TRADING & SETTLEMENT – THEN AND NOW

BY DAVID GORNALL, LBMA SENIOR CONSULTANT AND STEPHEN PENDER, SENIOR DEALER – CCM, ENGELHARD MATERIALS SERVICES, BASF

The dealing room at Sharps Pixley circa 1982.

David Gornall, Senior Consultant, LBMA, who at the time of the publication of the first *Alchemist* was working for Sogemin Metals Ltd recalls what it was like trading in the dealing rooms from 1995 through to 2002. Stephen Pender then picks up the story when his trading career began at J.P. Morgan.

DAVID GORNALL
The dealing rooms from 1995 to early 2000

At the time of the very first *Alchemist* in 1995, I worked for Sogemin Metals Ltd, part of the London Good Delivery refiner Umicore. Trading precious metals in the late 1990s at a refiner highlighted stark differences to today's world, especially when comparing it to life within a bank.

For example, we never mentioned the words 'balance sheet', 'liquidity' or 'tier one capital' as much as we do today. This was common in all refinery owned London Metal Exchange (LME) member trading companies, where the early days saw the refinery members outnumber the banks.

The chosen method of client communication was by phone and the preferred business continuity plan didn't involve a disaster recovery site, but would normally mean taking temporary office space in a hotel! How times have changed.

LANGUAGE BARRIERS

Verbal orders caused confusion. The German office would often place orders in German. Kauf (buy) and Verkauf (sell) were often easily confused in a noisy dealing room. Even a foreign accent could cause issues. When a client told his sales contact, "if you cannot buy it, you can sell it", the sales person was rightly confused until he understood that the intention from the client was to cancel the order – the client had not realised he had to place the stress on the first syllable of **cancel** and not the last!

RUDIMENTARY TECHNOLOGY

Electronic trading had only just started and, at the time, was considered a fad by many smaller houses as they tried in vain to access systems that required more credit than they were able to furnish. That all changed when they discovered prime brokerage.

Excel may have been around in the late 1990s, but analytical traders much preferred to record price history on their hand-written charts, which were often several metres long!

THE GERMAN OFFICE WOULD OFTEN PLACE ORDERS IN GERMAN. KAUF (BUY) AND VERKAUF (SELL) WERE OFTEN EASILY CONFUSED IN A NOISY DEALING ROOM.

From the metals desk to other branch offices, added to that the external brokers' commentaries, it was a cacophony of noise.

They all possessed a strange tool known as a parallel ruler, which was basically two rulers joined together on hinges, designed this way to capture trading channels and extend ranges.

Most dealing rooms were loud places with constant verbal inter-office communications. There would be 'hoot-n-holler' boxes everywhere for every purpose.

You weren't expected to put your cigarette down and walk over to another desk to speak to someone; instead, you could simply shout directly at another desk or you could use the speaker systems. From the softs desk to the metals desk, from the metals desk to other branch offices, added to that the external brokers' commentaries, it was a cacophony of noise.

From a price perspective, 1995 started with producer hedge buy-backs that saw gold move above $400 for the first time since 1991. That kept all the brokers very busy, with five-year forwards being asked for on as many occasions as the rest of the curve.

CENTRAL BANK GOLD SALES

In 1996, the IMF decided that it would sell a portion of the gold that it held (see *Alchemist 5*, October 1996, *'Howard Davies focuses on EMU issues'*). This started a domino effect of reviews by various governments which led to Switzerland, the Netherlands, Germany and Belgium announcing central bank gold sales (see *Alchemist 8*, June 1997, '*Gold and Central Banks – A Change in Attitude'* and *'LBMA Seminar – Dealers Dream or Dealers Nightmare'*). The UK duly followed suit in 1999 (see *Alchemist 16*, June 1999, *'Gold Auctions – The Way Forward'*).

It was during that year that the euro was launched and the European Central Bank was created, with 15% of its reserves held in gold. But gold will be remembered better in 1999 for the creation of the CBGA (Central Bank Gold Agreement). This would limit signatory states to sales of gold to a maximum of 400 tonnes a year.

Although gold may not have provided too much in the way of interesting material for the press that year, the whole period saw the metal create a solid price base from which it could rally two years later.

Y2K

We worried about different things in the late 1990s – mainly the internet. The late 1990s witnessed the dot-com bubble, described by the US Federal Reserve Chairman at the time, Alan Greenspan, as "irrational exuberance". Towards the end of the period, we were faced with a question that some believed could have serious negative implications for the market.

In 1999, we were instructed by management when completing due diligence on new clients and counterparties to find out if that company had created a Y2K policy (see *Alchemist 17*, October 1999). That was our main fear in those days. It feels like a lifetime ago now.

STEPHEN PENDER

Reflects on his trading career from 2002 to the present day

EARLY CAREER

My career in trading began in 2002, when after three years in the middle office, I joined the trading desk at J.P. Morgan (JPM). One of my earliest memories of trading is from those middle office days, when every two months or so, I would be dispatched to the Bank of England to submit bids into the gold auctions that it was running at the time. I was packed off with a wad of tickets, a few pens and one of the trader's mobile phone (that's right in those days some adults didn't have mobiles!). My job was to wait in the bank foyer for the auction bids to be relayed from the trading desk. Once received, the tickets needed to be completed and submitted to the cashier before the window was, quite literally, slammed shut. The format of the ticket was similar to that of a cheque, with both the amount and price needing to be completed in both numbers and letters. Of course, the traders tended to leave the orders to the very last moment and, with seconds to go, I would usually be frantically scrambling to complete all of this information onto five or six tickets, whilst at the same time desperately trying to keep my writing legible.

EVERY TWO MONTHS OR SO, I WOULD BE DISPATCHED TO THE BANK OF ENGLAND TO SUBMIT BIDS INTO **THE GOLD AUCTIONS THAT IT WAS RUNNING AT THE TIME.**

The pressure was intense as I knew any mistake or delay would leave the desk on the hook for the position, but the buzz was amazing, and buoyed by the confidence the traders had shown by giving me this responsibility, I quickly knew this was a career path I wanted to follow.

Below: Johnson Matthey trading floor circa 1983.

A typical precious metals trading desk circa 2012, with Reuters and EBS terminals to the left.

Alchemist 16, June 1999, *' Auctions – The Way Forward'* provides a fascinating insight into the furore surrounding the UK's decision to sell a large proportion of its gold reserves.

It includes the Bank of England making the case for the sales, the World Gold Council making clear its arguments against and a number of letters to the editor. Alternatively, tell any London cabbie that you work in the bullion market and they will gladly to tell you all about Gordon Brown and how he sold 'our' gold on the lows!

As a postscript to this story, I later found out that the Bank also accepted orders by SWIFT, which would have been far simpler and safer; however, the JPM traders didn't trust technology – luckily for me, you might say.

GOLD PRICE AUCTIONS

When I think back to those early days, sitting second from the left on a semi-circular bank of desks, I quickly realise that whilst the structure of the market (from then to now) appears unchanged, it is actually very different. The fixes still exist (auctions in today's parlance), but they barely resemble the ones I knew and none more so than the Gold Fix. I vividly recall when I began trading that the representatives of the five member banks would head off twice a day to the offices of the chairman, NM Rothschild. It's still twice a day, but it's independently administered (by IBA) with up to 15 participants from a wide spectrum of sectors other than just banks gathering online with an algorithm for a chairman!

MARKET MAKERS

The market was and remains an OTC market, but when I began, it was the Market Makers who provided the majority of the liquidity. They would make prices in almost any size of transaction to customers and in transactions of up to 10k ounces of gold and 200k ounces of silver to other Market Makers. Additional OTC liquidity could be sourced through EBS, with futures, for the most part, only available in the afternoon. Fast forward to today and direct bank-to-bank transactions are rare, EBS has almost disappeared from trading desks (although I understand it may be making a comeback) and futures are now the dominant source of liquidity. Market Making still takes place, but this is typically through e-platforms or price aggregators, and trading on a price from more than one person (system) at a time will likely get you a ticking off.

Alchemist 21, November 2000, *'Going for Broking Systems'* evaluates the 'new wave' of electronic broking systems entering the market, suggesting they may kill 'voice' brokering within 18 months. Twenty-one years later, the voice brokers are still very much part of the market, but the systems listed, for the most part, are not.

TWENTY-ONE YEARS LATER, THE VOICE BROKERS ARE STILL VERY MUCH PART OF THE MARKET, BUT THE SYSTEMS LISTED, FOR THE MOST PART, ARE NOT.

THE RISE OF THE EFPS

With the switch to futures/e-trading has come the rise (and fall?) of the Exchange Of Futures for Physical (EFP). For the first six or so years of my career, the EFP moved, without fail, 5 cents lower each day except on Thursday when it moved 15 cents to allow for the weekend.

The most sophisticated EFP trading we did was calling around on a Thursday hoping to catch someone who (through being either off guard or hungover!) had forgotten about the weekend and only adjusted their price 5 cents lower!

TECHNOLOGY HAS OF COURSE BEEN THE BIGGEST CHANGE

Now that the EFP has volatility, which at times is comparable to the outright price, it has gone from a sideline to a PnL generator in its own right.

FROM TELEX MACHINES TO MODERN TERMINALS

Technology has, of course, been the biggest change. I speak to young traders about Reuters dealers in the way I was told about telex machines, receiving puzzled looks as I recall the regular changing of the paper and the need to archive the carbon copy. Bloomberg is now the dominant supplier of both messaging and market data. I started with a system called Market Sheet, which has long since disappeared but seemed space age to me at the time. Access to market pricing outside of the office has moved a long way since the days of Reuters pagers (technology so old I can't find a single image or reference to them on Google!) via Blackberries to smart phones.

This is probably one of the most positive developments from my perspective – the amount of information now available to me in the morning has afforded me a good hour or so of extra sleep and I am more than happy to leave the 6.30 am starts in the past!

All of that said, this is not supposed to be a lament about how much better things were in the past.

I do look back fondly on the 'old days' because the experiences were so new, but also because of the many talented people I had the opportunity to work alongside, including some real legends of the market. However, I am in no doubt that the market and us as participants are better off for the developments that have taken place over the past 20 years and we have LBMA to thank for many of those.

I AM IN NO DOUBT THAT THE MARKET AND US AS PARTICIPANTS ARE BETTER OFF FOR THE DEVELOPMENTS THAT HAVE TAKEN PLACE OVER THE PAST 20 YEARS AND WE HAVE LBMA TO THANK FOR MANY OF THOSE

COMPLIANCE TO THE FORE

There are, however, a couple of areas where I believe that the changes over the past 20 years have not necessarily been for the best. The first of those goes back to my own journey – it is now very difficult to make the jump from middle office to trading desk. Whether that is due to compliance concerns or because of the academic qualifications that are now demanded, many potentially talented traders are not getting the chance to prove themselves and advance their careers (in the way that I and many others once did).

Secondly, with technology, we have lost that personal touch and, with that, some of the 'community' feel that was so apparent when I was starting out. Gone are the days of knowing your rival trader's family by name and of having beers in the evening after battling during the day (compliance again).

WITH TECHNOLOGY WE HAVE LOST THAT PERSONAL TOUCH

WHAT THE FUTURE HOLDS

Looking to the future, I think it will continue to be a case of same, but different. I can see a market where technology companies become bigger players and compete side by side with financial institutions. Ultimately though, whoever the players are, I believe the market will always need people at its heart. As the pandemic has shown, when disruption comes and markets move fast, liquidity can quickly dry up, leaving the machines with nowhere to go and requiring humans to step forward.

David Gornall started his career in 1979, trading silver at Lonconex Limited, part of the Primary Industries/Golodetz commodity trading group. After a spell at Morgan Guaranty Trust of New York, he moved to Sogemin, trading in the LME ring and heading the bullion and FX desk. In 1992 he joined NM Rothschild to start their LME base metals operation, before returning to Sogemin's successor, Natixis Commodity Markets – where he was a main board director until 2009. He became Global Head of Metals Trading at the French Investment Bank, Natixis. He was a member of the LBMA Management Committee from August 2005 and Chairman of LBMA from June 2011 to July 2014. He currently acts as a Consultant Advisor for LBMA.

Stephen Pender has over 20 years' experience trading precious metals. Since 2016 he has been at BASF Metals Ltd in the role of Senior Dealer, he previously held senior roles at Credit Agricole, INTL and Fortis Bank and before this he began his career at JPMorgan in the role of precious metals spot dealer. He is a member of the LBMA's Public Affairs Committee.