

Proviso 89.145
GP: Gold & Silver Investments
Office of State Treasurer

DIRECTIVE:

The South Carolina General Assembly directed the State Treasurer's Office to provide a report on the advisability of investing public funds in gold and silver. Below the *Conclusion*, there is additional information regarding investment options, statutes, information, and risk assessment

PROVISO:

89.145. (GP: Gold and Silver Investments) The State Treasurer shall provide a report to the General Assembly on the advisability of investing in gold and silver.

CONCLUSION:

Many people have seen their personal portfolios increase over the last decade when investing in gold and/or silver. Individuals and private organizations take responsibility for each investment and the risks associated with them. In the public sector, it is vital to safeguard all taxpayer funds from high-risk and speculative investments. While people have made fortunes with speculative personal investments, it is a different scenario when taxpayer funds are used. The State Treasurer, as the custodian of all public funds, believes that only accountable, responsible, and historically practiced investments are prudent to the fiscal health of South Carolina.

Due to the escalating speculation in the gold and silver markets, their value has increased significantly making it more expensive to invest and creating *what could be* another market bubble. Also, provisions in **S.C. Code of Laws 1976 SECTION 11-9-660** potentially create a legal conflict with regards to account and derivative investments of this nature. At this time, the State Treasurer's Office reports and concludes that within our Office, gold and silver investments with taxpayer dollars are not advisable.

However, the South Carolina Retirement System Investment Commission has broad statutory authority to invest in a variety of commodities that include gold and silver. RSIC was approached regarding their position and stated, "With respect to RSIC, we do not restrict ourselves from investing in commodities, including metals such as gold and silver. We actually have exposure to the metals through our passive commodities position."

GOLD AND SILVER VALUE:

1. As of September 23, 2011, the value of one ounce of gold equals \$1736.30.
2. As of September 23, 2011, the value of one ounce of silver equals \$32.65.

GOLD AND SILVER AS AN INVESTMENT:

Historically, investors have purchased gold as a hedge against an economic, a political, or a currency crisis. A decline in investment markets, a growing national debt, a weak currency, increasing inflation, military conflicts and social unrest are the most common reasons for investment in gold. Currently, gold and silver are at historic highs leading many expert investors to conclude that a bubble has been created in the precious metals market. Since the US recession began, the value of gold and silver has increased as investment markets perform poorly, troublesome economic news is announced, and when uncertainty in international markets intensifies.

Similar to other commodities, the value of gold and silver is determined by supply and demand, as well as speculation. The Federal Reserve, The London Bullion Market Association, JP Morgan Chase, and HSBC

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Holdings have practiced fractional-reserve banking and engaged in naked short selling causing artificial price suppression.

There are several ways to invest in gold and silver: bars, coins, ETP's, certificates, accounts, and derivatives. If a state were to choose to invest in gold (and silver), it would likely choose to invest by:

1. **ETP's—Exchange Traded Products.** This allows the stakeholder to invest in bullion without having to store bars and coins. The first gold ETF (Exchange Traded Fund) was created in 2003 and has been viewed largely as a success, but has also been compared to investing in mortgage-backed securities. The annual expenses of the fund (storage, insurance, and management fees) are charged by selling a small amount of gold represented by each certificate, so the amount of gold in each certificate will gradually decline over time. ETF's are investment companies that are legally classified as open-end companies or Unit Investment Trusts (UIT), but differ from traditional open-end companies and UIT's. The main differences are that ETF's do not sell directly to investors and they issue their shares in what are called *Creation Units*. Also, the Creation Units may not be purchased with cash but a basket of securities that mirrors the ETF's portfolio. Usually, the Creation Units are split up and re-sold on a secondary market.
2. **Certificates**—allow investors to avoid the risks and costs associated with the transfer and storage of bullion by taking on a set of risks and costs associated with the certificate itself. Banks may issue gold certificates for gold which is allocated (non-fungible) or unallocated (fungible). Unallocated gold certificates are a form of fractional reserve banking and do not guarantee an equal exchange for metal in the event of a run on the bank's gold on deposit. Allocated gold certificates should be correlated with specific numbered bars, however it is difficult to prove whether a bank is improperly allocating a single bar to more than one investor. The US first authorized the use of gold certificates in 1863. By the early 1930's the US placed restrictions on private gold ownership and therefore, the gold certificates stopped circulating as money, but certificates are still issued by gold pool programs for investment purposes.
3. **Accounts**—Many banks offer gold accounts where gold can be instantly bought or sold just like any foreign currency on a fractional reserve (non-allocated, fungible) basis. Pool accounts, facilitate highly liquid, but unallocated claims on gold owned by the company. Digital gold currency systems operate like pool accounts and additionally allow the direct transfer of fungible gold between members of the service. Different accounts impose varying types of intermediation between the client and their gold. One of the most important differences between accounts is whether the gold is held on an allocated or unallocated basis. Another major difference is the strength of the account holder's claim on the gold, in the event that the account administrator faces gold-denominated liabilities, asset forfeiture, or bankruptcy.
4. **Derivatives**—The product symbol for gold futures is GC, and it is traded in a standard contract size of 100 troy ounces. In the US, gold futures are primarily traded on the New York Commodities Exchange (COMEX). As of 2009 holders of COMEX gold futures have experienced problems taking delivery of their metal. Along with chronic delivery delays, some investors have received delivery of bars not matching their contract in serial number and weight. Because of these problems, there are concerns that COMEX may not have the gold inventory to back its existing warehouse receipts.

ADVISABILITY:

There is no statute preventing the State from investing in gold and silver. The various methods of investment in gold and silver each carry different and often significant risks, the foremost being speculation. As the US has experienced the recent bursts in the housing and tech bubbles, it is

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important to take caution when contemplating an unconventional investment. Taxpayer money (state funds and state pension) across the US has not typically been used to invest in gold or silver bullion.

Recently, with the uncertainty in global markets, the devaluation of the dollar, rising inflation, and a flat US economy, there has been a renewed interest in either moving back to a gold standard, investing in gold or both. The value of gold and silver has significantly increased in the last decade, meaning it would cost a great deal to invest at this time.

Risks:

1. **Bars and coins**—South Carolina does not have the capacity to store or funding to secure gold and silver bullion. For these reasons the State Treasurer’s Office does not advise investing in gold and silver bars and coins.
2. **ETP’s**— The annual expenses and costs associated with this type of investment are high. In recent years there have been issues surrounding gold ETP’s. The purchase price provides the investor with a fluctuating amount (in weight) of the metal. Over time, as value increases and more investors participate in the fund, the amount of metal owned by the investor decreases. ETP’s can also be split and sold on the secondary market. For these reasons the State Treasurer’s Office does not advise investing in ETP’s for gold and silver.
3. **Certificates**—Certificates for allocated gold present an accountability problem. Allocated gold certificates are supposed to be correlated with specific numbered bars; however, it is difficult to verify whether a bank is improperly allocating a single bar to more than one investor. Also, unallocated gold certificates are a form of fractional reserve banking and do not guarantee an equal exchange for metal in the event of a run on the bank’s gold on deposit. This is in conflict with **S.C. Code of Laws 1976 SECTION 11-9-660**. For these reasons, the State Treasurer’s Office cannot advise investing in gold and silver certificates.
4. **Accounts**—Similar to the risks associated with gold and silver certificates, allocated and unallocated metals held in accounts produce similar accountability problems. The strength of the account holder’s claim on metals is subject to the account administrator’s liabilities, assets, and/or solvency. Per **S.C. Code of Laws 1976 SECTION 11-9-660**, the State Treasurer’s Office cannot advise investing in gold and silver accounts.
5. **Derivatives**—Over the last three years, gold futures traded on the New York Commodities Exchange (COMEX) have encountered significant accountability problems. Holders of COMEX gold futures have frequently experienced delivery delays of their metals. Once delivered, there have been many reports of inaccurate weights and serial numbers on bars that do not match the holder’s contract. For these reasons the State Treasurer’s Office does not advise investing in gold and silver derivatives.

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S.C. CODE OF LAWS 1976

Title 11 - Public Finance
CHAPTER 9.

SECTION 11-9-660. Investment of funds.

(A) The State Treasurer has full power to invest and reinvest all funds of the State in any of the following:

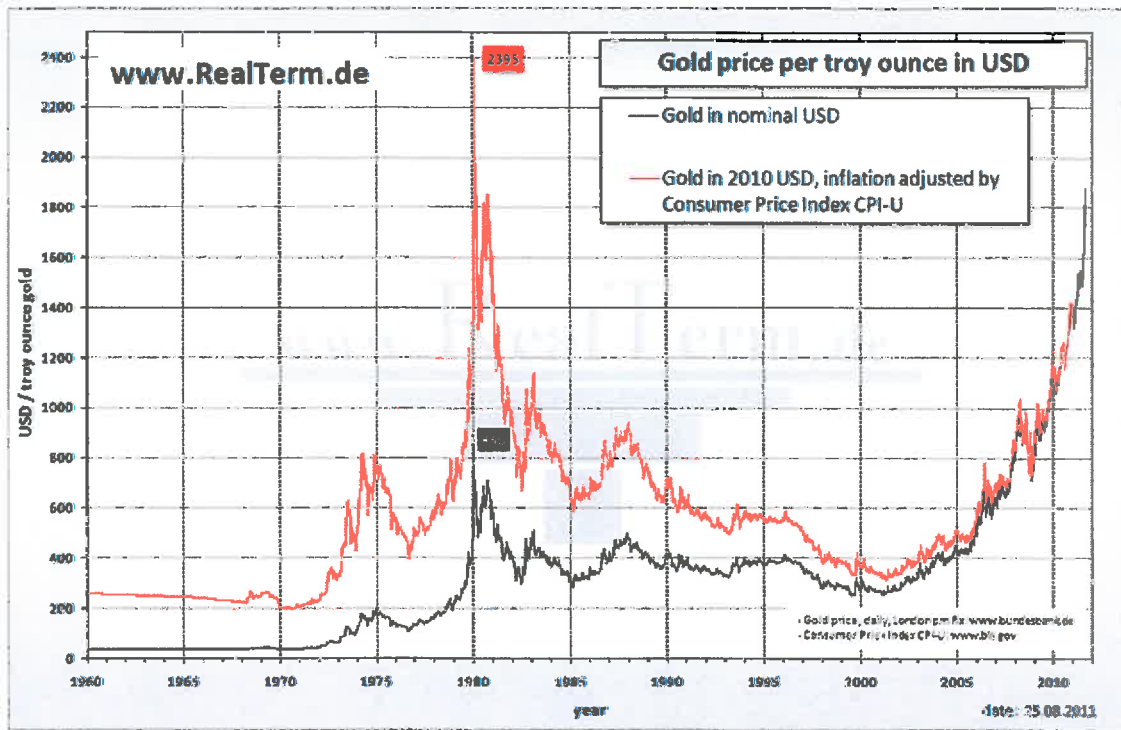
- (1) obligations of the United States, its agencies and instrumentalities;
- (2) obligations issued or unconditionally guaranteed by the International Bank for Reconstruction and Development, the African Development Bank, and the Asian Development Bank;
- (3) obligations of a corporation, state, or political subdivision denominated in United States dollars, if the obligations bear an investment grade rating of at least two nationally recognized rating services;
- (4) certificates of deposit, if the certificates are secured collaterally by securities of the types described in items (1) and (3) of this section and held by a third party as escrow agent or custodian and are of a market value not less than the amount of the certificates of deposit so secured, including interest; except that this collateral is not required to the extent the certificates of deposit are insured by an agency of the federal government;
- (5) repurchase agreements, if collateralized by securities of the types described in items (1) and (3) of this section and held by a third party as escrow agent or custodian and of a market value not less than the amount of the repurchase agreement so collateralized, including interest; and
- (6) guaranteed investment contracts issued by a domestic or foreign insurance company or other financial institution, whose long-term unsecured debt rating bears the two highest ratings of at least two nationally recognized rating services.

(B) The State Treasurer may contract to lend securities invested pursuant to this section.

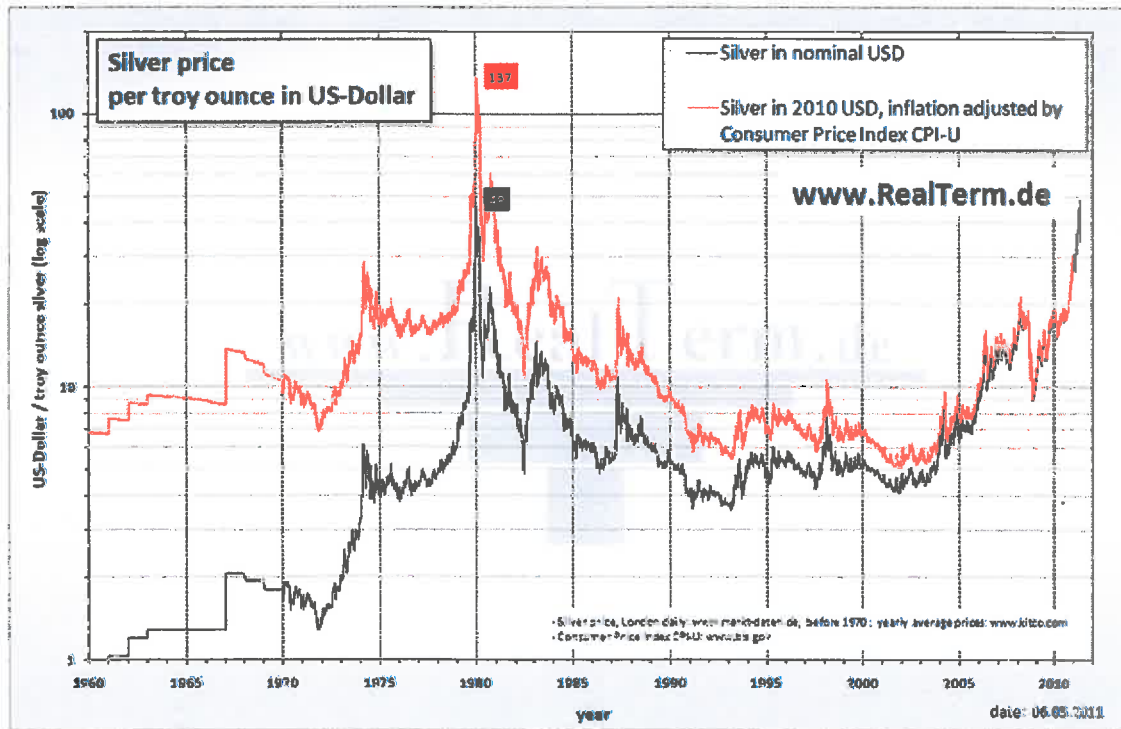
(C) The State Treasurer shall not invest in obligations issued by any country or corporation principally located in any country which the United States Department of State determines commits major human rights violations based on the Country Reports on Human Rights Practices by the Bureau of Democracy, Human Rights and Labor of the U. S. Department of State.

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PRICE OF GOLD AND SILVER 1960-2011



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THE DATA

Year	Silver Price	Gold Price	Gold/Silver Ratio
1840	\$1.29	\$20	15.5
1900	\$0.64	\$20	31.9
1920	\$0.65	\$20	31.6
1940	\$0.34	\$33	97.3
1960	\$0.91	\$35	38.6
1970	\$1.63	\$35	22.0
1980	\$16.39	\$612	37.4
1990	\$4.06	\$383	94.3
2000	\$4.95	\$279	56.4
2005	\$7.31	\$444	60.8
2009	\$14.67	\$972	66.3
2010	\$20.19	\$1225	60.7

London Fix Historical Gold, Silver 2010