at home and abroad.

Now, we are in a special historical time full of opportunities. In the future, the Exchange will further its marketing innovation, enrich the variety of trading models used and promote improved functioning of the market.

Increase communication between the two markets and make regular visits.
The London gold market has a history of over a century. Despite the fact that the London bullion market uses an OTC model which is totally different from the Exchange's model, there are still a lot of valuable experiences we can learn from the London gold market in areas of market management, product innovation, risk control, physical delivery, warehousing and logistics. During the last two years, I have been to London twice to study the specific subject of the tax system, OTC price quote model, and lending market at the London gold market. And I have learned a lot. Facing the rapid development of the market, I feel it is necessary to set up a regular visiting mechanism between these two markets to understand new developments and market information relevant to each other.

Now, we are in a special historical time full of opportunities. In the future, the Exchange will further its marketing innovation, enrich the variety of trading models used and promote improved functioning of the market. We will enhance our core competitiveness and increase our influence in the international gold market.

Wang Zhe
Chairman & President, Shanghai Gold Exchange

Mr. Wang Zhe, *is a member of the CPC and was born in August, 1960. He has an MBA degree. He started his career in July, 1984 and currently serves as the Chairman and President of Shanghai Gold Exchange. He spent four years studying at Jilin Trade & Commerce College before starting his career at the Currency Issue Division and General Office of the People's Bank of China from July, 1984. After that, he served as the General Manager of China Gold Coin Corp. (Shen Zhen) Company from December, 1991 to March 1995. From March 1995 to April 1999, he served as the Deputy Governor of CITIC Bank (Shen Zhen) Branch, Chairman of Da Peng Securities Co., Ltd. and Deputy General Manager of China Gold Coin Corp. From November 2001 to February 2011, he served as the Deputy Chairman and President of Shanghai Gold Exchange. And from February 2011, he became the Chairman. Mr. Wang Zhe is a well-known expert in the country's precious metals industry with rich experience in not only the precious metals market, but the banking and securities sector as well.*

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Market Moves

GFMS to Thomson Reuters

Thomson Reuters has acquired analyst firm GFMS (formerly known as Gold Fields Mineral Services), a leader in precious and industrial metals markets research and analysis.

Philip Klapwijk, former Executive Chairman of GFMS, takes on a new role of Global Head of Metals Analytics at Thomson Reuters. He has over 20 years' experience analysing the gold, silver and PGMs markets, most of this time working for GFMS, which is the world's leading specialist research consultancy on the precious metals markets. Philip is a frequent speaker at conferences on precious metals and commodities, and the print and electronic media regularly quote his views on the gold, silver and PGMs markets.

Paul Walker, former CEO of GFMS, has taken on the new role of Global Head of Precious Metals. After graduating with degrees in commerce and economics from the University of Cape Town, Paul worked as an economics researcher for a Member of Parliament in the UK House of Commons before joining the United Nations affiliated International Lead and Zinc Study Group, where he was involved in a wide range of economic studies and forecasts. He has a PhD in the application of mathematical optimisation to large non-linear economic systems from the University of Nottingham in the UK. Dr Walker joined GFMS in 1995, where he acted as Chief Executive Officer of GFMS, in addition to being responsible for gold, silver and PGM research in East Asia, India and South Africa.

Davide Collini to BNP Paribas

BNP Paribas has added Davide Collini as a Senior Director for precious metals sales within its Global Equities and Commodity Derivatives business. He reports to Mikko Rusi, European head of base and precious metals sales.

Zhiming (Samuel) Yang to Credit Agricole CIB

Zhiming (Samuel) Yang joined Credit Agricole CIB London in June 2011. He will be responsible for precious metals spot and forward trading. Samuel previously worked at ABN AMRO N.V., where he covered market making in precious metals, and before that he had traded precious metals/foreign exchange for the Bank of China in London and Shanghai.

Kevin Crisp to Deutsche Bank

Kevin Crisp is joining Deutsche Bank as Director of Precious Metals in September 2011. Kevin graduated in Mining Engineering from the Royal School of Mines, Imperial College and then undertook post-graduate research at Kyushu University in southern Japan. He worked in South Africa and Australia before joining Consolidated Gold Fields in London from where he was seconded to Gold Fields Mining Corporation in Denver. On returning to the UK Kevin worked as Senior Analyst for commodity research company GFMS, covering the Middle East and Asia. He then joined JP Morgan, working as precious metals strategist before moving into the marketing side of the precious metal business. Kevin spent the last five years managing Mitsubishi Corporation (Europe) Plc's bullion business and from 2009 to 2011 served as Chairman of the LBMA.

Richard Ringrose to Deutsche Bank

Richard Ringrose will join Deutsche Bank's Precious Metals flow business as a Director in September 2011. Richard has a Master's Degree in Finance from the National University of Ireland, Cork and joins Deutsche Bank with 10 years of experience in financial markets starting out at Citibank in 2001. More recently Richard spent three years at BNP Paribas where he has focused predominantly on commodity derivatives.

Matthew Lynch to HSBC

Matthew Lynch has joined HSBC as an Associate Director for Precious Metal Sales. Previously Matthew was with Mitsui for five years, and prior to that, Johnson Matthey.

David Govett to Marex

Marex has appointed David Govett as Head of Precious Metals in its London office. In this role, David will focus on establishing a dedicated Precious Metals division. David joins Marex with over 23 years of experience in the Precious Metals market. He began his career on the Precious and Base Metals desk at Prudential Bache London and was made Head of Precious Metals in 1987, followed by a similar experience at AIG. David also set up and managed Precious Metals broking desks at Cantor Fitzgerald and ICAP, before spending two years in Australia heading up the Precious Metals arm of TFS. He returned to England at the beginning of 2011.

Shane Lennox to Mitsui & Co Precious Metals

Shane Lennox graduated from Amherst College Massachusetts USA in May 2009. In October 2009 he joined MPM London Branch as a trader. Shane relocated to Mitsui New York office in June 2011 to assist Mitsui's global options team.

James Su to Natixis

James joins Natixis in London. He started his career in Australia in 2002 at Rothschild, before moving to ABN in 2005.

Kate W. Harada to TANAKA Holdings

Kate W. Harada joins TANAKA Holdings with over 25 years' experience in precious metals, FX and the fixed income market. She began her career on the Precious Metals desk at Sumitomo Corporation Tokyo, followed by variety of experience at Midland Bank, Lehman Brothers, SBC Warburg and Mitsubishi Corporation.

Regulation Update - Conflict Gold

Supply Chain Due Diligence – LBMA Involvement

By Ruth Crowell, Commercial Director, LBMA

The LBMA has continued its work regarding US and OECD regulation of conflict gold supply chains. Both the OECD and the US are in the process of creating due diligence requirements for gold emanating from conflict areas and in particular from the Democratic Republic of Congo (DRC).

Bullion Market Regulation Workshop: *Responsible Gold*
Le Centre Sheraton Hotel, Montreal
14:15 - 16:00 20 September 2011
Chairman - Ruth Crowell, Commercial Director, LBMA

OECD Due Diligence - Gold Supplement
Tyler Gillard, Legal Expert - Investment Division, OECD

LBMA Responsible Gold Guidance
Stewart Murray, Chief Executive, LBMA

Conflict Gold - The Good, the Bad and the Ugly
John Bullock, Chairman, IPMI Environmental and Regulatory Affairs Committee

Key Dates

15 September 2011
Expected publication of SEC rules to implement the Conflict Minerals section of the Dodd-Frank Act.

20 September 2011
LBMA Conflict Gold Workshop - Montreal, Canada

31 December 2011
Expected publication of OECD Gold Supplement

31 December 2011
LBMA will publish final Responsible Gold Guidance

Background

As a result of the Dodd-Frank Act, the US now requires all companies reporting to the SEC to file periodic reports disclosing their use of 'conflict minerals' and 'DRC Conflict Minerals'. (This reporting requirement applies only to SEC reporting companies; which are companies with more than $10 million in assets and whose securities are held by more than 500 owners.) Many different groups have been working on methods to assist companies in filing these reports to the SEC, including the SEC itself, the UN Working Group of Experts on the DRC, the OECD, the Responsible Jewellery Council and the World Gold Council.
The LBMA will continue to work with all these groups to ensure that the best possible scheme is produced and communicated to all members of the market.

LBMA Involvement

The LBMA has become more actively involved in supply chain regulation due to its unique relationship with international gold refiners in the form of the LBMA Good Delivery List.

In January 2010, the LBMA made a submission to the SEC on fundamental issues, including the need to grandfather in existing stocks of gold, recycled and scrap metal, public disclosure as well as unintended consequences for the gold market and Africa.

To date, the LBMA has acted as an observer on various groups which have addressed the issue of gold supply chains, including:
- The World Gold Council
- The Responsible Jewellery Council
- The OECD
- In the US, the Electronic Industry Citizen Coalition (EICC).

The LBMA will continue to act as a conduit of information to the market on the issue of 'conflict gold'. The LBMA will also continue to keep Members, Associates and, most importantly, Good Delivery Refiners informed as supply chain regulations develop. The Regulatory Affairs Committee (RAC), the Physical Committee as well as the Good Delivery Referees group have all been actively involved in finding a practical solution to the challenge of enabling all GD refiners to indicate that the metal they supply to the market is free from conflict gold.

LBMA Responsible Gold Guidance

In order to ensure that supplies from all LBMA GD refiners are free from conflict gold, the RAC and the Referees have been developing guidance on the due diligence needed to demonstrate this. It is envisaged by the RAC that the LBMA Guidance should form a foundation of legal compliance that is credible to the outside world and feasible for all Good Delivery Refiners.

The drafting of the Guidance Document is now at an advanced stage. The LBMA will hold a Workshop on Conflict Gold on 20 September 2011. This will follow on directly from the LBMA Conference in Montreal, Canada. Prior to this, a final draft of the Guidance will be circulated to all GD Refiners.

LBMA News

By Stewart Murray, Chief Executive, LBMA

MEMBERSHIP

Members

Effective 1 July 2011, Bache Commodities Ltd will be known as Jefferies Bache Ltd, due to an ownership change.

Associates

On 12 May 2011, Dillon Gage Inc. of the USA was admitted as an Associate.

On 25 July, Gold Standard DMCC of Dubai was admitted as an Associate.

These additions brought the membership to a total of 125 companies, comprised of 60 Full Members, 61 Associates and 4 Affiliate Members. This is the first time that the number of Associates has exceeded the number of Full Members.

AGM

The 23rd Annual General Meeting of the LBMA took place in Armourers Hall on 22 June. In his report for the past year, the outgoing Chairman, Kevin Crisp of Mitsubishi Corporation International (Europe) Plc, commented on the ever-broadening activities of the Association and thanked all LBMA Committee Members for their time and effort in supporting the market as a whole especially at a time when there are so many demands upon the individual. A copy of his speech can be found on the LBMA website: www.lbma.org.uk. The reports by the chairmen of the five sub-committees give a comprehensive picture of the LBMA's activities and are contained in the minutes of the AGM, which are available in the members' area of the website. Any staff in Member and Associate companies can obtain their user ID and password to access this part of the website from the Executive.

As well as the normal statutory business of approving the accounts and appointing the auditors, the AGM elected the members of the Management Committee.

The new committee met immediately after the AGM and elected David Gornall as Chairman and Steven Lowe as Vice Chairman.

LBMA Management Committee elected 22nd June 2011

Grant Angwin, Johnson Matthey Inc

Philip Aubertin, UBS AG

Simon Churchill, Brinks Ltd

Jeremy East, Standard Chartered Bank

David Gornall, Natixis

Raymond Key, Deutsche Bank AG

John Levin, HSBC Bank USA NA, London Branch

Steven Lowe, Bank of Nova Scotia – ScotiaMocatta

Clive Turner, JPMorgan Chase Bank

Our thanks go to Martyn Whitehead of Barclays who stepped down in June for his seven years of service on the Committee.

COMMITTEES

Management

The Committee met in June to prepare for the AGM and also held its first meeting after the AGM in early July. As usual, the Committee's work largely consists of reviewing and guiding the work of the subcommittees and making decisions based on their recommendations. A particular focus in recent meetings has been the formulation of a policy on 'conflict gold' based on discussions in the Regulatory Affairs Committee, the Physical Committee and the Referees' group. See the Regulatory Affairs Committee section below and the Regulation Update on page 23.

Noting that final decisions on the future regime for bank liquidity and capital will be promulgated by the Basel Committee for Banking Supervision (the Basel III regime) by the fourth quarter, the Management Committee has decided that the LBMA should organise a seminar for Members to inform them about the treatment of gold under Basel III. The seminar is likely to be held in early January and may also cover other regulatory matters.

The Committee noted the resignation of John Levin (owing to his return to Australia). Market Makers were asked to put forward nominations for replacement candidates to be co-opted on to the Committee. These nominations were considered by the Management Committee and it was agreed to co-opt Jeremy Charles of HSBC to replace him. John's role as Management Committee representative on the Membership Committee will be taken over by Jeremy East.

Regulatory Affairs

The RAC met twice in the last quarter to discuss a variety of regulatory issues. This included primarily conflict gold as well as EU and US proposals for mandatory clearing of OTC products via a central counterparty. It also assisted the World Gold Council in its lobbying efforts to ensure that gold is considered to be a high-quality liquid asset in the Basel III regime. This included the one-off survey of LBMA Members' gold trading turnover, which was carried out on the basis of their trading activity in the first quarter of 2011 (see article on page 9). However, the majority of the Committee's work has focused on conflict gold due diligence. The LBMA has become more actively involved in this area of regulation due to its unique relationship with international gold refiners, which are accredited under the LBMA Good Delivery system. From discussion in the RAC and Management Committee, a consensus has emerged that the LBMA should require Good Delivery refiners to indicate that they are taking measures to avoid receiving conflict gold in their feedstock. To achieve this, the LBMA has tasked the RAC and the LBMA Referees with developing guidance to allow GD refiners to demonstrate that their production is conflict free. It is envisaged by the RAC that the LBMA Guidance should form a foundation of legal compliance that is credible to the outside world and practicable for all Good Delivery refiners. The Guidance has recently been circulated to all refiners on the Good Delivery List. It has also been submitted to the OECD with a view to it being incorporated into the OECD's own guidelines on supply chain management.

Ruth Crowell, our point person on Conflict Gold, is now playing an active role on the OECD drafting committee that is developing its gold guidelines.

For more on conflict gold and other regulatory issues facing the precious metals market, see the Regulation Update on page 23.

Physical
The Committee has met each month other than August this year. The work of the Committee, other than GDL applications and Pro-Active Monitoring, has focused on the work of the vaults. A meeting of London vault managers took place in May to discuss various operational issues aimed at streamlining transfers between vaults (for example, standardising the arrangement of bars on pallets and the associated weight lists). It also discussed the best way of ensuring a consistent approach to the assessment of physical defects. The meeting also agreed on a standard form for use by the vaults when reporting examples of rejected bars to the LBMA Executive. Previously, vault managers have met on an ad hoc basis, but it is now planned that these meetings will take place more regularly in the future. The Committee also discussed the possibility of creating an LBMA Accreditation Scheme for vault staff. If it is decided to go ahead with this idea, further details will be published in a future edition of the Alchemist.

Public Affairs
The Committee's work has been dominated by intensive discussions on the speaker programme for the successful Shanghai Bullion Market Forum held in May (see review on page 17). In addition, the Committee has spent many hours discussing the speaker programme for the forthcoming conference, which will be held in Montreal in September. The Committee has also been considering various venues for the 2012 Conference as well as the organisation of a Bullion Market Seminar in the US in the spring of 2012. Unlike the recent forum in Shanghai, the purpose of this seminar is not to focus on the local market but instead to explain to North American investors, traders and regulators how the OTC bullion market works.

Membership
The Committee met once during the past quarter when it reviewed the operation of the new sponsorship regime for Member and Associate applications. The new system is similar to the Associate Review process in that it puts the onus on the applicant to ensure that letters of support are provided in good time by its sponsors. Sponsorship of applications for membership is a serious matter for Members and this can lead to delays while such requests are being considered. The new system is intended to ensure that the time required for processing applications is kept to a minimum.

Finance
The Committee met in June to review the three-year forecast in light of the income and expenditure for Q1 and Q2 2011. The Committee also agreed on the currency hedging for the 2011 Conference in Montreal.

Referees
The Referees group held its regular quarterly meeting in June where it discussed many different technical aspects related to the use of the LBMA reference samples for the testing of existing and aspiring members of the Good Delivery List. The meeting also agreed on the arrangements for the planned proficiency testing scheme for gold fire assayers, which it is hoped will be launched in October this year.

Staff Matters

We were sorry to lose the services of Alice Toulmin as our PR and Media Assistant at the end of July. Anyone interested in applying for the resulting vacancy should send their CV to the Chief Executive.

Committee Vacancies

Following his election to the Management Committee, Grant Angwin resigned from the Public Affairs Committee. Darryl Hooker has also left the Committee as a result of a change in responsibilities at EBS. There is therefore currently a vacancy on the PAC. Anyone interested in applying should send an email to the Chief Executive with a brief statement of their bullion market experience.

London Precious Metals Clearing Limited

London Precious Metals Clearing Limited has also announced that the cut-off time for the acceptance of transfer instructions on Friday 23rd December, and Friday 30th December, 2011, will be 14:00 G.M.T.

The London Gold Market Fixing Limited

The London Gold Market Fixing Limited has announced that there will be no afternoon gold fixings on Friday 23rd December and Friday 30th December, 2011.

Editorial

Editorial Comment by David Gormall, Chairman, LBMA

After having contributed a number of previous articles (mostly of a technical nature) to the *Alchemist*, I now have the honour of writing one as Chairman. First of all, I would like to pay tribute to my predecessor, Kevin Crisp, who stepped down at the AGM after a two-year stint in which he demonstrated both leadership and a tremendous work ethic in the role as Chairman. I have first-hand evidence of his dedication and total attention to the many tasks involved in chairing the remarkable organisation that the LBMA has become.

We also have a number of fresh faces on the Management Committee, and at the first meeting after the AGM, the new Committee focused on the goal of building on the work on regulation, which was initiated earlier this year with the establishment of the Regulatory Affairs Committee, or as we now refer to it, the RAC. This powerful new committee is made up of 14 representatives of Member companies plus Barbara Ridpath of the International Centre for Financial Regulation. The new Committee's activity is rapidly becoming an additional pillar to the Good Delivery system and the organisation of seminars and conferences.

We have seen a shift in what investors expect in both types of class and performance. This has led to an increase in physical demand and an even greater expectation that the highest standards will be maintained in the quality of metal traded and stored on behalf of investors.

We have seen a shift in what investors expect in both types of class and performance.

Whilst the physical demand has been facilitated by the marketplace generally, it is of course the Good Delivery List that assures the quality of the metal. This integrity provides the foundation of what is expected of us.

We now seek to fulfil some other aims that will further enhance the market in which our members operate.

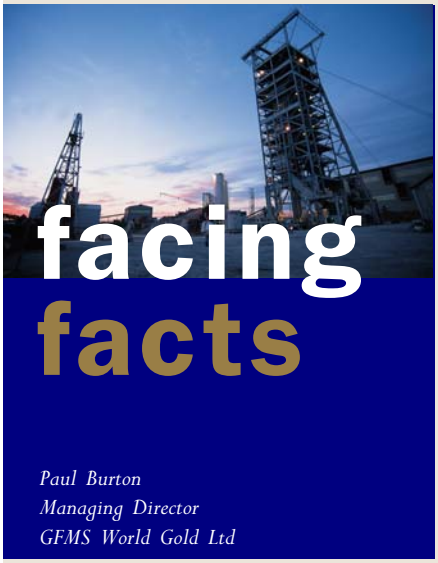
There are several pieces of legislation that require the engagement of the LBMA. The first challenge will be for the LBMA to complete the work already started to enable the compliance on the part of the GD Refiners under the US Finance (aka Dodd-Frank) Act relating to 'conflict gold'. Secondly, in September, the debate on bank capital ratios within Basel III will recommence.

Responding to these challenges, the new Management Committee has agreed that the LBMA must be at the forefront of the current regulatory debates. Where the topic is closely related to the OTC Gold and Silver markets, and more particularly when it comes to discussing changes relating to refining standards, the LBMA intends to lead the debate. This will provide a consensual and informed view on OTC practices for lawmakers to consider prior to any changes in law that relate to our market.

In short, we intend to reinforce the role of the LBMA as the competent authority for OTC Gold and Silver.

Towards the end of the year, we plan to organise a seminar on the topic of the Regulatory changes for the benefit of the LBMA membership. This should enlighten us all about what we face in the post Dodd-Frank and Basel III era.

Finally, looking ahead, we will soon be entering our 25th year, where we hope to provide the membership with more than just an annual party. Keep up to date with these plans and all our other news through the website and the *Alchemist*.



facing facts

Paul Burton
Managing Director
GFMS World Gold Ltd

The first half of the year was a fascinating time for precious metal market watchers, with record gold prices and rocketing silver prices grabbing the headlines constantly. But spare a thought for gold equity investors who, quite reasonably, should have expected spectacular gains on the back of the fast-rising gold price. Gold equities, producers and developers alike have, however, been laggards throughout this booming market. In many cases, not only have they failed to keep pace with the gold surge, but they have actually fallen in price – a dismal and perplexing outcome for investors.

Traditionally, investors have chosen gold-mining shares instead of the underlying metal in order to capture returns in excess of the extent of any metal price rise. This effect we call leverage.

For example, when the gold price goes up 23% (as it did over the 12 months to mid-May), they may have expected something like a 40% rise in their investments. For certain periods in the past, the producers, mainly because of their cost structures and the fact that they have a chance to expand the ounces invested in through exploration, but also because of the higher risk of actually getting the metal out of the ground, have outperformed

the gold price, in percentage terms, by a considerable amount usually. Leverage is one of the main reasons that fund managers put their money in a gold-producing company rather than the metal itself.

But that relationship has broken down in recent times. In fact, we can pinpoint the date that the positive correlation and unique relationship between gold and gold shares disconnected - October 2008. The time the worldwide economic crisis hit the markets. If you remember, the gold price plunged but recovered in short order to reassert the bull trend and has, in fact, gone from strength to strength since that time. Gold shares (developers as well as producers) were hit even harder in Q4 2008, clearly exhibiting leverage, but sadly on the downside! But whereas the gold price has recovered and strengthened, gold shares, as defined by indices such as the XAU and the FTSE Gold Mines, haven't regained the initiative and have lagged behind the upward movement in the underlying price. This has been particularly marked this year so far.

The chart below shows the gold price and the FTSE Gold Mines index, both indexed back to the start of the current bull market. You can clearly see how the index performed better than the gold price for the bulk of the period, but since late 2008, it has been a different story.

So why has this happened? It's difficult to say definitely, of course, but it seems that there may be two main factors at play. The first is that we have seen a shift in investing patterns away from gold stocks in favour of the metal. This has been facilitated by the existence of the ETF gold products. In late 2008 and early 2009, there was a noticeable steepening in the demand curve for such products and their popularity has continued, although in early 2011, we saw net redemptions, partly due perhaps to the fact that soaring gold prices have led investors to become overweight in gold, relative to their other assets, prompting them to divert funds elsewhere (such as into silver) or to simply book profits. The growth of investment and jewellery demand in China may also have been a contributing factor.

A second reason for the lacklustre performance of gold stocks may be a swing away from the larger gold producers to smaller companies, who may be producers or developers. Certainly, individual gold shares in this latter category have demonstrated great performances recently, but the overall picture is patchy and investors are clearly being selective. There are some signs also that investors are favouring a junior miners' ETF rather than the actual mining stocks themselves.

So in conclusion, the market's lack of leverage over the past couple of years may be down to a switch over to gold itself (through ETFs), or cash, but may also reflect a move into smaller gold producers and developers, again through an ETF vehicle. The case is not proven but does offer a feasible explanation of the longer-term malaise.

The sharp downturn in the first half of this year in all gold indices is more baffling but does present a buying opportunity, I believe, over the historically weak summer months.

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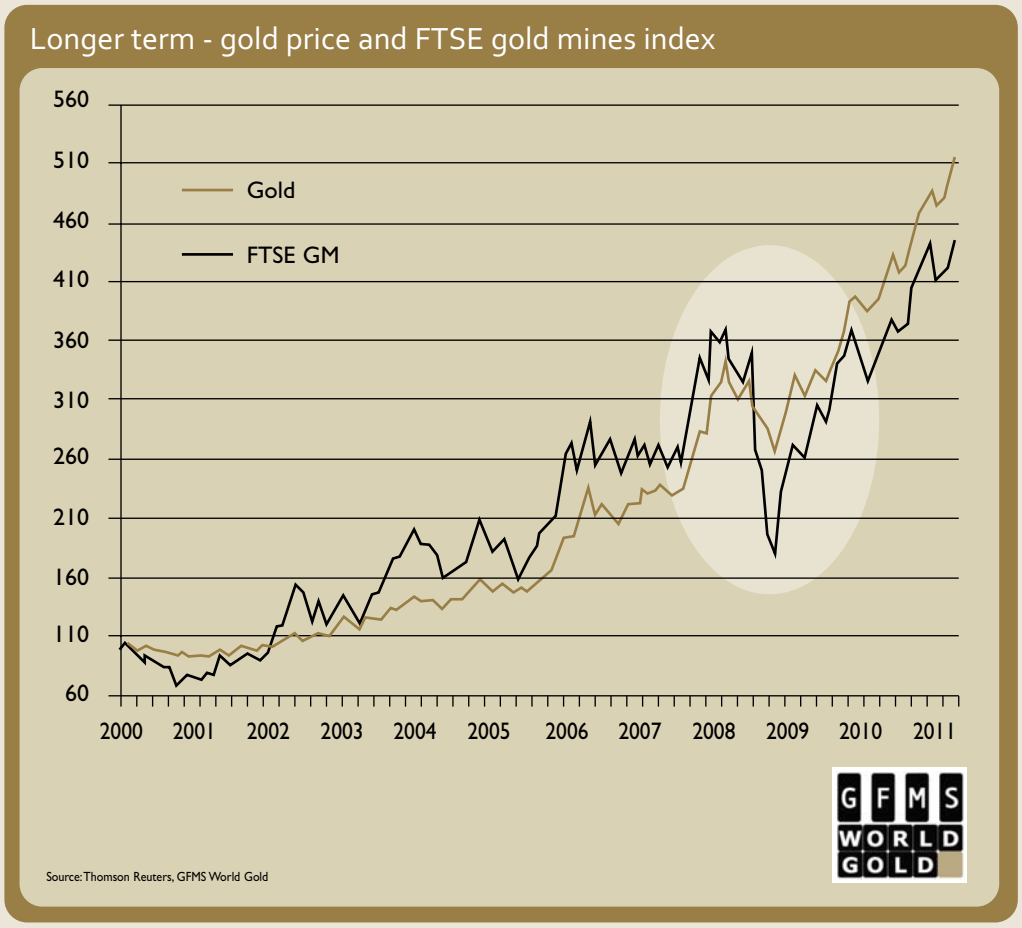

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The *Alchemist* is designed by Ion River.