

To: All Members, Warehouse Companies and London Agents

Ref: 11/141: A135 : W092

Date: 27 May 2011

Subject: **Warehouse Study by Europe Economics**

The Europe Economics report “Assessment of Warehouse Minimum Loading Out Rates” has been considered by a steering committee of the Executive together with the Independent Directors of the Exchange. A recommended course of action will be presented for a decision to the Board of LME Limited at its meeting on 16 June 2011.

The report is extremely detailed and contains a great deal of proprietary information that makes it impossible to publish the full version. However, the executive summary and the recommendation section from the Europe Economics report are attached to this notice and will be published on the LME website.

The decision to commission the report was taken because the LME recognised the concerns of various sectors of the industry with regard to the existence of long waiting times for the delivery of aluminium out of LME listed warehouses in North America.

It should be noted that this issue currently is specific to aluminium and to one location; the LME does not have a systemic issue with its warehouse network.

The mechanisms and systems that the LME approves are subject to the various pressures of the economic cycle, and that means that different problems will arise at different points in the cycle. The current LME procedures have developed over a long period in response to market requirements. It is desirable that the LME approves procedures that are capable of dealing with different circumstances with the minimum of change, but it is also necessary to recognise the impossibility of designing ‘one-size fits all’ regulations.

Market participants will recollect that only two years ago the North American aluminium industry was facing a major recession with the apparent collapse of its major automotive customers. At that time the concerns of the industry were all centred on the need to deliver material into warehouse, with dire warnings about the consequences for the LME should there be a capacity constraint that affected the free flow of surplus material onto warrant.



We now find that the major concern of that same industry (and in some cases, the same participants) is the ability to take material out of warehouse. It is not surprising that there should be some tension created by such a rapid journey between the two poles of the aluminium economic cycle. We also note that the situation has been exacerbated by the coincidental availability of surplus aluminium with the widespread policy of central banks holding down interest rates and creating a pool of cheap money that increases the attractiveness of financing deals and in turn increases the pressure for fiscally-motivated stock movements. We do not make value judgements about the different motivations for warrant cancellation, but we do note that the system is under pressure as a result of some extraordinary factors.

The challenge for the LME is therefore to manage its warehouse regulations in such a way that the changing nature of the business environment can be managed within a relatively stable mechanism. It must also be recognised that there are consequences to all decisions (often leading, among other things, to higher costs) and that all actions must be viewed, as far as is possible, with a long term perspective.

The Europe Economics report contains a number of policy options that might appear to address the situation under review. The LME agrees with the authors of the report that the capping of storage capacity in particular locations is not consistent with the LME's general policies.

The report suggested that the implementation of rent rebates for material that is 'stranded' in a queue should be the subject of further discussion, though it noted that there are significant feasibility issues with this option. The LME believes the feasibility issues do indeed outweigh the advantages of this option.

The option of a significant increase in loading out rates across all warehouses is also not attractive. The increased cost of such an approach would impact all warehouses and therefore all users of the market and might simply create a new generation of problems.

The LME does agree that there should be a link between the amount of metal stored in a company's warehouses at a location and the minimum load out rate. The current regulation has a sliding scale of load out minimum rates, rising to an upper level of 1,500 tonnes per day. The scale is based on the total storage capacity that the company has in the location.



We are recommending to the Board of the LME that the sliding scale be changed. If the Board approves the recommendation then the load out requirement will be linked to the amount of metal stored rather than the storage capacity and the new scale will be as follows:

Warehouse company's tonnage stored per location	Minimum delivery out
Up to 300,000 tonnes	1,500 tonnes
300,000 to 600,000 tonnes	2,000 tonnes
600,000 to 900,000 tonnes	2,500 tonnes
More than 900,000 tonnes	3,000 tonnes

(The daily delivery rate does not include deliveries out for cobalt and roasted molybdenum concentrates: any deliveries out for these metals must be made in addition to the rates stipulated in the table above.)

The changes would be effective from 1 April 2012. The date has been chosen to give ample time for the warehouse companies to prepare for the new regime and for the market to digest the consequences of the change.

Martin Abbott
Chief Executive

cc: Board directors