Physically-backed gold ETFs do not lend their gold

There has been a lot of discussion in the market about sourcing gold, the gold lease rate and borrowing gold from ETFs. I thought it would be worth breaking down some details on one specific area of the market, which is often misunderstood: the US-listed physically-backed gold ETFs (gold ETFs) market and related lending activities.

Let me be crystal clear and upfront—gold ETFs do not lend their gold.

This includes SPDR Gold Trust (GLD), iShares Gold Trust (IAU), SPDR Gold Mini Shares Trust (GLDM)[1] and all the additional US-listed gold ETFs.[2]

Simply put, it is not permitted by the product design, nor is it permitted under the regulatory approval granted to each product. Yet, I can't tell you how many times I've cringed hearing a market professional mischaracterize the market by saying that they borrow gold from gold ETFs or that a gold ETF lends its gold. Nothing could be further from the truth.

Why US-listed Physically-backed Gold ETFs Cannot Lend Gold

Gold ETFs hold only one asset: gold. There are three key distinctions that provide assurance the underlying assets are never lent:

- No regulatory approval has been provided to lend any of the underlying assets held by the fund/trust
- No economic benefits from activities related to securities lending are received by the fund/trust
- No risk factors are cited related to securities lending as it is not a feature embedded in the structure

Additionally, if an ETF engages in securities lending, there are required disclosures informing investors that the fund may lend the underlying assets and of the associated risks.[3] By contrast, US-listed physically-backed gold ETFs have no such disclosures, and the publicly filed agreements governing the trusts do not allow for securities lending by the trusts.[4]

What Happens Instead: Borrowing and Lending ETF Shares

Now that we are clear that US-listed physically-backed gold ETFs do not lend any gold, let's discuss what is possible once a gold ETF becomes established, liquid and mainstream.

As a gold ETF becomes well-adopted into the market, it often becomes a key component of the capital markets ecosystem around the asset it represents. This is the case with GLD and IAU, for example, which have significant levels of AUM, high volumes on the US equity exchanges, and are regularly available for borrowing and lending in the securities finance markets.

Here's how it works: Traders and speculators often borrow shares of such a gold ETF through standard securities lending relationships, which involve the gold ETF's shareholders, and do not involve the London gold lease market, or the trust, itself.

Those looking to access bullion short will use the securities finance market to borrow shares of the gold ETF. These shares are lent by the shareholder, not by the trust. For the borrower to access a short gold position, they need to either short that gold ETF (which carries risk) or redeem the shares for physical gold, which can then be sold in the London market.

Importantly, these transactions are conducted between owners of the gold ETF, the custody bank that maintains a "lending program" for the client who owns the gold ETF and those who are borrowing the shares.

1. See the most recent prospectus for iShares Gold Trust available here, SPDR Gold Trust available here, SPDR Gold Mini Shares Trust available here.
2. Gold ETF: Stock, Holdings and Flows | World Gold Council
3. For example, see the most recent prospectus for iShares Core S&P 500 ETF (IVV) available here and SPDR Portfolio Long Term Treasury ETF (SPTL) available here.
4. For example, see the most recent prospectus for iShares Gold Trust available here and SPDR Gold Trust available here.

The following are also true:

- All fees, income and risks associated with that transaction are separate and distinct from the activities of the fund or trust;
- The transaction has no bearing on the gold ETF's ability to perform its role as an appropriate access mechanism to a unit trust that provides the price performance of gold with little or no variance from the reference price (in this case the LBMA Gold Price PM);
- No economics are received by the gold ETF; and
- No risk of recall, no risk of market dislocation and no risk of credit default are taken by the gold ETF.

When it is time for this independent lending transaction to close out, the borrower of the gold ETF will either buy shares in the secondary market to cover their borrow or unwind by purchasing gold in the OTC market. Once the gold is purchased, using the proper channels, they will submit that gold to create gold ETF shares and use those new shares to close out the borrow.

Either way, the borrowing and unwinding of the trade will result in a healthy level of activity in both the primary market (OTC London bullion market) and the secondary market (listed exchange volume in the US), which will match buyers and sellers. Any imbalance again gets handled by creation or redemption with approved authorized participants.

Market Benefits of Physically-backed Gold ETFs

This type of activity illustrates how gold ETFs add liquidity to the overall gold market ecosystem. Increased trading volumes and the participation of more market participants lead to tighter bid-offer spreads, reducing costs for investors and improving market efficiency. Additionally, these ETFs make gold a more mainstream investment instrument by eliminating the challenges of trading physical gold, such as storage, transfer, or questions about gold type or authenticity.

Conclusion

To summarize: US-listed physically-backed gold ETFs, including GLD and IAU, do not lend their gold. However, their role in the secondary market indirectly contributes to the overall liquidity and sophistication of the gold market, making gold a more accessible and appealing investment option.

World Gold Council

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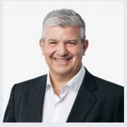
We drive industry progress, shaping policy and setting the standards for a perpetual and sustainable gold market.

Author



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