



LBMA OTC Market – “Alchemists” Turn Paper into Gold

By Adrian Douglas

I have written several articles recently that have discussed how much “paper gold” has been sold, principally through the unallocated accounts of the LBMA although there are other vehicles that achieve the same end such as pool accounts, unbacked ETF’s, futures, and derivatives etc, but the LBMA dwarfs them all.

<http://www.gata.org/node/7911>

<http://www.gata.org/node/7908>

I estimate that as much as 50,000 tonnes of gold has been sold that does not exist. That is equivalent to all the gold reserves in the world that are yet to be mined, or put another way, 25 years of gold production. That is the grand-daddy of all short positions! The fractional reserve operation of the LBMA is likely to be the next Madoff scandal, except multiplied by 100...a 5 trillion dollar fraud as opposed to a 50 billion dollar fraud.

Like all financial scandals before it, this one will be exposed just as surely as night follows day. Gold is unique among all commodities. It is the only commodity that is not bought to be consumed. It is purchased as a store of wealth. Because it is not consumed the buyer does not need to take possession of his gold but can be persuaded to trust the seller to store his gold on his behalf. This unique wrinkle allows bullion bankers to sell gold that does not exist. This allows them to make huge profits as they have very little cost as they don’t have the inconvenience of actually having to purchase the gold they sell! The consequence of this illegal activity is that it suppresses the price of gold because the “paper gold” supply has the same effect on prices as if real gold had actually been supplied to the market. This means that this racketeering is extremely beneficial to the central banks, who are hostile to gold because a free market gold price would blow the whistle on their perpetual inflationary actions. A suppressed gold price makes fiat currencies appear to have an artificially higher purchasing power. The central banks do not just turn a blind eye, but actively aid

the bullion banks; they lease them central bank gold at a pittance of a lease rate to make sure there is always enough liquidity such that the scam is not exposed due to the bullion banks being unable to deliver real metal when requested to do so.

There is nothing new about gold bankers selling gold that they don't have. The goldsmiths invented the scheme in the 16th century. As recently as 2005 Morgan Stanley was sued for selling non-existent precious metals. Morgan Stanley even had the audacity to charge storage fees on the non-existent precious metals. The firm settled the class-action lawsuit out of court but no criminal charges were ever filed. Morgan Stanley maintained that they did nothing wrong because none of their clients had lost any money in the scam! That's certainly innovative. I will try stealing a billion dollars from a bank and then I will pay it back the following day and see what the FBI thinks of that legal defense strategy!

The LBMA operates a fractional reserve system. They sell much more gold than they actually have. They keep on hand the amount of gold that they estimate, in the worst case scenario, they will be called upon to deliver.

In a recent article I analyzed data from the LBMA's own website that shows that a net of approximately 20 million ounces of gold are traded each and every day.

<http://www.gata.org/node/8248>

This means that we are meant to believe that the equivalent of 25% of global annual gold production changes hands each day on the LBMA! On a gross trading basis it probably represents the entire global annual gold production traded each and every day! In dollar terms it represents 5.7 Trillion dollars of net trade annually. That is almost 60% of the entire US economy or 10% of the entire global economy being traded through a handful of gold bullion banks. It is simply mind boggling. You don't have to be a rocket scientist or a market regulator to smell something fishy. To back that level of trading on a 100% reserve ratio the bullion banks would have to own almost 40% of all the gold ever mined in the world. There are simply not enough London Good Delivery bars in the world for that to be the case.

You don't have to rely on me to tell you the LBMA is running a fractional reserve gold racket. This is from their website:

<http://www.lbma.org.uk/london/accounts>

QUOTE

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. 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.

Should the client wish to receive actual metal, this is done by 'allocating' specific bars or equivalent bullion product, the fine gold content of which is then debited from the allocated account.

END

There are some real peaches in this description. For example "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."

They don't say that the bullion dealer has to hold the amount of gold he has sold, just that these unallocated accounts are backed by the bullion dealer's stock. His stock could be 1000 ozs or even zero. Note the statement "The client is an unsecured creditor". So this really spells out what "unallocated" means. It means literally there is no gold allocated to the customer. The customer owns an I.O.U for gold.

If the LBMA were running a system where they had on hand 100% of all the gold they had sold but they just didn't want to assign specific bars and serial numbers then all creditors would be secured. They spell out that all clients are unsecured creditors. They have no gold guaranteed against the I.O.U. from the bullion dealer!

Who exactly are the members of the LBMA? The clearing members are as follows:

HSBC Bank USA National Association
JP Morgan Chase Bank
The Bank of Nova Scotia
Barclays Bank
Deutsche Bank
UBS AG

HSBC and JPMorgan Chase are the biggest short sellers on the COMEX, they together own 95% of the OTC precious metals derivatives, they are custodians of the bullion supposedly held by GLD and SLV respectively and they are clearing agents for the LBMA. That is one fine set of credentials! These people are so

arrogant and confident about their racketeering not being exposed that the quarterly publication of the LBMA is titled "The Alchemist"! Unlike the Alchemists of the middle ages who unsuccessfully attempted to turn lead into gold, the Alchemists at the LBMA turn paper into gold; well, "gold I.O.U's" to be accurate.

In 2003 Graham Tucker, Chairman of Gold Bullion Securities, made a presentation to the annual LBMA Precious metals Conference about their newly launched gold backed ETF that today trades on the ASX 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 he said:

QUOTE

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.

END

You have to remember that 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 weren't true. And we know it is true because the LBMA says the same thing on their website. They say their clients are "unsecured creditors"! The LBMA peddles gold promises to those gullible enough to trade off convenience against title.

Many people do not understand what fractional reserve accounting means. I will give you an example of a less important real life case. The airlines routinely sell more seats than exist on a plane. If the plane holds 200 passengers but from statistics the airline knows that on average only 50% of the passengers show up for check-in then they can sell 400 seats and be almost certain that the plane will fly full, which increases their profitability. If they were only to sell 200 tickets the plane would fly half empty. Occasionally the airline gets caught out when, say, 210 passengers check-in. In such circumstances the airline offers a free night in a hotel, a first class upgrade and some cash for any ten passengers volunteering to fly the following day. The passengers all purchased tickets believing they were buying actual available seats on an aircraft, not unallocated virtual seats.

This is exactly the same situation with the LBMA; they sell more gold than they have. They know from statistics on average how many clients will ask for delivery and that determines their minimum stock level.

However, just like in the case of the airlines this scheme is destined to be discovered. When more gold is demanded than the bullion banks can deliver they try to lease or buy gold from the Central Banks. If this can be done in a timely fashion the clients are none the wiser. If the Central Banks can not supply then the bullion banks are obliged to offer premiums over spot for clients to accept cash in lieu of the metal.

We are hearing anecdotal stories that recently there have been cases of up to 25% premium being offered for clients to settle in cash. It would seem the bullion banks have pushed the game too far and are on a collision course with default. In addition the Central Banks have dishoarded a large proportion of their gold and are not in a position to come to the rescue of the bullion banks as they have been in the past.

I recently made an analysis of the COMEX warehouse inventory of gold and silver in an article entitled "Alarming Trend in COMEX Gold and Silver Inventory Data"

<http://www.gata.org/node/8373>

One of the conclusions is that in the last 6 months there has been a dramatic decline in the inventory held by the dealers on the COMEX (the registered category), while over the same period of time the Open Interest has increased. This essentially means that each open contract has less warehouse gold or silver backing today than it did 6 months ago. This is a classic reduction in reserve ratio. It is a sign that the Gold cartel is running out of physical gold and silver. This observation is supported by other data. During the last two years the US mint has periodically suspended production of gold and silver eagles due to shortages of bullion, the COMEX futures have displayed contracting contango and/or mild backwardation, which is indicative of physical market stress. There is anecdotal evidence of the LBMA OTC market in London having difficulties in making deliveries and requiring central bank gold to do so. There are also rumors of large premiums being offered for cash settlement in lieu of the bullion. Sources active in the London market tell us it is difficult to find bullion in size. The Central Banks have stopped selling and have become net buyers of gold. Furthermore, the highly politically connected Barrick Gold announced a panicked buying back of its hedges at the end of last year.

The clients of the LBMA are not speculators or gamblers. They have bought gold which they believe, in good faith, is being held in a vault for them by the LBMA members. As the suspicions about the LBMA rise, more and more clients will ask for delivery which will expose this fraudulent operation. As stated at the beginning of the article I estimate that as much as 50,000 tonnes of gold has been sold that does not exist. That is equivalent to all the gold reserves in the world that are yet to be mined, or put another way, 25 years of gold production. That is the grand-daddy of all short positions! The fractional reserve operation of

the LBMA is likely to be the next Madoff scandal, except multiplied by 100...a 5 trillion dollar fraud as opposed to a 50 billion dollar fraud. Those holding real bullion will see the price multiply many fold as the price adjusts to the real supply and demand fundamentals of **real** physical metal.

There is only one way to protect yourself and to profit. You should own physical bullion. Simply don't trust intermediaries like the LBMA who purportedly sell you gold but label you an "unsecured creditor". Anyone who thinks they hold gold on the LBMA should demand delivery. The major desirable and unique characteristic of gold is that it is no one else's liability, unlike almost every other financial asset. If you own a credit risk, an I.O.U. gold, you have not achieved the principle objective of owning gold. Are you a "gold owner" or an "unsecured creditor"?...you can not be both!

Adrian Douglas

March 1, 2010

www.marketforceanalysis.com

Market Force Analysis is a unique analysis method which provides reliable indications of market turning points and when is a good time to enter, take some profits or exit a market. Subscribers receive bi-weekly bulletins on the markets to which they subscribe.