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BANK CITES POOR RISK MANAGEMENT — PAYS $44 MILLION FINE

Weak internal controls were cited by a London bank as the reason a precious metals trader was able to manipulate the gold fix on June 27, 2012. Some say the $44 million fine — only 10 percent of the previous LIBOR-fix scandal fine against the same bank — handed down late last month was hardly a sufficient penalty. But the ease with which the precious metals markets can be manipulated raises new concerns about adequate regulation of banks that trade in these commodities.

The London Gold Fix

A customer of the bank essentially placed a $43 million "bet" that the price of gold would not rise — in this case above $1,558.96 per ounce; otherwise, the bank would be out $3.9 million, and the trader himself would stand to lose. The trade was based on the benchmark price of gold as set by London's five biggest bullion banks. Via a conference call, they set a common price — known as The London Gold Fix — for large-scale purchase and sell orders twice per day, at 10:30 a.m. and again at 3 p.m. This system — with variations in technology — has been in use for 95 years.

Digital Options Vulnerabilities

The customer's two-year digital-options contract was based on a June 28, 2012, ending date. As of June 27, the gold fix was at $1,573.50 and heading up that evening — already above the mark that would trigger a loss for the bank and the trader. The trader emailed his bank's metals trading desk on June 27 and informed it that he was expecting a fall in gold price the following day. According to bank regulators, the morning of June 28, he notified colleagues: "Hopefully we fix 1,558.00, or 1,558.75…"

The 3 p.m. Fix Call

At the 3 p.m. conference call, the market-maker banks arrived at a proposed gold fix of $1,558.50. But as the price of gold, nevertheless, began to rise, the trader then entered a sell order for about $90 million worth of gold, hoping to further head off a rise — which he apparently did. The customer smelled a rat and immediately complained to the bank, which, after an investigation, agreed to make the customer whole.

Conflict of Interests

At the time of the manipulation, the bank's internal control systems were not able to detect tampering with benchmark prices such as the trader committed. Furthermore, the obvious conflict of interest — a gold-fix participant that is supposed to exercise equitable practices toward its customers having a vested interest in the customer's loss — seemed lost on the bank. The British Financial Control Authority (FCA) agreed and fined the bank the equivalent of $44 million.

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