

The Bank of England's Gold Vault Operations

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I. Introduction

Thank you, Terence, for the introduction and thank you to Stewart and the LBMA for the opportunity to speak here today. As Terence said, customer banking is the part of the Bank of England that includes responsibility for gold storage. It also includes our relationship with government from a banking perspective and also our banking relationships with other central banks, so that is why I am presenting to you today.

As Terence said a couple of times in his introduction, things are organised a little differently in the UK and, indeed, this has been the case since we came out of the gold standard in the 1930s. The Finance Ministry takes responsibility for investment decisions in gold and we simply store it for our them. We also store it for other central banks and, indeed, Clemens was kind enough to disclose in his presentation that we store it, amongst other people, for him.

What I am going to focus on today is our role in the gold market and the unique challenges that arise from being both a long-term central bank store of gold as well as an interface with the London gold market. I am aware that I am all that stands between you and a cocktail in the sun, assuming the sun is still shining in Rome, which I hope it is now, so I do promise to keep to time as well and I will make this quick.

II. Bank of England's Role in the Gold Market

1. History

The Bank has a long historical association with gold. We have been storing gold for more than 200 years. We are one of the largest central bank stores of gold in the world with over 400,000 gold bars in our vaults, even though the Bank of England itself only owns very few bars. In fact, we own two and that is not 2,000 or 200, that really is two and we keep them in our museum. If you want to visit the Bank of England Museum, you would all be very welcome to come and see them. However, we hold a much larger number of bars (more than 400,000) for other central banks.

2. Regulatory Responsibilities

I will also talk about our history in the sector since the LBMA was created in 1987. Before I get on to gold specifics, more broadly, regulation has changed a couple of times since then. From the LBMA's creation date, in the run up to 1997 the Bank was responsible for prudential regulation of the financial sector and interfaced with a number of the banks here via that route. In 1997, that changed and prudential regulation was moved across to the Financial Services Authority, where prudential and conduct regulation were done together.

That remained the case until very recently when, after the financial crisis started in 2007, on Easter Monday 2013 prudential regulation, as many of you will know, came back to the Bank of England in the form of the part of the Bank that is now known as the PRA (Prudential Regulation Authority). Those are our broad regulatory responsibilities.

More specifically on gold, even though we are not active traders in the market but we are a large custodian, some of the people in our team responsible for gold observation sit on the LBMA Management Committee and the LBMA Physical Committee as observers. Thus we retain a significant engagement with the gold market via that route.

3. Key Services

We provide three key services, which are covered on this slide. However, I will start by focusing on the first word 'allocated', because this is a critical nature of the service that we provide. At all times in our custody service the customer retains ownership of the gold bar and they retain ownership of the specific gold bar. Specific gold bars are allocated to specific customers. That has an important financial effect, because that means the gold bars do not feature and do not show on the Bank of England's balance sheet. They are owned by the customer at all times.

As well as our storage service, we also obviously have to offer physical movement in and out of the Bank when customers want to deposit and collect their gold. We also offer book entry transfers, which is a means via which gold can be traded from one customer to another. I will talk about that in more detail later.

4. Challenges

The combination of those characteristics, the allocated method of holding gold where the customer owns the bar at all times and the other products that we offer, specifically book entry transfers, means a number of operational challenges arise in our operations. The main thing I wanted to get over today is a chance to explain to you a little more about those challenges and the issues that we face when running our vaults. Therefore, that is what I am going to focus on from this point onwards.

III. Operational Challenges

1. Vaults

We are going to do that by taking a look inside the gold vaults of the Bank of England. The one you can see here is called our 'show vault' and the pictures on the wall date back for some years, because this vault was used as the Bank's cafeteria during the War, when it was only safe to eat in the basement. Those pictures have been there ever since.

Before I go further, I will describe a little bit about the Bank of England's vaults. We always tell this to people when they come. The Bank quite famously has more floor space below ground level than it does above it. That means we, thankfully, have quite a large amount of vault facilities, which are interchangeable for bank note storage and gold storage. That flexibility is very helpful to us at times of high demand. The reason why that flexibility is

particularly important is London, as those of you who have been there may know, is built on clay. Therefore, unlike any banks you may have visited that are built on bedrock where they can pile their gold bars up to the ceiling, we cannot do that. We can only stack our bars to about chest height because otherwise the Bank of England would suffer subsidence and that would be very bad for us. Floor loadings mean that we cannot get that large a density of bars in our vaults and I have some pictures later to illustrate this.

I said I would talk about challenges, which is what I am now going to do. Depending on what is happening in the market, as you have all discussed today, our workload can vary quite significantly. Gold may be coming in or going out. We want to provide a very high quality service, so we have a dedicated gold team who are trained to work on gold movements on a full-time basis. That means we have to spend quite a lot of time planning and trying to predict what their workload is going to be and this is why I want to give you more detail on the challenges of managing our vault operations.

2. Book Entry Transfers

The first example I am going to use is based on the book entry transfers, as I talked about earlier. To recap, these are transactions where bars can change ownership without moving in and out of the Bank of England vaults and without physically moving in the Bank of England vaults either. Hence it literally is a book entry model. It is a secure and efficient way of trading gold bars, but it has an interesting side effect for us. Using the example on these slides, when the gold initially comes in from a customer it remains in nice demarcated piles which, at the start of this animation, were red, green and yellow. However, as time goes on, those customers who trade their gold via book entry transfers can end up with gold bars dotted all around the vault of the Bank of England. If they then want a physical delivery out, this can mean it is a very time-consuming task to locate those bars, as we have rather more than are illustrated on the slide here. Therefore, even though they were nice and neatly stacked when they came in, after a few years of book entry transfers the bars can be jumbled up and one customer's bars could be dotted all around the Bank of England vaults.

3. Digging for Gold

That then presents us with challenges, as I mentioned, when it comes time to deliver bars out of the Bank of England. Here we are taking a hypothetical example of finding 400 bars for one customer dotted around our vaults. As the maps that are cycling around the screen show, these 400 bars can be placed in a great many locations. Each page is a different vault. We have a number of specific vaults at the Bank of England and to put that delivery together we have to visit each of these locations and perform a process on the bars called 'digging out'. That is what the next series of slides are going to show. My colleague there is quite literally digging for a gold bar.

This is how digging out works. Our gold bars are arranged on pallets like this and because our vaults are quite full pallets are sometimes stacked together and they might have to be moved out of the way to get to a pallet that is nearest the wall. There is no clever way to do this. We literally have to follow a manual process of lifting pallets out of the way, stacking

them in the aisles until we can get to the pallet we want where we know the gold bar that the customer has asked us to deliver is placed. Then, under triple control, as you can see here, the specific bar is located by checking the individual numbers stamped on each bar. Imagine having to do that 400 times. That is a very time-consuming process.

I hope that has helped to illustrate to you, if you are one of our customers and you have phoned us and asked for 400 bars to be delivered, if my colleague Louise sometimes replies that it will take us a few days to put that order together, this is why. We have to get the bars from, potentially, a large number of locations in some vaults that tend to be quite full.

IV. Perks

I have explained why we face some unique challenges being both a long-term central bank store of gold as well as an interface to the London trading market, but my last slide shows that there are some perks to the job too. We get some high profile visitors and there are none who are more high profile than the Queen, who very kindly came to see us at the end of 2012. Louise, who is in the audience, can tell you all about it, as you can see her there in the picture. Even though the Queen visited many departments in the Bank and was only in the gold vaults very briefly, as I am sure none of you will be surprised to hear, it was gold that attracted all the attention, because that is what people are really interested in. That was a very nice visit for our staff and we hope Her Majesty enjoyed it too.

I am going to finish there. I hope you enjoy your cocktails this evening and the rest of the conference. Thank you very much.