# Client Alert

## Global Mining and Metals Industry Group

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# Finding your fix

## Removing the price fix for gold and silver may cause a rethink on the reliance on spot prices in contracts

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The fix is finished. Amid ongoing technological and regulatory changes, the twin committees that have set silver and gold prices for a century will have disbanded by the end of 2014.

As large financial institutions around the world reoriented their commodities-related businesses in 2013 and 2014, Deutsche Bank announced that it would stop participating in the silver and gold benchmarking bodies.

The London Bullion Market Association (LBMA) then initiated transitions in the benchmarking of silver and gold. Indeed, the silver fix has already ended. New price participants are trading under an electronic benchmarking system. The gold fix will end later this year. Potential price participants are striving to have a new system in place by then.

Similar standards will govern the benchmarking of silver and gold in the 21st century. Although the metals have different uses, prices, volumes, locations, and types of trade, participants in both markets require similar standards: broad participation; real-time information exchanges; transparency; administration; and oversight.

Above all, market participants require an indicative, global price.

The continuing consensus is that a global market price must reflect deep market liquidity and allow trade to be settled locally and physically.

The London Silver Price (set until August 15 this year by the London Silver Market Fixing Ltd.) and the London Gold Price (currently being set by the London Gold Market Fixing Ltd) sought to provide for this need by setting a price that reflected the largest amount of gold traded at one place, at one time, twice a day.

Whether merited or not, in the wake of increased scrutiny of benchmarks by regulators and industry-participants, the LBMA is striving to ensure the new price setting systems will in time reflect a deeper market providing for more direct participation by an increased number of accredited market participants, while bolstering the transparency of the benchmark.

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## Devil's metal in the digital age

Nearly 120 years ago, a group of bullion traders began meeting to set a price for silver. For a century, participants would meet directly to enter bids for the purchase and sale of silver, thereby arriving at the posted price.

The system evolved over time. In 1999, for instance, participants began setting the price by conference call. At the beginning of this year, the London Silver Fixing Company Ltd – a committee of banks, which at the beginning of 2014 included HSBC, Deutsche Bank, and Bank of Nova Scotia – operated and administered the London Silver Price.

Under the new system, the Chicago Mercantile Exchange will provide the electronic trading platform on which the price will be calculated algorithmically, while Thomson Reuters will administer and oversee the governance of the benchmark as well as its publication and dissemination in real time through numerous data vendors. Accredited participants now include HSBC, Mitsui & Co, and the Bank of Nova Scotia.

Other participants – including banks, traders, refiners, and producers – are likely to join the process.

In 30-second rounds, accredited participants work towards the relevant day's LBMA Silver Price by buying and selling volume orders in lakhs (100,000oz) or quarter-lakhs until the market is balanced (using an algorithm that matches buy and sell orders within a permitted tolerance level of three lakhs). Shortly after midday on the relevant day, the LBMA will also post the price. Thus far, the electronic system has run smoothly and the market has not seen significant price volatility or disruptions in the trading of silver.

## Getting to gold

The century-old London Gold Fix will come to an end this year. The London Gold Market Fixing Ltd – formed formally in 1994 as a committee of banks which now includes Barclays, HSBC, Societe Generale and the Bank of Nova Scotia – currently meets twice a day to set morning and afternoon benchmarks.

London Gold Market Fixing Ltd and the LBMA have jointly requested proposals from parties interested in administering a new (or slightly modified) system.

Interested parties have been submitting proposals in recent months: the London Metal Exchange, the Chicago Mercantile Exchange, and the Intercontinental Exchange have, for instance, submitted ideas ranging from a modified telephonic system to auditable electronic platforms.

The LBMA and interested parties will likely be influenced by the new silver standard's design.

## Private parties in global markets

The twin transitions will probably unfold smoothly from an industry-wide standpoint. Continuity has characterised the silver benchmark transition. Gold should be no different.

In both instances, the LBMA and potential price participants have encouraged the industry to identify concerns and tailor systems to attract market makers possessing the sort of liquidity needed to support the benchmarks.

Some uncertainty, however, may cloud price determination in existing contracts. Under English and most governing laws, pricing provisions must have sufficient certainty not to be considered void. Parties should thus check existing contracts to see if they provide for the new LBMA gold and silver price mechanisms.

Many existing contracts refer to the nowdefunct London Silver Fix and soon to be discontinued London Gold Fix without incorporating an alternative or replacement price mechanism.

Other contracts may refer generally to a spot price in London (or another location), arguably incorporating successors – such as the LBMA Silver Price – to the benchmarks in force at signing. Other existing agreements may base their price on the London Silver Price or London Gold Price benchmark but envisage alternatives to apply if the LBMA has ceased operations.

Parties may wish to rethink their reliance on existing spot prices in their contracts. Pricing "waterfalls" are one relatively sophisticated option. For example, parties could agree to a contract price governed by the relevant LBMA-accredited London benchmark; or an alternative benchmark or generally accepted industry alternative – if available.

This could, for instance, include: standards in New York or Asian markets if the parties wish to contemplate region-specific benchmarks; or a replacement agreed to by the parties within a predetermined period of time; or, failing that, a price arrived at under the auspices of an alternative dispute resolution procedure, including, but not limited to, arbitration.

Other options are available. For instance, the International Swaps and Derivatives Association has published an amendment agreement for derivatives contracts that would replace references to the old London Silver Price with the new LBMA Silver Price.

But no fix is permanent. As recent transitions in the metals markets and loan markets have demonstrated, benchmarks may be replaced. Parties may wish to consider including fall-back language in contracts to contemplate such an eventuality.

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