



## All That is Paper Does Not Glitter

By Adrian Douglas

At the Public Hearing on the Metals Markets held by the CFTC on March 25, 2010 I was able to introduce testimony on the record that the LBMA is operating a massive fractional reserve gold market that I called a "Ponzi Scheme". You can read a transcript and view the video clips [here](#). Jeffrey Christian of CPM Group confirmed that what is loosely referred to as the London "physical market" is actually trading 100 times more paper gold than there is the underlying physical metal to back those trades.

How is it possible for the LBMA to sell so much more bullion than they actually have in the vaults? It is possible because of what they define as 'allocated' or 'unallocated' accounts.

An allocated account is when the investor has specific bars of gold or silver which are segregated and the investor is given the serial numbers. This gold and silver can be audited and the customer can have confidence his investment is safe insofar as it really exists, it is being stored on his behalf and that he has title to it.

The LBMA describes "allocated" accounts on its Internet site as follows:

*"These accounts are opened when a customer requires metal to be physically segregated and needs a detailed list of weights and assays. The client has full title to the metal in the account, with the dealer holding it on the client's behalf as a custodian."*

One would be justified in thinking that an unallocated account is when the investor's metal is held by the bullion bank but not specifically identified by serial number. For example, if two different customers each want to buy 200 ozs of gold they can not have allocated bars because the standard gold bar is the "London Good Delivery" bar (LGD) which is 400ozs. This would mean that these two investors could together be assigned an LGD bar but a specific bar and serial number can not be allocated but a real bar is held on their behalf. A casual

review of the LBMA definition of an “unallocated account” would support this view.

The LBMA states:

*“Unallocated Accounts*

*This is an account where specific bars are not set aside and the customer has a general entitlement to the metal. It is the most convenient, cheapest and most commonly used method of holding metal. The units of these accounts are one fine ounce of gold and one ounce of silver based upon a 995 LGD (London Good Delivery) gold bar and a 999 fine LGD silver bar respectively.”*

The LBMA clearly states that an unallocated account is still an account for "holding metal." The LBMA further says that specific bars are not set aside and that the customer has a general entitlement to the metal. I think a reasonable understanding of this description is that if 10,000 unallocated account holders have collectively purchased 100 tonnes of gold then there will be 100 tonnes of gold in the vaults of the LBMA for those unallocated customers. But that understanding would be wrong, for the LBMA's statement is misleading and deceptive. The LBMA's definition of unallocated accounts continues as follows:

*“Transactions may be settled by credits or debits to the account while the balance represents the indebtedness between the two parties.*

*Credit balances on the account do not entitle the creditor to specific bars of gold or silver, but are backed by the general stock of the bullion dealer with whom the account is held. The client is an unsecured creditor”*

The balance on the account is a measure of “indebtedness between the two parties”. In other words the account balance is an I.O.U. bullion. It is NOT a “method of holding metal” as described in their first paragraph. The account is backed by the general stock of the bullion dealer but that may be, as Jeffrey Christian confirmed, one physical ounce for every hundred ounces that have been sold in unallocated accounts. The most important assertion about unallocated accounts is: "The client is an unsecured creditor." If 100 tonnes of gold had been bought by 10,000 unallocated account holders and the bullion bank commits to holding 100 tonnes on their behalf the creditors can not be unsecured. The clients would be secured by 100 tonnes of gold. The very fact that the account holders are described as “unsecured creditors” means that their accounts are being operated or are subject to operation on a fractional-reserve basis. They are not, therefore, *“the most convenient, cheapest and most commonly used method of holding metal”*, they are a method for holding an I.O.U. bullion, a paper promise of bullion, an unsecured debt instrument issued by the bullion bank.

This is an unscrupulous scam that is being perpetrated on a massive scale. The LBMA trades on a net basis 20 million ozs of gold each day and 90 million ozs of silver. At current prices that represents \$6.3 Trillion annually or 60% of the entire US economy!

If the bullion bank does not really purchase the bullion that unallocated account holders think they are buying, then these investors are essentially making interest-free loans to the bank. Actually, it's a negative interest rate, because the bullion bank customers pay fees. These loans are index-linked to the price of bullion.

So what better motivation could there then be for the bullion banks to suppress the price of gold and silver? They are getting money loaned to them through these unallocated accounts at negative interest rates but they are indexed to the price of gold or silver, so the last thing they want is the price of gold or silver to go up.

At the CFTC hearing the bullion dealers and their apologists argued against imposing position limits in the gold and silver markets of the New York Commodities Exchange because the dealers have to hedge their "positions" in the London physical market. But none of them actually stated categorically that they were hedging real physical metal holdings.

In my statement to the Commission I said the bullion banks essentially had "paper hedging paper." Christian confirmed this. He also stated that in 2008, when gold and silver purchases were heavy, the bullion dealers had to hedge those sales by going SHORT on the Comex. When CFTC Chairman Gary Gensler challenged the logic of what Christian had just said, Christian explained that he had misspoken. But I believe it was a Freudian slip. The bullion banks have a massive and leveraged vulnerability to rising bullion prices and so their response in 2008, as bullion prices threatened to break out, was indeed to sell short on the Comex to drive down prices.

HSBC and JPMorgan Chase are market makers on the LBMA. Together they own 95 percent of the over-the-counter precious metals derivatives as reported to the U.S. Office of the Comptroller of the Currency, and, by comparison with the CFTC Bank Participation Report, HSBC and JPMorgan Chase are the biggest short sellers on the Comex.

Since the LBMA is not really buying all the metal that investors are supposedly purchasing from it in unallocated accounts, not only is the LBMA hurting those investors but it is also suppressing the exchange price of the bullion held in allocated accounts for their customers. If the LBMA was to back all bullion sales with 100 percent unencumbered bullion, the price of bullion would be multiples of the current price because physical demand would be many times higher.

Where is the warning to owners of allocated metal accounts that their bullion dealer is running a scheme that involves deliberately and willfully selling naked short against their investment?

In 2003 Graham Tucker, chairman of Gold Bullion Securities, made a presentation to the annual LBMA Precious Metals Conference about the newly launched gold-backed ETF that today trades on the American Stock Exchange under the ticker GOLD. The transcript of his speech can be found here:

<http://www.lbma.org.uk/docs/conf2003/2e.tuckwellLBMAConf2003.pdf>

In that speech Tucker said:

*"There are three essential components of [a] listed security in our opinion. Firstly, ownership of the gold; investors want allocated gold, not a third-party credit risk, which is what unallocated gold is. In fact, you could argue unallocated gold isn't gold; it's just a piece of paper issued by a bank, and in most cases, unsecured risk."*

This is a speech being made in front of all the members of the LBMA. You simply can't make those types of statements in front of such a crowd if they aren't true. And we know it is true because the LBMA says the same thing on its Internet site. The LBMA say its clients are "unsecured creditors."

Goldman Sachs has just been charged with fraud for failing to advise customers to whom they were selling a particular investment that the firm had been paid by the John Paulson Fund to engineer the investment in a way that made it likely to go down in price.

There is an exact parallel in selling allocated gold as a safe haven investment and failing to disclose that activities of the same bank will impede its price from rising or even make its price go down.

In 2007 Morgan Stanley settled out of court a class action [suit](#) by precious metals investors. The complaint alleged that Morgan Stanley told clients it was selling them precious metals that they would own in full and that the company would store; but Morgan Stanley either made no investment specifically on behalf of those clients, or it made entirely different investments of lesser value and security.

In an interview with [King World News](#) investors Harvey and Lenny Organ recount their difficulties in getting their gold and silver which was supposed to be held for them by Bank of Nova Scotia. They recounted a visit to the bank vault, where they saw very little inventory.

Some bullion dealers and fund representatives have countered with their own eyewitness accounts, asserting that they have allocated metal stored at the bank and they have verified that the bullion is in storage there. These bullion dealers and fund representatives have misunderstood the issue, for the sanctity of allocated gold and silver investments was not in dispute. The Organs were referring to unallocated metal, not allocated. The Organs had bought metal on the Comex and taken delivery and asked Bank of Nova Scotia to move it to the bank's vault in Toronto. In the process the Organs' metal apparently was switched to unallocated and the unallocated metal inventory they were shown was insufficient to contain their holding.

Those rushing to defend Bank of Nova Scotia to claim there is plenty of gold and silver in the bank's vaults should check the bank's Internet site first:

<http://www.scotiamocatta.com/products/faq.htm>

QUOTE

*How secure is a "gold certificate"?*

*Scotiabank gold certificates are backed by the assets of The Bank of Nova Scotia.*

END

There is no guarantee that the certificates have any gold or silver backing at all. Elsewhere they say:

QUOTE

*Unallocated gold is a claim on The Bank of Nova Scotia for the ounces entitlement to a specific quantity of gold bullion.*

END

So unallocated bullion is not bullion at all; it's an unsecured claim against the bank.

Bank of Nova Scotia is a market making and clearing member of the LBMA and is also a member of the London Fix.

Economics tells us that the price of something goes up when demand goes up and/or supply goes down. How can the price of precious metals increase when the supply of unallocated gold and silver can be created to infinity out of thin air? Investors make investments in precious metals as wealth protection against unlimited fiat currency creation. What a cruel irony that their unallocated precious metal investment is also being created out of thin air!

What should investors do?

Investors need to do their due diligence. They need to determine if they are actually holding a 100-percent precious-metal-backed investment.

There are some unallocated investment vehicles that are entirely honest where all the gold and silver sold is actually purchased and held on behalf of the customers. One such example is GoldMoney.com, which conducts and publicizes third-party audits to verify 100-percent backing.

If a bullion dealer's contract does not unequivocally and expressly state that the unallocated investment is 100-percent backed by bullion or states that the investment is unsecured in any way or is only a claim against the dealer, then investors should take delivery or convert to an allocated investment.

If unallocated bullion investments have a reserve ratio of only 1 percent, as suggested by CPM Group's Christian, such instruments are an accident waiting to happen, the next fraud waiting to be exposed.

But whatever the reserve ratio, if it is significantly less than 100 percent, this source of "paper bullion" created out of thin air as a ledger entry is the main reason gold and silver prices have not kept pace with inflation, because the apparent supply is so much higher than the real physical supply.

You should not facilitate this price suppression by holding such vehicles. You should take action. All that is paper does not glitter, and when the music stops it will not fulfill the investment goals for which it was intended.

If you buy a lifeboat on the Titanic, you want a lifeboat on the Titanic. You don't want an IOU for a lifeboat on the Titanic, where, if no lifeboats are available, you may be offered a settlement in cash.

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