

ICE Benchmark Administration and the LBMA Gold Price

By Finbarr Hutcheson, President & Chief Executive, ICE Benchmark Administration Ltd.



Additional ways we are working to raise the benchmark's credibility include consulting with the market on key aspects of the process – such as the Seller's Premium and the publication of non-USD prices – and establishing the LBMA Gold Price Oversight Committee, which meets regularly to review key issues related to the benchmark. We are also maintaining our dialogue with the regulators to provide input on the new rules they are considering. Finally, we recently published our commercial model to support these ongoing efforts. In this article, I will provide my perspective on each of these topics.

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On 20 March 2015, ICE Benchmark Administration Ltd (IBA) became the administrator for the LBMA Gold Price, which replaced the London Gold Fix as the principal global benchmark for daily gold prices. That day was the culmination of a tremendous amount of work by the London Bullion Market Association (LBMA), IBA and the day one participating firms – Bank of Nova Scotia-Mocatta, Barclays, Goldman Sachs, HSBC, Societe Generale, UBS and JP Morgan Chase (which joined one week later). That morning, the transition from the London Gold Fixing Company Limited phone call methodology to the electronic WebICE platform was seamless. I was delighted to witness the first-ever gold auction, which published the LBMA Gold Price at \$1,171.75.

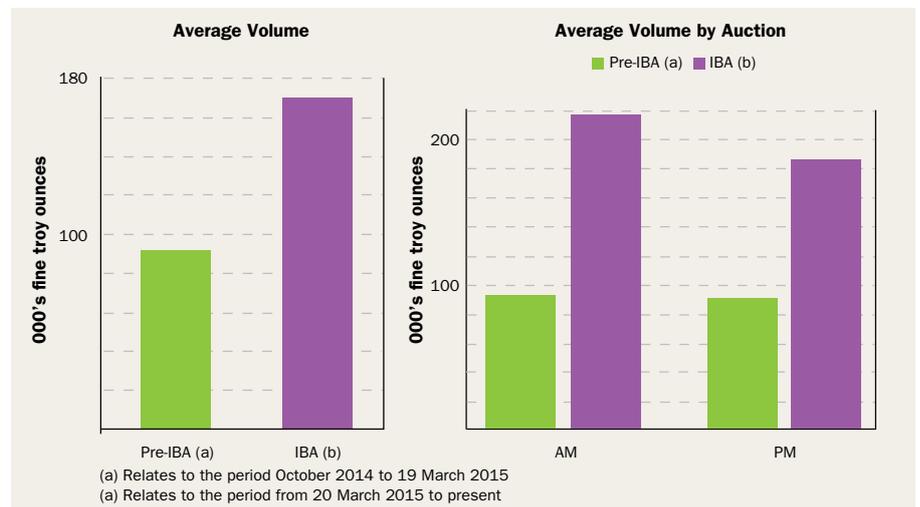
Operating and supervising the auction is now part of our daily routine at IBA, but our role as administrator extends beyond the daily production of the benchmark price. We are continuously working to raise the credibility of the benchmark through increased participation and volumes in the auction, high-quality benchmark administration, improved governance and oversight, and in many other ways as well. We have expanded the number of direct participants in the auction from four (under the London Gold Fixing Company) to ten and with more on the way. Bank of China recently became the first Chinese direct participant, and both China Construction Bank and the Industrial and Commercial Bank of China have announced their intent to join the auction. Compared to the volumes of the last five months of the London Gold Fix, volumes in the auction have almost doubled. Volumes prior to the launch of the LBMA Gold Price were on a net basis, ie after netting off house and client

orders, whereas volumes since the launch of the LBMA Gold Price can be submitted either on a net or gross basis.

Consulting on Key Changes

Just three weeks after the LBMA Gold Price began, we launched a consultation on three aspects of the auction process: the Seller's Premium; the non-USD prices (EUR and GBP); and the fallback procedures if there are not enough direct participants to run an auction.

The Seller's Premium is a historical market convention of adding \$0.15 to the benchmark



for settlement purposes. There is little formal documentation on the origins of the Seller's Premium, but we believe it was put in place a long time ago to incentivise miners to bring their metal through London.

The upshot is that trades between direct participants from the auction are not settled using the benchmark price itself, but a different, higher value. Consequently, transactions between direct participants and clients settle at a spread around this higher value and not around the benchmark price. For example, if the benchmark were \$1,200.00, direct participant transactions would settle at \$1,200.15 and direct participants would settle transactions with selling clients lower than \$1,200.15 (e.g. \$1,200.05) and transactions with buying clients higher than \$1,200.15 (e.g. \$1,200.25). Due to the requirement for client spreads, it makes sense that customer business might not settle at the same price as trades between direct participants. However, as a result of the Seller's Premium convention, trades based on the auction for the LBMA Gold Price do not settle using the LBMA Gold Price as the mid. Since the benchmark is intended to represent the price of trading activity in the auction, transparency is not served if the mid-price for settlement is actually different to that established by the auction.

The Oversight Committee has considered the feedback from the consultation and has come to the conclusion that removal of the Seller's Premium would promote a more transparent LBMA Gold Price and provide a further benefit of the removal of a tracking error. This new standard will come into effect on 1 January 2016, allowing the market adequate time to prepare for the change. If there is sufficient interest, IBA will run implementation forums in conjunction with the LBMA and ISDA. Please contact IBA if you would like to attend.

The non-USD prices are indicative settlement prices for trades in the auction and are also part of the regulated LBMA Gold Price benchmark (used for reference in contracts outside of the auction). The consultation respondents' use of the non-USD prices was mixed: the prices were important to some and not at all to others. Based on the feedback, IBA will continue to publish the non-USD prices. The settlement price for any non-USD trade in the gold auction is agreed bilaterally between each client and their direct participant. The non-USD prices that IBA publishes are indicative-only prices for settlement in the auction. They form part of the regulated benchmark, the LBMA Gold Price, for use in contracts outside of the auction.

The feedback on the fallback procedures highlighted the need for daily benchmark prices in order to protect contractual certainty even if there are not enough direct participants to run an auction on a given day. Therefore, as the administrator of the benchmark, IBA will publish benchmark prices even on days where there is an insufficient number of direct participants to run an auction.

Oversight Committee

The LBMA Gold Price Oversight Committee is a key part of IBA's governance and administration of the benchmark. The Committee is the mechanism by which the market provides ongoing guidance to IBA to ensure the credibility and longevity of the benchmark. The committee achieves this goal by making decisions on the evolution of the process based on changes in the market and regulatory environments. The inaugural meeting of the Oversight Committee was held on 27 February 2015, three weeks ahead of the go-live, and the Committee has now met four times.

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The Oversight Committee represents a diverse cross-section of the market, populated by respected industry veterans. It includes: Grant Angwin (Johnson Matthey Refining); Shekhar Bhandari (Kotak Mahindra Bank); Tony Evanson (Brink's Global Services); Rob Hayes (AngloGold Ashanti); Sakhila Mirza (LBMA); Aram Shishmanian (World Gold Council); Simon Weeks (Bank of Nova Scotia-Mocatta); and Tim Wood (Denver Gold Group). Additional Committee members include Michel Prada and André Villeneuve, two independent non-executive directors of IBA. Michel Prada served as Chairman of the Executive and Technical Committees of IOSCO and was a founding member of the Financial Stability Forum (now the Financial Stability Board). He is currently Chairman of the International Financial Reporting Standards Foundation Trustees. Previously, he was Chairman of the Autorité des Marchés Financiers (AMF) and its predecessor body for 12 years. André Villeneuve served as Chairman of the City of London's International Regulatory Strategy Group from 2006 to 2012 and he was Non-Executive Chairman of the London International Financial Futures and Options Exchange (LIFFE), now part of Intercontinental Exchange, from 2003 to 2009. He was an Executive Director of Reuters from 1989 to 2000.

I am honoured that these two esteemed professionals, along with the gold market representatives, have committed to work with IBA for the good of the benchmark. Emma Vick, IBA's Benchmark Administration Manager, and I round the committee membership to 12. Together, we are working to deliver the best results for the benchmark.

The Oversight Committee is responsible for reviewing all aspects of the determination of the LBMA Gold Price, including the auction methodology, process and parameters; the eligibility criteria for new direct participants; and overseeing any changes. The Committee reviews potential conflicts of interest and oversees the administration of the benchmark. Standing agenda items reflect supporting benchmark integrity and include reviewing surveillance reports.

The Oversight Committee oversees the LBMA Gold Price Code of Conduct. All direct participants must agree to the Code, which requires direct participants to have sufficient internal systems and controls to mitigate potential conflicts of interest; staff training and experience; whistleblowing policies; adequate record-keeping; and proper compliance and audit policies. The Committee will review the Code regularly and can update it at any appropriate time.

Regulation

It would be impossible to write anything about benchmarks in 2015 without referring to the regulatory environment. While the market benefits from and favours clear regulatory structures, there is always the challenge of interpretation in times of change. It is easy to forget that when markets have been functioning for a time, they benefit from common interpretation of rules and they adopt accepted practices. With new rules, we need to build up a history of normal practice, and four months of running of the gold auction has provided consistency and reassurance to the market.

The LBMA Gold Price is now a 'specified' benchmark, which means that it is regulated by the FCA. It also means that the administrator must be a regulated benchmark administrator and must comply with the FCA's rules for benchmark administrators as set out in MAR 8.3.

One of the key concerns for regulators is the mitigation of potential conflicts of interest. This is reflected in both the Code of Conduct and the design of the technology platform for the auction – WebICE.

A key potential conflict that direct participants must mitigate is that of house trading when in possession of information about their client order flow. House trading is a welcome and valuable part of the auction, provided that possible conflicts are appropriately mitigated.

WebICE can be configured to provide full segregation of client and house orders so that house traders have no knowledge of the client order flow during the auction or when trade confirmations are sent afterwards. The feedback we have received from some firms is that their business in the auction has increased as a result of this segregation – they are now freer to trade than before, because the traders do not see the client orders.

The ultimate step in mitigating this potential conflict of interest is for clients to have their own WebICE screens in order to manage their own orders in the auction. Clients would still face their direct participant (who would continue to provide the intermediation service for credit, etc.), but they would have the same level of access to information and control of their orders that direct participants currently do. This 'level playing field' provides a full audit trail from the point of entry of the order and also provides useful granularity for IOSCO compliance. The technology for this is already in place, and we will continue to work with direct participants to enable this for their clients.

Increasing Participation

As mentioned before, we have increased the number of direct participants from four to ten, and more are expected to join. Growing and diversified participation in the gold auction, both geographically and across the industry, has been key to strengthening the credibility of the LBMA Gold Price.

Since the launch of the gold auction, I have presented in New York to wholesale and retail jewellery companies at the Initiatives in Art and Culture Conference, and in Shanghai to the professional market at the LBMA Bullion Market Forum. In Shanghai, I had several meetings with Chinese banks eager to follow in the footsteps of Bank of China. Bank of China, a founding Ordinary Member of the LBMA, became a direct participant of the auction in June.

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We continue to work with new applicants to become direct participants and have a streamlined on-boarding process. If you are interested in learning more about becoming a direct participant, please contact the team, who will be happy to guide you through each step of the process (details are at the end).

Commercials for Sustainability

Systemically important benchmarks need to be operated on a commercially sustainable basis to ensure the required level of investment and attention from independent administrators.

For gold, we designed the commercials to promote direct participation and broad usage of the benchmark in order to further raise global confidence in the LBMA Gold Price and the London gold market. We decided to postpone implementation of fees until the fourth quarter of 2015, to concentrate on a successful launch.

How the LBMA Gold Price is Set

The LBMA Gold Price benchmark is published twice a day using the price from the final round of each gold auction. The gold auctions start at 10:30am and 3:00pm (London time), and are run on the WebICE electronic trading platform.

The auctions provide a market-based platform for buyers and sellers to trade physical spot gold (Loco London delivery). The price discovery is in USD and the final auction price is published as the LBMA Gold Price benchmark in USD, EUR and GBP.

The auctions run in rounds of 45 seconds. At the start of each round, IBA publishes the price for that round and then participants enter their buying and selling volume. At the end of the round, if the difference between buying and selling volume is within the imbalance threshold (20,000 oz) then the auction is finished and the price is set. If the difference in volume is larger than the imbalance, IBA announces a new price and begins a new auction round. Direct participants' orders carry across from round to round and participants can cancel or adjust their orders at any time during or between the rounds. The minimum order size is 1 oz to allow client orders to be exactly represented. Participants can place as many orders as their business requires. Any imbalance is shared equally between the direct participants.

When the auction is finished (i.e. in balance at the end of a round), WebICE automatically nets direct participants' orders to produce the minimum number of trades and notifies the counterparties. The LBMA Gold Price is then published in USD, EUR and GBP, and resulting trades settle two days later.



Based on market feedback, IBA is not charging trade-matching fees to direct participants or their clients; additionally, usage and data access fees are waived for direct participants – to encourage firms to become direct participants. The fee structure is based on benchmark usage and timeliness of access to data, and our commercial model is transparent and non-discriminatory.

Thank You Notes and Conclusion

It has been my pleasure to get to know many of the ladies and gentlemen of the world bullion market, and I look forward to meeting more participants in the future as we continue to grow participation in the auction. I would also like to thank the Oversight Committee members who have demonstrated their commitment to the London gold market by providing their valuable perspective, time and expertise.

I encourage you to visit the IBA web content devoted to the LBMA Gold Price. You will find a comprehensive overview of the technology, governance, oversight and fees associated

with the IBA Gold Auction. If you have thoughts on how to further evolve the auction or would like to become a direct participant, please send your feedback to me or the IBA team at iba@theice.com.



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subsidiary of Intercontinental Exchange (NYSE: ICE). Previously, he served as the Chief Executive of NYSE Liffe, the international derivatives business of NYSE Euronext, and was responsible for the Group's European Fixed Income, Currencies and Commodities (FICC) businesses; he joined NYSE Euronext in 2011. Prior to this, he spent 15 years working for Goldman Sachs in a variety of roles in derivatives. Most recently, he was Global Head of Futures Services Business Development within the Securities Division.