

## Warrants as collateral

### Frequently asked questions – March 2020

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LME Clear has expanded its collateral service for members to pledge LME warrants as collateral against their margin requirements. This is a unique offering from LME Clear – the clearing house purpose-built for the metals market.

#### What is warrants as collateral?

LME Clear allows clearing members to utilise certain LME warrants as acceptable collateral on a metal for metal basis i.e. aluminium warrants would be used to cover aluminium positions.

#### Which warrants can be used?

Copper, aluminium, zinc, nickel, lead and tin can currently be used to cover margin requirements on a metal for metal basis

#### Are there plans to add other metals?

Whilst there are no plans currently to add other metals, we are constantly working with the market and our regulators to enhance our post-trade service offering.

#### Can warrants be used to cover both house and client margin?

Yes. There is no restriction on using member owned warrants to cover either house or client accounts.

If a member wants to use warrants belonging to a client then these can be used to cover margin for the same client who holds positions at the clearing member in an individual segregated account (ISA). For more information on using client warrants, contact the LME (details at the end of this FAQ).

#### Why is using warrants as collateral more attractive for the market?

Benefits of using warrants as collateral will differ from member to member and client to client. By using LME warrants as collateral, this can help utilise metal sitting in LME-approved warehouses that may otherwise not be utilised to its full potential. Using warrants to cover margin requirements can free up other types of collateral for members to use for other parts of their business giving them more optionality and flexibility.

#### Are there any advantages to using warrants as collateral?

Using warrants as collateral may allow members to optimise assets on their balance sheet in a more cost effective manner. For clients, warrants as collateral is an alternative way to finance their margin requirements. For some, using warrants as collateral may also have a positive impact to their regulatory capital requirement.

### LMEmercury and LMEsword

#### Which systems are used to transfer warrants to LME Clear?

Pledge and withdraw intentions are entered into LMEmercury. The actual transfer of warrants is completed by an ex-cleared transfer in LMEsword. Once the ex-cleared transfer has

been received by LME Clear, the pledge/withdraw instructions will be updated in LMEmercury.

### **How are LME warrants charged as collateral to LME Clear?**

LME warrants are pledged by the member in favour of LME Clear. The pledge is enforceable if the member goes into default.

### **Do the existing systems allow for streamlined transfers of client warrants?**

Yes. The existing systems and processes currently in place allow for the transfer of client warrants.

### **Will the same warrants be returned when a withdraw is submitted?**

Yes. The exact warrant ID numbers can be viewed in LMEmercury once the pledge has settled. Each individual warrant ID can then be withdrawn as required

### **Can warrants held at LME Clear be used for physical delivery settlement on the same day?**

Yes, as long as the withdraw instruction has been entered prior to the cut-off time of 09:00. Withdraws are processed shortly after the cut-off time, and the warrant will be ex-cleared to the member at around 09:30 London time.

### **What are the cut off times for pledging and withdrawing warrants to/from LME Clear?**

The deadline for pledging warrants is 12:30 London time. The deadline for withdraws is 09:00 London time.

### **Will the warrants be transferred same day?**

Yes. All transfers are completed the same business day within the cut-off times mentioned above.

## **Margin requirements**

### **Will using warrants reduce the number of margin calls?**

Whilst using warrants as collateral will not reduce the likelihood of a margin call, if an excess balance of warrants is held on a collateral account then this excess would be used (taking into account the metal for metal cover) before a margin call would be issued.

### **Can warrants be used to settle margin calls?**

No. Where a member has insufficient collateral to cover their margin requirement, a USD cash margin call would be issued (or GBP cash on a USD holiday when LMEC is open)

### **Will the LME warrant collateral positions be factored in when calculating concentration margin?**

Yes. Concentration margin will be calculated on existing cleared positions after consolidating with any collateral positions on a metal for metal basis.

### **Can the warrants be used to cover all margin requirements?**

LME warrants can cover both initial and variation margin, but they are only acceptable on a metal for metal basis i.e. aluminium warrants would cover aluminium positions.

### **Will the use of warrants as collateral be subject to limits?**

Both market liquidity and diversification limits apply. The limits can be found on the LME website by registering free under the "documents" tab at [lme.com/acceptablecollateral](https://lme.com/acceptablecollateral)

## **Fees, haircuts and warehouse rent**

### **How much does it cost to use warrants as collateral?**

Currently, LME Clear charges 25 bps annual accommodation fee on the total amount of warrants encumbered. A \$4.00 per warrant ex-cleared transfer fee is also applied when transferring warrants from member to LME Clear (capped at \$3,000 per year).

### **Will haircuts be applied to warrants as collateral?**

Yes. Haircuts will be applied to the total value of the warrants used. The haircut amounts will be updated on a regular basis and can be found at [lme.com/haircutmethodology](https://lme.com/haircutmethodology)

### **Does warehouse rent still need to be paid on warrants used as collateral?**

Members will still be required to pay rent directly to the warehouse agents. However, LME Clear will support members by endorsing warrants on their behalf in LMEsword when requested. This will ensure members do not need to withdraw the warrants and incur ex-cleared transfer costs prior to rent payment.

### **Are there any restrictions on using warrants with rent payments due?**

LME Clear will not accept any new pledges of warrants with a rent due date within five business days, and will not give value to any warrants held with a rent due date within three business days.

## Contact us

For more information about warrants as collateral, please contact [business.development@lme.com](mailto:business.development@lme.com)

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