



Gold Corporation
(trading as The Perth Mint)
ABN 98 838 298 431

310 Hay Street, East Perth,
Western Australia, 6004,
Australia

A statutory authority under the
Gold Corporation Act (1987) of
Western Australia

Founded in 1899, the Perth Mint is
an integrated precious metal
operation refining circa 10% of
world gold production; servicing
investors with legal tender [bullion
coins and bars](#) and the [Perth Mint
Depository](#) custodial facility;
providing collectors with innovative
and high quality [numismatic coins](#);
supplying mints with [precious metal
blanks](#); and operating a leading
Perth [tourist attraction](#).

RESPONSE TO DAVE IN DENVER

TF Metals Report has [posted](#) some comments from
blogger Dave in Denver responding to my [ETF Price
Suppression Mechanics](#) last week. Below is my response.

*Dave: "... biased toward the precious metals custodial
operators and clearly he has to defend industry practices
..." and "... a pathetic apology for a system ..."*

I would argue that the fact that the Perth Mint competes
against these other custodial operators means people
should be alert to biases I might have **against** them. The
ETFs are competitors to the Perth Mint, both in respect of
physical coins and bars as well as our Depository
business.

Dave's assumption that I am an apologist is one I've
encountered often. It seems people think that when I
"nitpick" and refute factual inaccuracies that I must
therefore see no problem with these products at all. That
doesn't logically follow.

Those who are familiar with my [personal blogging](#), which I have been doing since mid-
2008, and comments on various forums and blog, would find Dave's comments
surprising. While Dave and I had a [run in 18 months ago](#), I would not have expected
him to read my blog fully at the time and thus form a correct view of where I am coming
from. So in my defence, I submit the following comments I've made on ETFs in the
past.

December 2008: In this post titled "*Warning on the existing Au and new Ag, Pt & Pd
ASX listed ETFs*" (does that seem biased towards ETFs), I drew attention to ETF
Securities' Australian listed precious metal products, saying that "*the prospectus (which
also covers the existing GOLD product) has some alarming "features" I thought needed
highlighting ...*" particularly around the incredible "custodian does not have to insure it,
we don't intend to insure it and the trustee is not responsible for ensuring it is insured"
type clauses that exist in almost all of the ETFs.

August 2010: Here you will find me praising two critiques of the ETFs - "*In an otherwise
good analysis of GLD (Precious Metals ETF Alchemy GLD – the new CDO in
disguise?) and building on Catherine Fitts' Precious Metals Puzzle Palace Hinde
Capital (as does Ms Fitts) gets it wrong on leasing ...*"

January 2011: Quote - "*The point of my discussion above is not to suggest GLD is a
safe investment. It is just to introduce a little more nuance beyond a simplistic "GLD is
bad because bullion banks involved."*



February 2011: Quote - *“The ability of non-APs to borrow GLD shares and then sell them short I think we are in agreement on and is another problem with GLD, or to be fair with stock exchanges in general it seems.”*

February 2011: Quote - *“Their focus was on physical offtake and thus obsessed about the metal behind GLD being Allocated gold. Funny when you consider that the legal structure introduced, in my opinion, some holes that negated the “security” of the Allocated gold backing.”*

While it would be in the commercial interests of the Perth Mint for ETFs to be revealed as scams, as I say in [this post](#), “... I operate under the *ethic of reciprocity*, otherwise known as “do unto others as you would have others do unto you” so I’ll have to be fair and factual in my analysis of this analysis.” Being fair and factual to one’s competitors is what I think confuses people. So for avoidance of any future doubt, may I say:

- 🌐 I do not recommend ETFs for anything but short-term trading.
- 🌐 If you don’t hold it in your hands, you have counterparty exposure - period. Allocated with bar numbers in a non-bank vault does not have some magical force-field that stops it from being stolen. You are trusting your custodian.
- 🌐 If you hold it in your hands, you have theft exposure. All precious metal investment has risks, only you can decide what risks you are comfortable with. Don’t let anyone tell you that you are an idiot for storing it yourself or for storing with a custodian.
- 🌐 If you don’t understand a prospectus/agreement, stack physical.
- 🌐 If you don’t understand a company’s business model (which includes the Perth Mint’s “use in our business” unallocated), stack physical.

Dave: “... his unwillingness or perhaps lack of knowledge regarding those problems ...” and “...Mr. S was stone silent on that matter” and “this issue is egregiously problematic and he conveniently ignores it” and in [this comment](#) “... the glaring omissions ...”.

I can see how Dave interpreted my “omissions” as further proof I was being an apologist, but he missed the fact that Andrew’s article and my response to it were about the mechanics of how GLD works and if it could be used as a tool of manipulation. Andrew’s article was not about how bad GLD is as a product.

The article was about the **use of** GLD, not **about** GLD itself. At around 5,000 words my response was already long enough that the inclusion of a critique of GLD as well would have made it unreadable.

Dave also missed the point of my inclusion of Ways to Own Gold #1 & #2 which I contrasted with the relationship between the ETF participants. I put this in to support this statement later in the article: *“A lot of people are involved in the ETF process. More people, more buck passing when something goes wrong.”* I also included a link to Jim Sinclair’s good work on helping people getting their shares out of street name – the result of which would be to make share borrowing (and shorting) more expensive.



Dave: "...pedantic nitpicking/correcting of Andrew McGuire's loose use of terminology as a device to try and diminish Andrew's comments."

As I said in my article, I was seeking to explain some of Andrew's "mechanics" a bit more clearly. I suppose it can be perceived as nitpicking, but there was no intent to use it as a "device" to diminish Andrew's comments. When Ed Steer said he hasn't "*clue as to what he's talking about*" I felt the importance of what Andrew was discussing justified an attempt to clarify and explain.

Dave: "Not once did he address the issue of naked short-selling."

Andrew's article talked about the borrowing of GLD and shorting and not about just selling GLD shares without borrowing them. Naked short-selling was not central to the mechanics Andrew was talking about. Yes it is another potential manipulation tactic, but my article was a response to Andrew's and to start introducing other mechanisms would have confused the reader when the subject material was complex enough.

I did consider including something about it, but felt that discussion of [Regulation SHO](#), locate and close-out requirements, threshold securities, fails to deliver, the SEC's weak reasons why they don't "*provide more detailed information for each threshold security, including the total number of fails, the total short interest position*", etc would have overburdened my response.

I would note that the SEC's [Holding Your Securities - Get the Facts](#) is skewed towards street name registration and doesn't mention its key disadvantage being exposure to one's broker. Interesting, because at the end of their "facts" they mention the [Securities Investor Protection Corporation](#) and how "*your securities and money held at your broker-dealer are protected up to \$500,000 with a \$100,000 limit for cash*". One only needs protection if one has exposure.

I do think the naked shorting/fails to deliver issue is of concern, but it is a complex issue worthy of its own post rather than being buried in another article.

Dave: "But I would bet him \$10,000 that if I were to ask every single retail brokerage hold of GLD shares if they were the owner of those GLD shares, every single one would say yes."

No need for that bet, I agree and quote from my article "*Many investors are not aware what "street name" means or that "their" shares can be lent without their knowledge when they agreed with their broker to hold their shares in this way.*" That is why I included the explanation of street name and a link to Jim Sinclair.

Dave: "the short-selling argument Mr. S tries to dispel with technical pedantry"

I don't see how I was dispelling with Andrew's argument when I said "*in terms of price suppression, I've demonstrated that the "borrow and sell" process can achieve this*" as well as agreeing with Andrew that the "borrow and sell" process can provide a bullion bank with a supply of physical to meet unallocated redemption requests.



What I did say was that I didn't think the short position in GLD shares was material in size compared to the COMEX and OTC markets and thus *"bullion banks don't use it as a serious source of borrowing for short selling price manipulations or physical supply"*. Note I didn't say they don't use it **at all**, just that it is not a serious source.

Dave: "If they both converted at the same time, then legally, of course, the original buyer would not be entitled to the shares. His shares have been legally hypothecated."

Thank you. I will bookmark this so the next time someone says that the borrowing of shares creates two owners or that the shares are "unbacked".

Dave: "BUT, if this situation were allowed to stand without making both end-buyers of the GLD shares whole on their bullion, it would likely trigger a collapse of confidence in the brokerage business because no one in their right mind would ever buy stocks that could be hypothecated and re-sold."

Agreed. That is why I think informing as many people as possible about what street name means is important. Lending someone's shares behind their back, without informing them, is dishonest as they have not consented to an action that affects the value of their shares.

Dave: "BUT, if you read through how Inspectorate is retained by the Trust, they do a physical audit once per year."

So at least once a year you will agree they have the gold? 😊

Dave: "The second audit is more of a paperwork-check, spot-check reconciliation of the Trustee files with the custodial records. That leaves plenty of time during the year to play fractional "shell games" with the bullion that is supposed to be moving in and out of the custodial vault on a weekly basis."

It is pretty hard to count 96,968 bars in one day, so from the [audit certificate](#) you'll see that Inspectorate does the audit over three months, which would require a reconciliation of the records as at the 30th June with movements over that period. So it is pretty hard to play shell games if you have auditors in the vault for three months of the year. Note that 96,968 bars over 13 weeks, 5 days a week, 8 hours a day is counting 186 bars an hour, so the auditors are there pretty much full time.

I also think it is hard to play shell games when you have to produce a bar list every day (not weekly, which Dave implies) which people like [Warren James](#) are watching and keeping track off and not slip up.

Finally, Dave doesn't understand that the bullion doesn't necessarily physical move in and out of the custodian's vault. That is the point of the [London Precious Metal Clearing](#) system – all the custodian is doing when allocating or de-allocating the GLD Trust's metal is changing title to the bars from/to GLD and the bullion bank's own physical reserves that (fractionally) back its unallocated liabilities.



Dave: "... the custodian/sub-custodian structure and the lack of legal glue in the legal wording used in the Prospectus to create a full-faith, binding, full-indemnification agreement between the custodian and the sub-custodians and between the custodian and the Trustee/Sponsor ..."

Agreed. In contrast to the [Government Guarantee](#) the Perth Mint operates under, which has no exceptions or cop out clauses – the Government guarantees it, no matter what.

Dave: "...mindless investment advisors who sell them GLD for commissions in generated in lieu of recommending the purchase of physical."

Agreed. The inability of advisors to earn any commission on physical sales hampers a wider distribution of precious metals. Something I think the Gold Bullion International system is addressing.

Dave: "Alasdair Macleod wrote a piece last week in which he describes factually how GLD altered its prospectus in order to move regulatory oversight for custody of client assets from the FSA to the LBMA/BoE."

I'm not sure how much of a difference that made to an already loophole riddled prospectus. I sent an email to Alasdair congratulating him on a good bit of detective work. Below is an extract from my email, which readers may find useful:

I would note here that even if the Custodian was regulated by the FSA it doesn't seem to me that they could or would have scope to override the fact that the GLD prospectus says that the Custodian is only liable for losses that are the direct result of its own negligence, fraud or willful default. In terms of losses which are not the Custodian fault, such as theft, the prospectus states that:

- 🕒 the Trust does not insure its gold;*
- 🕒 the Custodian does not fully insure the gold;*
- 🕒 the Trust is not a beneficiary of the Custodian's insurance;*
- 🕒 neither the Trustee nor Custodian require Sub-Custodians to be insured.*

The end result is that "a loss may be suffered with respect to the Trust's gold which is not covered by insurance and for which no person is liable in damages" and for circumstances where a person is liable, they may not have the financial resources to make good the loss, a likely result considering the amount of gold held by GLD. With regards to Sub-Custodians appointed by the Custodian, the arrangements are loosely defined, further exposing GLD shareholders:

- 🕒 no written contractual agreements*
- 🕒 neither the Trustee nor Custodian monitor their performance*
- 🕒 Trustee has no right to visit their premises to examine the Trust's gold*

It is our understanding that insurance can only be obtain for up to \$1.5 to \$2 billion per vault, which would mean that GLD's metal is fractionally insured considering how much physical metal the bullion banks hold in their vaults.



Dave in the [comments](#): “A colleague of mine just reminded me that the Perth Mint was one of the first promoters of paper gold, unallocated account products with their Certificate program.”

Unallocated accounts/certificates, such as Mocatta Delivery Orders, were around well before we launched the Certificate program in the late 1990s. In no way are we one of the first promoters of these products.

Dave in the [comments](#), quoting Market Skeptics: “Gold Corporation and the Western Australia government can default on the Perth Mint's UNallocated bullion certificates by using Perth Mint's "force majeure" clause.”

Further down in the comments to that Market Skeptics article I left some responses refuting the claims it made, as well as in this blog post. Regarding the “force majeure” clause in our [Depository agreement](#), it says that (my emphasis):

*“... these obligations shall be **suspended**, but only so far and for so long as Gold Corporation is affected by the Force Majeure; and Gold Corporation **shall resume performance** of its obligations under this agreement **as soon as it is no longer affected by the Force Majeure.**”*

That does not provide a default mechanism.

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