

The London Metal Exchange

The essential element of the physical market



SETTING THE GLOBAL STANDARD

28

Ni

NICKEL

29

Cu

COPPER

1

LME

47

Ag

SILVER

79

Au

GOLD

30

Zn

ZINC

13

AL

ALUMINIUM

82

Pb

LEAD

London Metal Exchange services to the physical market: Why producers and consumers of metal value the LME

The London Metal Exchange (LME) has been helping metal producers and consumers manage their price risks since 1877. But our unparalleled insight into price discovery is not the only reason the LME has become the essential partner of the metal markets.

From our unique forward prompt-date structure and large lot sizes, to a world-wide warehouse network that provides the metal community with trusted global reference prices and a market of last resort, the physical metals market is very much part of our DNA.

And it is this blueprint that shapes almost all facets of our business.

Most producers and consumers, that is, makers of metal and makers of things out of metal, use the LME to hedge their price risk. Deals struck for future delivery of metal in the physical markets are naturally subject to a number of risks. The time between a physical contract being agreed and the time it is settled can span days, weeks, months and years - and in that time a lot can happen to the price of a metal.

It is this risk that the physical market seeks to mitigate through the purchase and sale of LME futures and options contracts.

But what is it about the LME that makes it the venue of choice for physical market?

Let's look at some of these in detail.



1

Services to the physical market

Price discovery: We at the LME pride ourselves in providing the world with daily, transparent, credible and real reference prices. The prices are discovered using risk capital and are truly reflective of global of supply and demand. The ability to hedge is predicated on these prices.

Price convergence: LME contracts are physically settled via our global warehouse network. This is key because it means that futures prices discovered on our markets converge with (are reflective of) physical metal.*

Global warehouse network: We don't claim to replace metal producer and consumer supply lines, but our worldwide network of licensed storage facilities provides the metals community with a market of last resort in times of both over-supply and extreme shortage. The fact that the network is spread worldwide means LME prices are not local, but global.

Daily prompt date structure: LME contracts can be traded daily out to three months in the future, weekly to six months and monthly out to 123 months. No other market offers such a range of forward dates and no other market provides the metals community with such flexibility in matching and hedging their real-world deals.

Physical settlement: Only brands of metal that are actually used by the physical market are accepted for good delivery. This coupled with ongoing testing, reference to numerous global standards and a constantly updated and comprehensive list of approved brands and producers means our contracts are always relevant. Relatively large minimum contract (or lot) sizes mirror physical deals too.

*The fact that divergent physical prices can be arbitrated using LME futures and vice versa means prices converge, necessarily.



2

Services we have recently improved

Warehouses reforms: We recently ended a three year review and reform of our warehouse infrastructure. It was one of the most comprehensive and far-reaching programmes in our 140-year history and sought to address warehouse queues and associated queue-based regional premiums.

After extensive market-wide consultation, 12 elements have been implemented, including:

- the Linked Load-In / Load-Out Rule (LILO)
- increased minimum daily load out rates
- the creation of the Physical Market Committee
- the new Commitment of Traders Report (COTR) detailing market positions by user type
- queue-based rent capping (QBRC)
- and charge capping

The reforms have led to declining queues and a lower queue-based premium component.

Rebalanced fees: After extensive discussion with members and market users we undertook a review of our fee structure with the view to optimising market structure and trading opportunities.

- We reduced the fees on short-dated carries* by 44%
- We capped the position transfer fee at \$10,000 (vs. an average fee of approximately \$30,000 in 2015).

Initial margin reduction: LME Clear have designed an innovative margining methodology which, following regulatory approval, will reduce the initial margin payable for LME positions, while continuing to provide best-in-class risk management and market stability.

Liquidity enhancement: We are reviewing our suite of liquidity incentive programmes with the aim of improving market and trading opportunities for all participants.

*Short-dated carries enable users to roll their positions from day to day – a vital component of inventory management.



3

Products and services we have recently added or coming soon

LMEprecious: We are excited to be launching gold and silver futures in 2017. In partnership with the World Gold Council and a number of leading industry participants, LMEprecious will provide the market with on-exchange risk management tools that are:

- tradable daily and monthly out to five years
- physically settled, loco London
- cleared by LME Clear.

All of the above are traded via a distinct membership, trading and clearing platform.

LMEshield: A new global warehouse system designed to bring confidence back to the world's "off-warrant" commodity receiving market by making it better, more secure and more efficient.

LME ferrous: The ferrous suite was expanded to include cash-settled scrap and rebar contracts – providing the market with a tradable 15-month forward price curve – the first of its kind in the world.



Find out more

For more information please visit our website at www.lme.com/physicalmarkets

If you have any questions or would like to find out more, please get in touch with our team by email at sales@lme.com



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THE LONDON METAL EXCHANGE
10 Finsbury Square, London EC2A 1AJ | Tel +44 (0)20 7113 8888