

# VIRTUAL SUMMIT

16 April 2020

## Regulatory and Responsible Sourcing Developments

### Speakers:

Taylor Birch, Events Coordinator, LBMA/Speaker 1  
Sakhila Mirza, General Counsel, LBMA/Speaker 2

### Summary:

Sakhila also provides an update on LBMA's future vision and strategy for Responsible Sourcing, including the challenge of the supply chain which is one of the key risks facing the market. We recently hosted webinars featuring other industry specialists including Dr Mark Pieth and Sasha Lezhnev, on their recommendations for change. Sakhila reflects on these in the context of LBMA's strategy and vision for the future.

### Speaker 1:

Good afternoon. Welcome to today's live LBMA webinar. We are, once again, thrilled to welcome you today to listen to the LBMA's General Counsel and Executive Director of the Board, Sakhila Mirza, as she provides the regulatory and responsible sourcing update. If you have any questions, please feel free to write them into the chat function of the webinar, and Sakhila will try to answer them at the end of her speech, should there be time. Once again, thank you and welcome Sakhila.

### Speaker 2:

Thank you, Taylor, for that and welcome everybody to today's webinar. As Taylor said, I'll be covering the regulatory update, as well as the LBMA's Responsible Sourcing programme and supporting strategy for our programme. So with that, let's get started. Before I actually refer to the actual detailed regulatory developments, I want you to take a moment to highlight how much has changed and how many issues we've been trying to address over the last, perhaps six weeks. Obviously, there's been lock downs, market volatility, there's been challenges around logistics. There's been a lot of discussion around supply and capacity. Obviously with some of the discussions also focusing on COMEX, Chinese Gold Market, the vaulting, the volatility, benchmarks – they've all been discussed quite heavily – they've been reported on. Some have been challenging. The LBMA has been working with the infrastructure providers to get more clarity, discussing business continuity – understanding business continuity plans. So, the “business as usual” has, somewhat, been hard and the key focus has been addressing the challenges we are currently facing. That said, the business as usual also needs to happen. And, whilst I can probably give you a very long list of some of the projects that we have to park at the LBMA, there are certain areas that we have to continue to prioritize and make sure that we've got the momentum and we continue to push forward with those agendas. I'm going to primarily just focus on the regulatory agenda. So, I have highlighted three key

regulations. SFTR – Security Financing Transaction Regulation – which is due to go live now on the 13th of July; Net Stable Funding Ratio – which is due to be implemented in fourteen months' time – so, June next year; and then there's the Conflict Minerals Regulation – which is due to be implemented in January, 2021. Time is short on all three of them. Whilst we did get an extension on SFTR, and there has been quite a few discussions around Basel III being extended as well, unfortunately, Net Stable Funding Ratio was not part of those deadlines that got extended. So, we have to continue to prioritize and make sure that we are achieving full compliance, for when those deadlines do kick in.

So with that, let me move to the Security Financing Transaction Regulations first. This basically aims to reduce systemic risk in the security financing transaction space. It requires you to identify SFTs, and then report on those SFTs. Sounds relatively straightforward, except it's not quite clear what it means when it comes to the gold market. What is an SFT? Is a gold loan an SFT? Is a gold lease an SFT? After several months of discussions, consultations, engagement with law firms, other associations, as well as the regulator, the conclusion is: gold loans and leases are reportable. However, the second question is are the exemptions available? In January this year, ESMA did publish guidance, which basically said, 'Physical loans and leases for industrial or operational purposes would be out of scope and so, therefore, not reportable'. However, what the guidance did not explain: how do you define industrial operation purposes? What measures do you use to understand if a certain transaction has taken place for an industrial or operational purpose? In addition, the guidance highlighted that any linked transactions would also be reportable, but again, it didn't go and explain what exactly a linked transaction would look like. So, over the last several months, the LBMA has set up two working groups: one focusing on policy, and the other focusing on operation. And firstly, I would like to thank everybody who's been part of these working groups. On one of them, we had over 50 individuals who represented various institutions to take part and made sure that they are representing a market view as to how those transactions should be reflected in the reporting. Just to remind everybody, under the regulation, the obligation to report is dual-sided. So, therefore, it is absolutely important that there's consistencies between the reporting entities. So with that, we published a guidance which was issued yesterday. It is referred to as the market position, and it helps to answer some of the questions that are raised. It provides a little bit more guidance on how to apply the operation and industrial exemption. It provides more guidance on what would constitute a legal transaction. So, I do encourage everybody to read this market position paper, and actually use it when implementing the controls required for compliance with the regulation. Again, by way of reminder, the reporting obligations rules kick in from the 13th of July. In addition, the operations working group, they have been focusing on creating a template. So, this template again has been published, will help market participants recognize which fields need reporting under which transactions and, again, hopefully provide some consistencies, and remove some ambiguities. If you have any questions or any follow up with what you're reading in our market position paper that we issued yesterday, please do get in touch, with either myself or Rachel Hart, because we want to make sure that's a live document that is continuously being updated with further questions and, where necessary, reflects market practice.

Following on from SFTR, the next regulation that I want to be focusing on is the Net Stable Funding Ratio. The Net Stable Funding Ratio – I'm sure a lot of you have heard me speak about this for the last five years, if not longer – basically what this requires is an 85% hair cut for gold, as well as other precious metals. What would be the impact if Net Stable Funding Ratio was applied as is, i.e., the 85% was applied as is? There would be a fall in market liquidity, as banks would look to potentially exit. Cost of doing business could go up, but the biggest impact and, perhaps the most serious impact, and one that we are quite concerned about, and are speaking to the regulators about is the impact that this ratio would have on the clearing banks. Clearly, without LPMCL, it would be a challenge to effect settlement, and if the cost of effecting that settlement goes up – because these banks are holding gold on the balance sheet – there's a very big question mark around, will they continue to provide the clearing and settlement service, or, will they be passing the cost on? So, we have been speaking to the regulators in trying to understand what risk are they trying to mitigate when it comes to LPMCL? What is the systemic risk that the LCMCL business model poses and how can we work with the regulators and the authorities to make sure that the challenges that they face with the 85% haircut are mitigated? In order to demonstrate a lot of the discussions that we've been having, and in order to prove the points that we've been making, we finally have trade data that

helps. The LBMA launched its trade reporting obligations back in November 2018, and I'll refer to that in a second. But we've used that data and we basically use the Amihud Formula that the regulators use to estimate liquidity trends. And the result we've gotten is that gold is an extremely high-quality liquid asset. It's not just a high-quality liquid asset, it is an extremely high-quality liquid asset. So we want to use this data and actually take it to the authorities and explain to them, if they had this data when they came to the conclusion back in 2013, they may have reached a different conclusion. It's just a shame that we didn't have this back then, but now we do. Can we please revisit some of the reasoning used to allocate the 85% haircut to gold?

So next steps, we are going to be gathering more data from, especially in last few months. One of the criticisms that we have faced, with the data sets that we have is, we don't have enough information from times of stress when there is a crisis. We don't have enough information as to how gold behaves. Well, in some ways over the last month, we've certainly been able to gather a lot of data. And so from last month, this month, and hopefully next month, we'll hopefully be able to collate some of that data and share that with the regulators to explain how gold behaves during times of stress and, again, hopefully use that as a way to explain that gold is the go-to asset when there is a crisis. And, again, make sure that this is reflected in the report that EBA has been tasked to produce. Although, they do have a deadline of June 2021, it sort of also coincides with the actual implementation date for NSFR, so we're quite keen to present this to EBA as soon as possible. A little bit about the LBMA trade reporting data. So, as I highlighted, this was launched in November 2018 when we had the LBMA Market Making Members report their trading volume. By November 2019, the number of entities reporting had significantly grown. So, we now have just over 50 entities reporting under the LBMA trade reporting requirements. And then in November, we reported something along the lines of 32 million ounces of gold, in terms of the transaction – in terms of the trade reporting. In March, that number has obviously grown, quite a bit, with the average being reported at 47 million ounces per day. That's roughly 83.1 billion U.S. dollars. But especially during recent times, this data has become really interesting to understand. I mean, we also saw recent daily highs of a hundred billion U.S. dollars for gold. So, there's a lot of data sets that we're trying to work on to actually publish through NASDAQ and other data vendors. We already have the data for all four precious metals, so that's gold, silver, platinum and palladium. We can also provide breakdowns for spot forward and options, and we'll also be publishing further data sets, which includes volume and price tranches, as well as other option reports. So, please get in touch with NASDAQ, and they will be able to take you through some of these data sets, and how it can actually help your own analysis and understanding of, in particular the gold market, but also silver and the PGM market.

Now moving onto another piece of regulation: Conflict Minerals Regulation. This regulation applies to all companies who are importing a hundred kilograms of gold or more into the EU. It requires companies to implement the requirements under the regulation, which is broadly aligned with the OECD 5-Step due diligence framework. But what does this actually mean for the importer? Well, all importers must identify the refiners and their gold supply chain, and they are encouraged to source only from refiners who comply with the recognized due diligence schemes. So with that, the LBMA has made an application to the EU to be a recognized due diligence sourcing scheme. We are currently going through the process. There's a number of steps involved in the process. There's desk reviews, interviews with stakeholders, shadow audits and, obviously, understanding the programme overall and its future development and progress. So we are providing as much information we can to the EU. And then, hopefully, within time we'll have some answers from them as to whether the LBMA programme would be a recognized programme under their regulation. And then the reporting obligation on all importers also begins from the 1st of January 2021. So they need to be reporting on their due diligence practices. Again, eight months is not a long time. If three months ago we were challenged on the timelines, those timelines have become even more challenging today. So, again, we encourage you to engage with the LBMA and then to see where we can today, on a voluntary basis, try and achieve compliance with some of the regulatory requirements. And one of those is very much focusing on the reporting side. Whilst the deadline is January, 2021, there is nothing stopping us from putting those reporting templates together today, and agreeing those templates on a market level so that it helps people with the reporting obligation in eight months' time. So that is very much the top three regulations affecting the precious metals market. There's are many others, but I think these are the top three priorities.

Moving on to responsible sourcing now. The LBMA Responsible Sourcing programme has been in place since 2012. I'm not going to go through the details because I'm sure most of you are very familiar about what it is that the programme has tried to achieve, what's been successes, and where more can still be done. I want to focus on what can still be done. Yes, we have achieved a lot and more recently, last year, we extended the scope of the responsible sourcing guidance by including the ESG agenda. We would be receiving those sets of audits for the first time this year but we also recognize, whilst we've expanded the scope, whilst we've pushed for better and higher standards, more can still be done. So with that, we are working on the LBMA's three year Responsible Sourcing strategy. Again, it's about identifying those priorities. So we've identified five top priorities that we want the strategy to reflect: transparency, a robust audit programme, advancing standards, ASM and high-risk area engagement, as well as building leverage across the value chain. We believe that together, by focusing on these five areas, it will help the LBMA, as well as the precious metals market, achieve higher standards and actually address some of the issues and some of the criticisms that we face as a market, and also the challenges we've faced in terms of the programme itself. So let's talk about transparency. So, whilst from the OECD framework, we did ask for refiners to be reporting on their audit requirements., we understand that more can still be done. So, with that, we've appointed or we're engaged with Synergy, who are helping us understand what more can we be asking from refiners when it comes to disclosure requirements. What more can the LBMA be doing when it comes to reporting on some of the work that we are doing – some of the escalations that we're reviewing, the grievances have been escalated to us, the whistle blowing issues that are being escalated to us and even information that is being provided to us – how are we addressing some of these? So we recognize we are doing a lot of work behind the scenes, but we perhaps need to be sharing a lot more of that, but balancing confidentiality and, obviously, making sure that we don't impact any external inquiries, or investigations, that might be going on, but we are seen to be supporting market in working towards a sustainable precious metals market. So, that's transparency.

We also understand the audit required under the OECD framework, and under the LBMA Responsible Guidance is only as good as the auditor. The audit programme provides trust in the programme. If the auditor doesn't have the understanding, and the audit results are of poor quality, then it jeopardizes the trust that you would have in the Responsible Sourcing programme. So with that, in 2019, we undertook a thorough review on our current auditors, who are known as Approved Service Providers. We looked at whether further restrictions needed to be provided for some auditors; we removed some auditors; we asked for more information from some other auditors. So, a lot of work was done and we got into the position where it provided us with a lot more confidence in terms of the auditors. However, we understand that, given the diversity in the supply chain risks, we need to find ways of ensuring that the auditors that are carrying out those audits have a sufficient understanding about the diversity of the risks that are highlighted. And I'll move on to that point a little bit later when I speak about some of the webinars that we hosted from Dr Pieth and also Sasha. The third priority is and, by the way, the priorities are in no particular order, we just identified five. The third priority is making sure we're advancing the standards, reflecting the feedback we're getting and, as far as our programme is concerned, we can always do more – we can always push for better standards. And this has been demonstrated over the last eight years. Like I said, we're on version eight in eight years, and we haven't stopped there. We need to carry on revising the programme, making it dynamic and making sure it's a live piece of document that is reflecting the forever changing circumstances, but also highlighting the risks and making sure that we've got the right controls and asking the refiners for appropriate amount of information. Also, understanding how can we, as the LBMA, work with the market, work with the different market initiatives in providing a much more of a comfortable platform where refiners can source responsibly in high-risk areas, as well as ASM. ASM in high-risk areas, we understand, are always going to be a challenge. But what is it that we need to do *together* to help address some of those challenges? We can source responsibility, for high-risk and ASM, and in situations where there is responsibly sourced ASM, you still have market participants who are reluctant to accept. So what is it that we need to be doing together to overcome some of this reluctance when it is responsibly sourced?

And finally, and this touches on pretty much on everything that I've been saying about responsible sourcing, is building leverage across the value chain; understanding our supply chain; seeing where we can actually build some leverage; working with the miners to develop a miner's toolkit that helps to bridge the communication between refiners and miners. What is it that the refiners need to help with their due diligence? What is it that the miners should expect to support that due diligence? So, that tool kit should hopefully be helpful. I have already mentioned the reporting requirements that the conflict minerals regulation is imposing. Working with the bullion banks to actually get this template implemented across the markets. And to give you an idea about – in terms of the challenges that we're facing and how we can also adopt some of the recommendations – we've engaged with some of the speakers that had committed to speak at the Responsible Sourcing Summit, which we were going to be hosting last month, but got cancelled due to unfortunate circumstances. So, we've been recording some of the speakers. So far, we've recorded Dr Pieth – and we've also recorded Sasha – and they both have provided some recommendations as to how they think that the gold market can further improve. So, talking about Dr Pieth, here are some of his recommendations. One point that both Dr Pieth and Sasha agreed on was 'de-risking is never an option'. It's certainly not the first step. There is risks – I've already highlighted – there are opportunities for responsibly sourced ASM, but we also understand there's a lot of challenges in making sure that you're demonstrating this is responsibly sourced. So, whilst de-risking is not an option, according to Dr Pieth and Sasha, the question should really be, 'How can we work together to avoid that from happening?' What is it that the refiners need for them to be more comfortable when they are sourcing from high risk jurisdictions?

We've also heard about the audits, and I've already covered in terms of how important the audit programmes are, and more needs to be done in providing a better education, better understanding of the supply chain risk. There's been a proposal – Dr Pieth proposed – you could almost engage an external service provider to carry out some of that due diligence on the ground. Whilst that could potentially be helpful, you have to be very careful that the obligation for that due diligence isn't then pushed to the external service provider, and the organization who is responsible for due diligence decides that it's going to shift that responsibility. So, we have to make sure that when you're engaging that third party service providers to carry out on the ground due diligence, that it's seen as a partnership. But, I mean, there's a lot more challenges we need to understand and address before we pursue this recommendation. Additionally, we've also recognized how important education is. Understanding the supply chain – whether you're working for a bank, whether you're working for a mining company, whether you're working for a jewellers or even a refiner – everybody's understanding about the due diligence supply chain risk is slightly different, because they're looking at it from a different lens. It's about understanding each other's perspective, coming together, understanding what those challenges are and finding real, meaningful solutions to address some of them. We understand, you're not going to be able to answer every question on day one, but we also understand coming together, and working together, to start addressing those challenges and having, and taking, steps in implementing that, will certainly take us a lot further than if we just sat here and made it somebody else's issue. So, it has to be a collective engagement. Again, very similar to what Sasha had also highlighted in his recommendations, are highlighting that there needs to also be consequences for those who trade conflict affected gold – real, meaningful consequences. There also needs to be, like I said, a platform where you can actually source responsibly from higher risk. So, thinking about questions and recommendations that we want to be exploring with market participants, with stakeholders, and it was something we were hoping to do at the summit last month but, that said, we are going to find alternative ways. We are going to host the meetings and come up with real, tangible next steps. But, before we do that – I've highlighted at the beginning of the Responsible Sourcing session – we are working on articulating our three-year strategy, providing some more details around what this strategy would look like. Hopefully, issuing that over the next few months, and then getting together to understand, okay, how do we now move forward with some of this strategy.

And here's a slide that shows you all the different stakeholders that can be involved in helping and support a lot of the objectives that we have under the Responsible Sourcing strategy. It is quite complicated. There are a lot of stakeholders. There's lots of projects out there as well. I mean, if you look at the ASM side, there's a lot of initiatives that are currently being discussed, and there's a lot of engagement, but it's understanding the impact of some of these. It's understanding how we can be

more supportive and actually work together as a market to provide more momentum behind these projects. So, certainly something that we are not slowing down on, and we need to make sure that we continue to build leverage across those supply chains. Another area that we have had to slightly slow down on, and given the recent challenges in the market, is the area around technology, and how can technology help with some of the efficiencies in addressing some of the supply chain risks. We've heard a lot about blockchain. We've heard a lot about various other technology development – AI, for example – it's, how can we use those technologies efficiently in helping us address those challenges? So, the LBMA, we've been working on the gold bar integrity project in understanding what are the key risks that we want to prioritize? So fraud, duplicate bars. Do we need a database? Yes, we do. And what does this database need to look like? How would it be supporting the underlying physical, and how would we make sure that the data imported into that database is credible and there's integrity, behind this database. So, certainly, work that we are looking to pursue, but these had to be slowed down recently. That said, over the coming months, you will be getting more information on this as we flesh out the requirements of this database.

And finally, to conclude, a little bit on the LBMA update. I just wanted to remind everybody about all the various tools that are out there. I've already spoken about Responsible Sourcing; there's also the LBMA rule book, for members and the good delivery refiners. There is a Global Precious Metals code, which market participants should absolutely be referencing to help them make sure that the systems and controls remain fit for purpose. And then there's the engagement that the LBMA has with the various infrastructure providers, market participants, media, stakeholders, regulators and authorities. We would love to continue hearing more from our participants as to how we can actually support business better. And, also, there are more webinars. So, there will be another webinar next Thursday. So, please, stay tuned on Thursdays at 1:30 – it is becoming a regular spot for LBMA webinars. We really like to hear from you to see what topics you would like these webinars to be addressing, and how these webinars can be improved to help your understanding of the precious metals market. If you have any further questions, please do get in touch with me. And, please do let me know if there's anything else we can do to help at least from the Regulatory Agenda, as well as the Responsible Sourcing Strategy. So, with that, thank you very much for your time today.

### Interested in contributing?

For information, suggestions, or comments about content of LBMA Webinars, or our Virtual Summit, please contact:

**Taylor Birch**

Events Coordinator

[events@lbma.org.uk](mailto:events@lbma.org.uk)

Tel: 07388 798 992

1-2 Royal Exchange Buildings, Royal Exchange, London EC3V 3LF  
Tel: +44 (0)20 7796 3067 [www.lbma.org.uk](http://www.lbma.org.uk)

**April 2020**