Can a Cyprus-Like "Bail-in" Occur with Gold?

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By Nick Barisheff

Last week's Bullion Buzz article, *Cyprus and Gold: Lighting a Candle in a Dark Room*, seems to have touched a nerve with many investors, and my inbox has been inundated with concerns about an event like this occurring in Canada. Most expressed concern over whether such a "bail-in" could occur with gold. We have found gold investors and the gold community in general to be better-informed about the dangers of central bank intervention than those who have no interest in gold, but when it comes to the opaque machinations of central bankers, the best any of us can offer is little more than an educated opinion. Where we at BMG do have unique expertise is in the field of wealth protection through uncompromised bullion ownership and allocated bullion storage. It is from this position that I would like to respond to the concerns that the threat of bank expropriation of funds has caused.

The issue has been exacerbated further by a flood of blog posts based on the most recent 2013 Canadian Budget, and pages 144 and 145 of the Canadian *Economic Action Plan 2013* in particular. This document makes it clear that such a Cypriot-style bail-in, a euphemism for outright expropriation of depositors' funds, is being considered for uninsured deposits over CDN$100,000. In fact, a similar program is already in place in the United States for uninsured deposits, and will likely be implemented in most of the southern EU countries that have major banking problems.

Events in Cyprus have led to the realization that people who have worked hard and put their savings into a bank are technically lenders to the bank. In the case of insolvency they are "unsecured creditors," and not automatically entitled to their own funds. Understandably, this has caused a great deal of concern amongst depositors and investors alike, especially to someone who has viewed economic activity from the standpoint of gold, as I have, for the past fifteen years.

As mentioned last week, a significant crisis in confidence is beginning to develop thanks to the light shined on the dark underbelly of central banking by the Cyprus fiasco. Central bankers know that the only thing keeping their Ponzi scheme, our modern fiat currency economic model, alive is confidence. The most important tools central bankers have in their arsenal are the right to create unbacked fiat currency, fractional reserve banking and the perception management resources they use to prevent mass withdrawal of funds. The right to create unbacked currency is the crown jewel privately owned central banks have fought to possess for hundreds of years. This privilege has come under more scrutiny over the past few years, thanks in large part to the Internet and to former Texas congressman Dr. Ron Paul, who educated an entire generation about the true nature of the Federal Reserve and its private ownership. Fractional reserve banking, which allows banks to lend out nine dollars for every dollar invested, works until there is a loss of confidence and people rush to remove their currency from banks since, at best, the banks have only a fraction of the funds lent out on reserve. Finally, the vast resources the banks and financial services industry have amassed over the past three hundred years allow them to control all sides of almost any financial discussion, and to manage perception quite effectively. This effectiveness is clearly reflected by the success of their campaign against fiat currency's number one alternative—gold. After a decade of solid gains against all currencies and after holding purchasing power better than any other fiat currency in existence from as far back as biblical times, gold is still considered a risky and "barbarous" investment by mainstream investors.

This entire matrix is in jeopardy now due to events in Cyprus. The threat of such drastic action as expropriation of investor savings tells us that something quite serious is occurring behind the scenes.

Gold has a target on its back because when it is pegged to currency, it restricts the amount of currency that can be created. President Nixon removed this peg in 1971, and central bankers went one step further by attempting to apply the fractional reserve banking model that worked so beneficially for them with paper currency to gold.

As a result of this attempt we have a world flooded with complex paper gold instruments that are essentially derivatives or proxies for gold. Many who have purchased these products, which include gold certificates, gold accounts, pooled gold, futures contracts, options, mining shares and ETF shares, believe they are invested in gold and are therefore hedged against financial calamity. Investors have been attracted to these paper gold investments because of convenience and low fees. In order to own uncompromised gold, investors need to do their homework; it is more complicated than a quick Internet search and the click of a mouse, and he or she will have to pay higher fees for allocated storage with a credible custodian.

Therefore the short answer to the question of whether such a "bail-in" could occur with gold is yes and no. It could easily occur with what we call compromised gold ownership, but highly unlikely with uncompromised gold. Knowing the difference between these two could mean the difference between financial devastation or financial survival and prosperity.

Compromised Gold

Compromised gold, by our definition, is any gold that is not owned outright and held in hand, or owned outright and held in allocated storage. There are no exceptions to this rule, even though many people believe that the form of gold they own is an exception.

This is a complex subject that BMG is qualified to discuss, having spent significant sums on legal advice. To make the issue simple, we can say that the reason most forms of gold ownership are compromised is because in the event of a crisis, gold owners may find that they are simply unsecured creditors similar to bank depositors. At best, they will receive a cash settlement, but this will likely come after years of legal battles with other third-party claimants; if and when it does come, gold will most certainly be trading at a much higher price.

Uncompromised Gold

Gold to which a person holds clear title and stores in a vault as "allocated" bullion cannot be legally dealt with by anyone but the owner. However, ensuring that gold is uncompromised is costly, and true allocated storage is more expensive than simply holding gold in a bank safety deposit box or in one's home. Both forms of gold ownership involve risk, as bank safety deposit boxes can be raided in the name of national security. This occurred in Britain in 2011, when police raided 7,000 safety deposit boxes; many people claimed the gold they held in those boxes, with no proof of ownership, went missing. Holding significant amounts of gold directly not only creates the risk of losing the gold to theft, but also may put your entire family at risk. Most insurance companies will not insure gold stored at home, nor gold stored in a safety deposit box.

Uncompromised gold bullion is gold to which we hold a title document stating the refiner, serial number of the bar, the weight, the fineness or purity and the name of the owner.

Allocated and Unallocated Storage

Owning and storing gold in secured allocated storage is a two-step process. First we buy the gold and receive title documentation, and then we store it in a vault under a custodial agreement on an allocated basis.

Vaults can also be compromised, which is why bullion owners should not look for the cheapest storage available. Guaranteeing that a vault is not subject to third-party claims from landlords and lenders requires extensive legal work. Otherwise, we may find the contents of the vault tied up in court as collateral against the debts of the failed storage facility.

Ultimately, the most secure storage at this time is within the London Bullion Market Association's (LBMA) "chain of integrity" defined as:

> "A locally recognized chain of custody among trusted trading partners where bullion bars are accepted at face value without an assay test. COMEX rules specify an official "chain of integrity" for COMEX GOLD contracts. The London Bullion Market Association maintains a "Good Delivery List" of member refineries that meet certain membership requirements and have passed assay tests. Bullion products from these refineries will generally be accepted by other members of the LBMA on face value without further assay testing. However, the LBMA's chain of integrity is purely informal. When purchasing bullion products the face value can generally be accepted if the product can be shown to have remained in the custody of a certified

bullion repository since its manufacture at an acceptable refinery."

It is possible to hold pooled gold in allocated storage as BMG mutual funds do. However, not all bullion funds store their gold on an allocated basis.

The following chart compares the two:

Unallocated	Allocated
No regulatory requirement to be fully backed by physical metal. Investors hold a promise of bullion ownership.	Supervised, secure storage arrangements for owners with full legal ownership of specific bullion bars.
Bullion forms part of the working capital of the financial institution, just as cash accounts do. Holders are not protected by depositor insurance.	Owners have title documentation that identifies each bar by refiner, exact weight, fineness and serial number.
Holders are dependent on the solvency of the institution. In the event of default, metals held by the institution are provided to creditors with first priority.	Bars may not be lent to the market as part of custodian's pool of metal. Bars are not subject to third-party claims of the custodian and not part of the custodian's assets in the event of bankruptcy.
Holders are not entitled to specific bars and are ranked as unsecured creditors of the institution in the event of bankruptcy.	Bullion is owned solely by purchaser. Written agreements executed by custodian and owner set out all terms of agreement, including storage fees and insurance, identifying each bar.

Conclusion

One would have to be quite uninformed in order to be complacent about the events in Cyprus, because they reflect a state of desperation on the part of central bankers that is alarming. Something must be near the boiling point to cause these established institutions to make such a desperate move that in truth disarms one of their most powerful weapons—investor confidence. Jim Sinclair, quoted in our previous article, feels it may be the "quadrillion dollars" in derivatives that could explode any day.

Perhaps it is one of the six major trends discussed in *$10,000 Gold*, the movement away from the U.S. dollar, that is at the root of their concern. This past week saw a $30-billion trade agreement between China and Brazil, and following that a trade agreement between China and Australia. Both agreements will bypass the U.S. dollar completely. The U.S. dollar, the world's de facto reserve currency since the Bretton Woods agreement in 1944, is more directly threatened by gold than any other currency. Much of the downward pressure on gold and the ramped-up negative publicity campaign against gold is likely a direct result of this competition.

Therefore, it our conclusion now, as it was when we started our first fund in 2002, that the most effective way to protect oneself from the potential for wealth confiscation through bail-ins is through gold, owned outright and stored in secure allocated storage.

In my new book, *$10,000 Gold: Why Gold's Inevitable Rise is the Investor's Safe Haven*, published by John Wiley and Sons and to be released in May, I discuss the long-term and irreversible trends that will lead to $10,000 gold. The book looks more deeply at the issues discussed above. It also describes how investors can protect their wealth through precious metals ownership, just as many in the developing nations have been doing methodically for the past decade.

Each week BMG presents a free newsletter called the BullionBuzz that is a compilation of articles, charts and videos that follow the developing trends that will lead to $10,000 gold.

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Widely recognized as international bullion expert, Nick has written numerous articles on bullion and current market trends, which have been published on various news and business websites. Nick has appeared on BNN, CBC, CNBC and Sun Media, and has been interviewed for countless articles by leading business publications across North America, Europe and Asia. His first book $10,000 Gold: Why Gold's Inevitable Rise is the Investors Safe Haven, will be published in the Spring of 2013. Every investor who seeks the safety of sound money will benefit from Nick's insights into the portfolio-preserving power of gold.
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