

LME warehouse reform

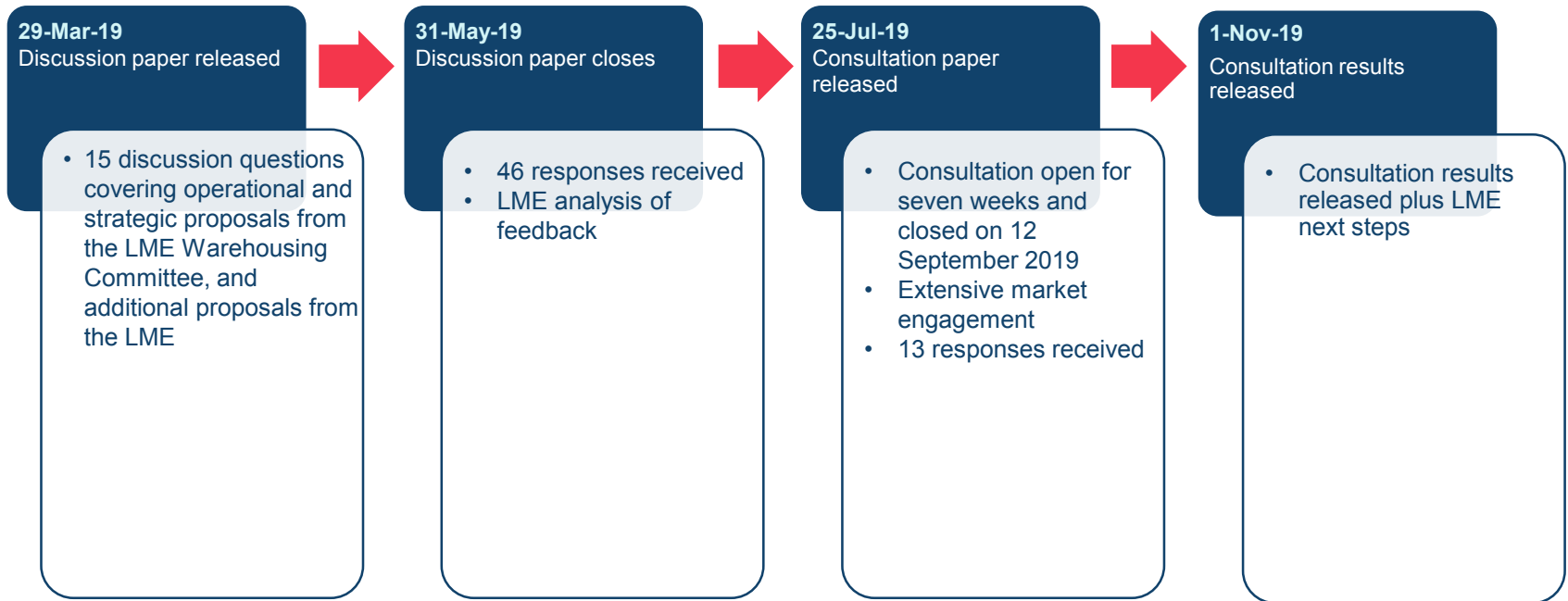
1 November 2019



SETTING THE GLOBAL STANDARD



Process to date



Consultation proposals

Logistical optimisation



- CP1 Proportionate restrictions on evergreen rent deals
- CP2 Freeze headline rents and free on truck ("FoT") charges
- CP3 Definition of "load-out"
- CP4 Clarification on FoT denomination
- CP5 Door wording amendment
- CP6 Stock reporting clarification
- CP7 Probation period for new Delivery Points
- CP8 LME discretion on approving new Delivery Points
- CP9 Review period
- CP10 Specific ban on sharing queue information

Transparency and compliance



- CP11 Enhanced transparency through reporting of stocks which may become warranted
- CP12 Daily stock reporting amendment to allow for greater transparency over status of cancelled stocks
- CP13 Sanctions
- CP14 Greater protection for warrant holders against warehouse insolvency
- CP15 Revised Complaints Procedure
- CP16 Applicable law for warrants

Rebalanced rules and a pathway to simplification



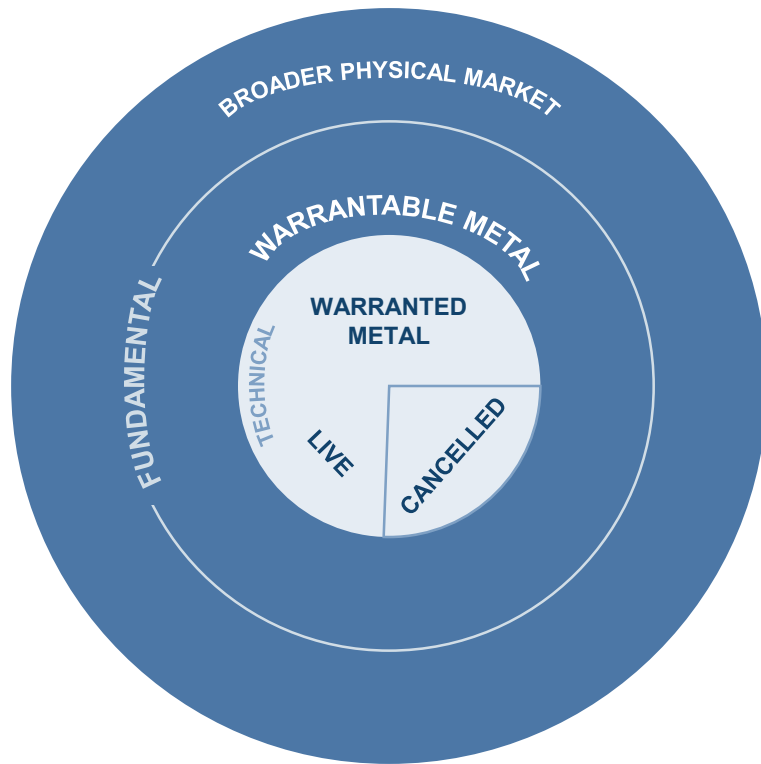
- CP17 QBRC parameter change
- CP18 LIFO clarification and queue protection amendments
- CP19 Policy housekeeping updates

If changes are successful, proposed future migration to simpler proportional stock load-out obligation

KEY

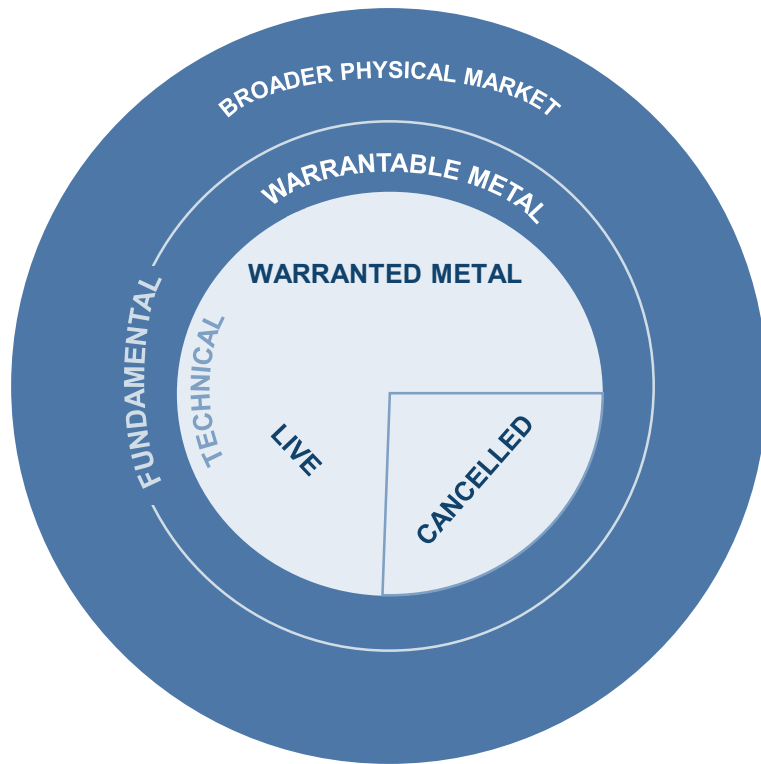
- CP No objections
- CP Some discussion
- CP Significant feedback

Market concerns over stock levels...

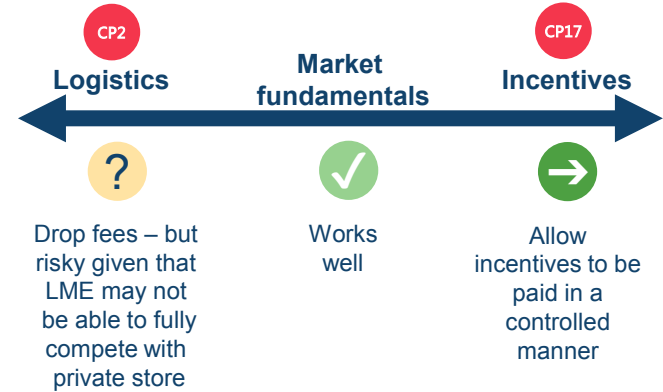


- The LME proactively queries large warrants and cancellations – parallel workstream to broaden market guidance around market abuse and stocks figures
- “Technical” tightness is driven by low observable stocks of warranted metal
- May not be driven by “fundamental” metal shortages
- But ultimately, it is a metal owner’s decision where to store their metal
- As incentives have fallen (due to warehouse reform and other factors), more metal has moved off-warrant

...addressed both by a more hospitable warranting environment...



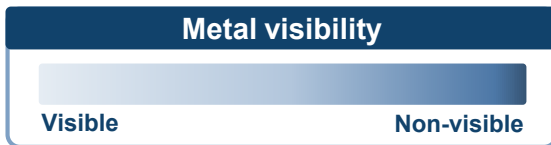
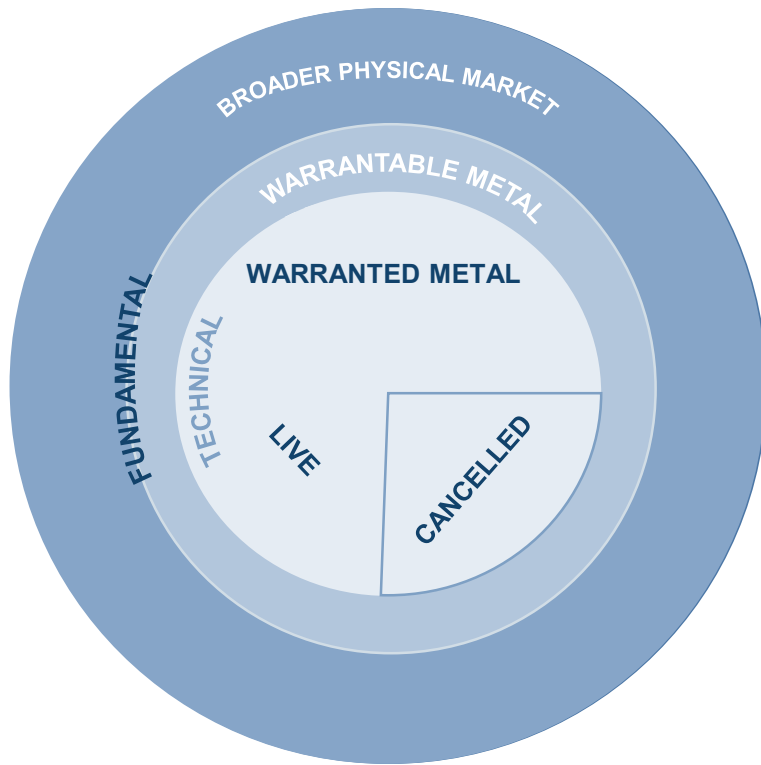
What attracts metal on-warrant?



- By permitting a controlled and phased set of rule changes, it may be possible to allow warehouses to compete more effectively for metal
- This would be expected to increase warrants (and hence visible) stocks

CP17 QBRC parameter changes

...and greater transparency

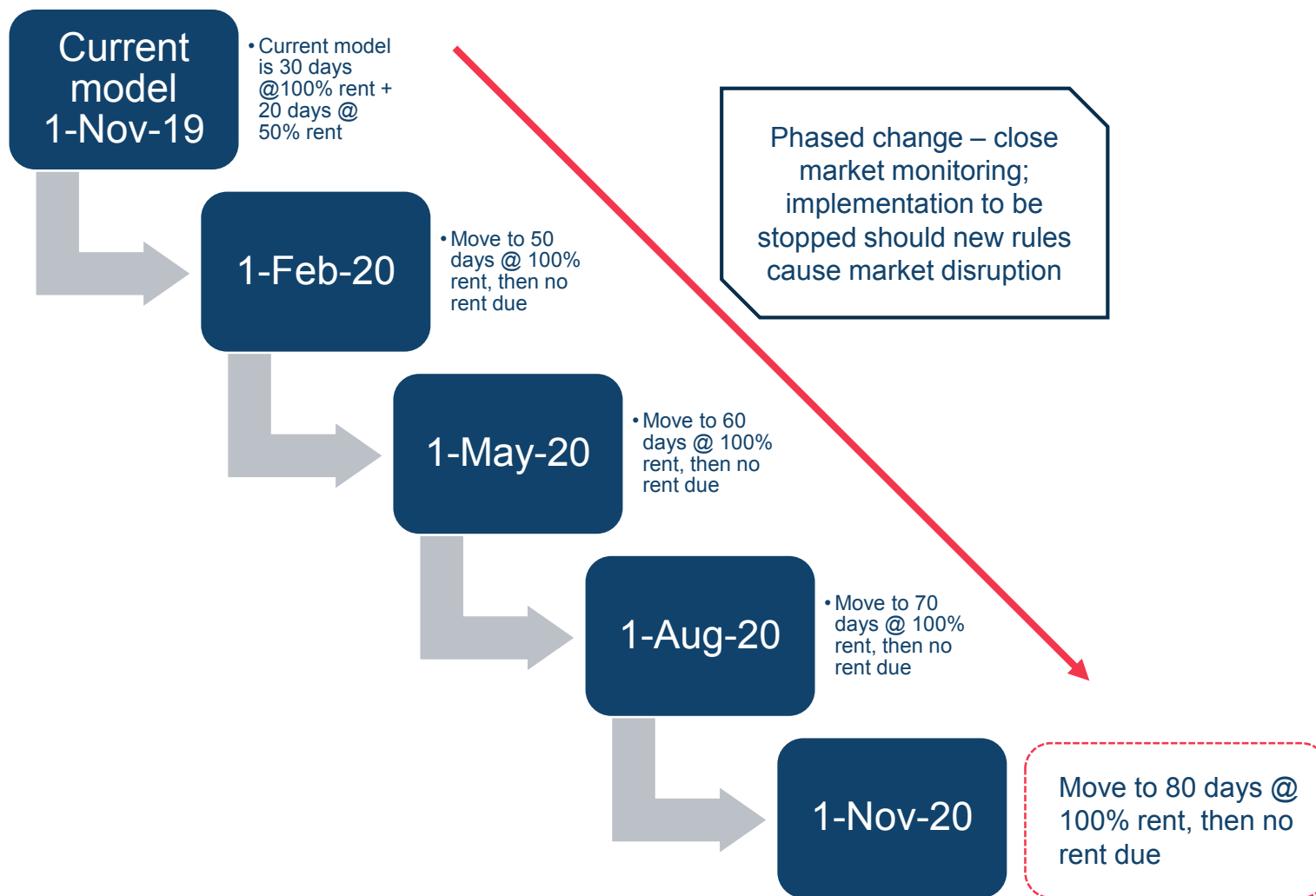


- By providing transparency over a broader set of material, the market will be able to trade on the basis of a more holistic supply story, even if core warrantable metal is limited

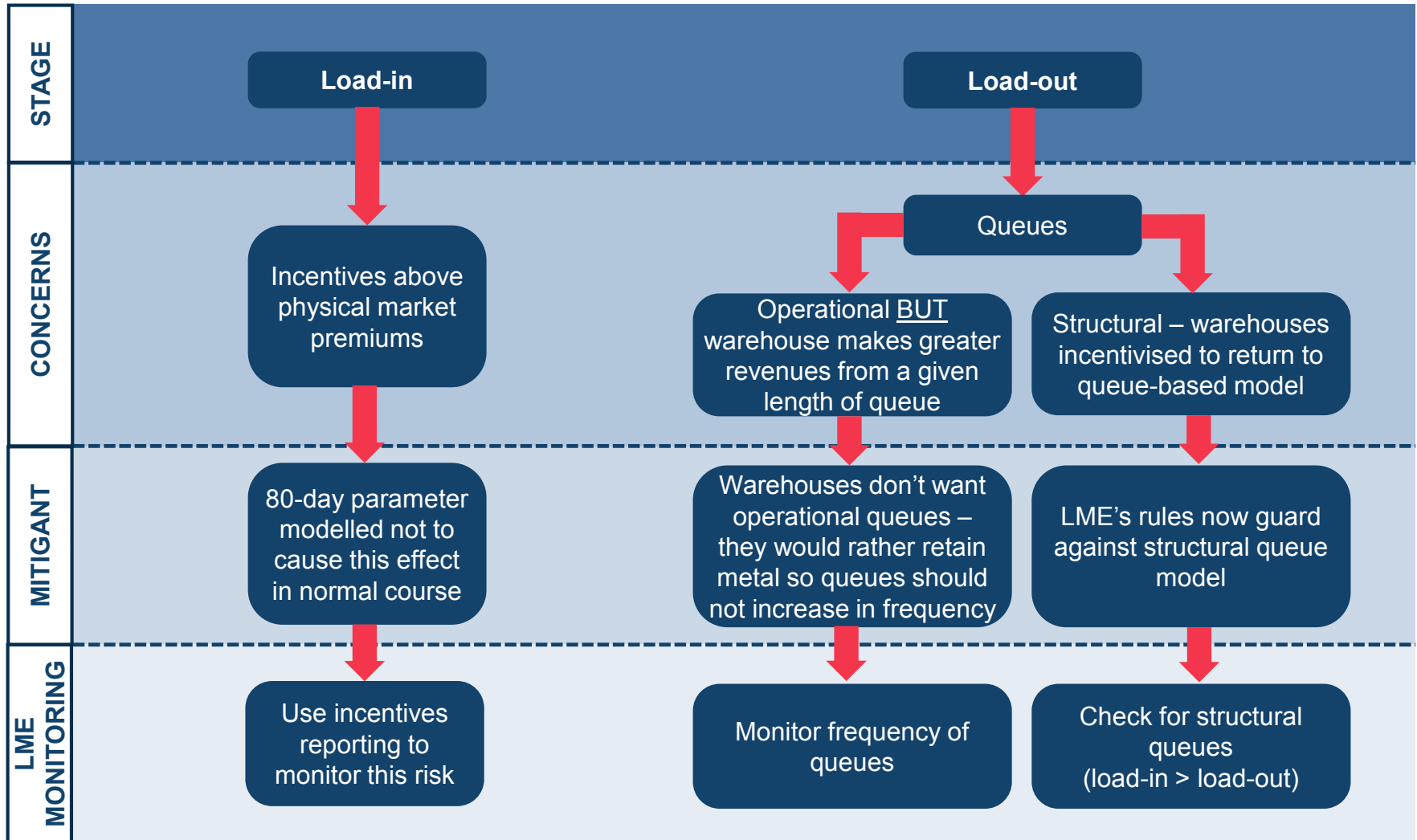


CP11 Off-warrant stock reporting

QBRC threshold changes implemented in a phased manner...



...allowing evidence-based monitoring of concerns



Off-warrant stock reporting...

1

Metal stored under an agreement requiring use of LME-registered sheds

2

Metal stored under an agreement where owner has right to warrant

3

Metal where the owner has voluntarily asked the warehouse to report stocks



No competitive disadvantage for LME-approved warehouses since others cannot offer these services in any event

Data reported to the LME

LME will analyse data, and publish if meaningful and representative

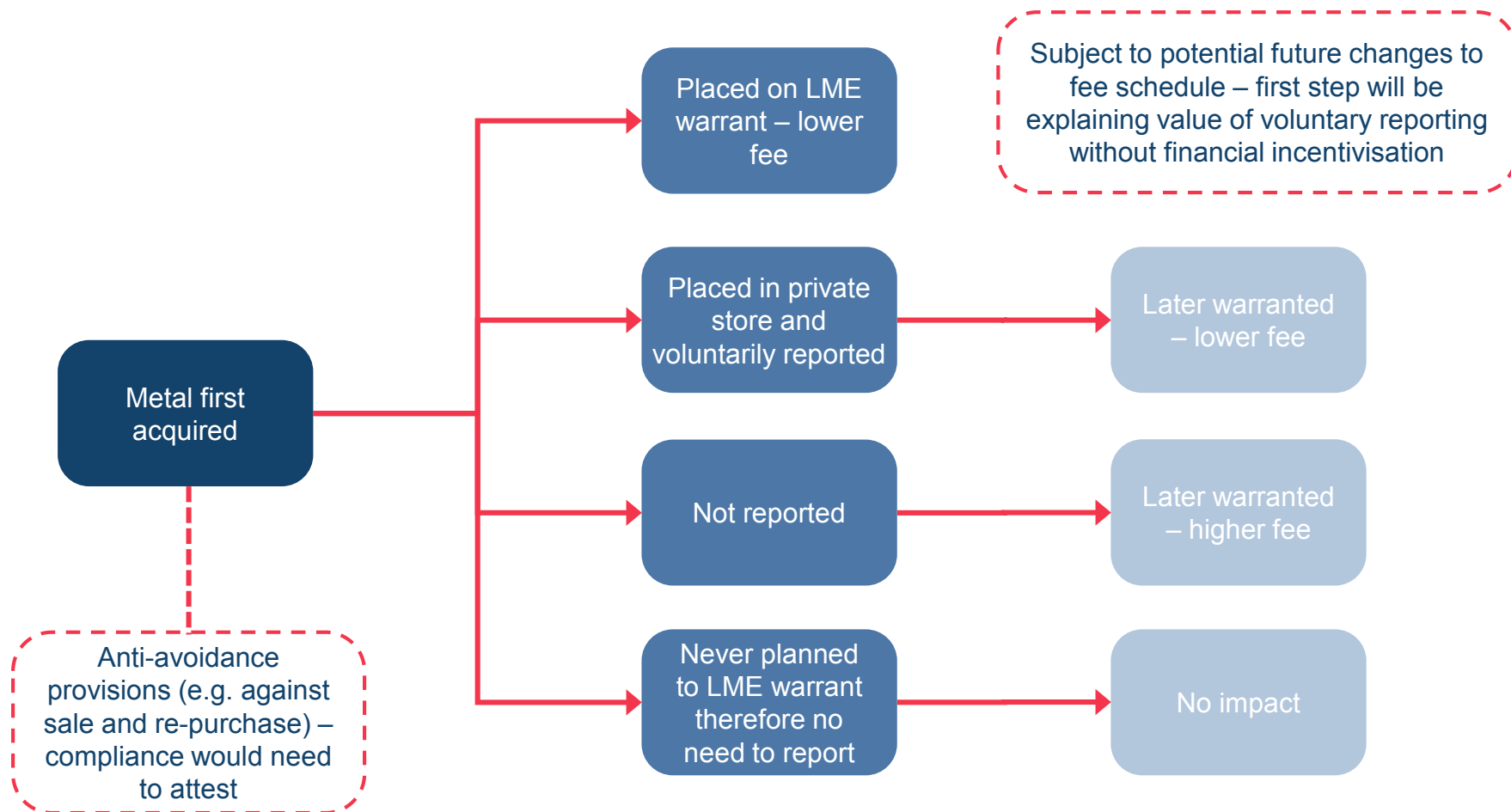
- The LME hopes that metal owners will embrace a voluntary reporting approach
- If not, the LME will consider an alternative approach whereby metal placed at LME-registered warehouses AND not voluntarily disclosed to the LME at the earliest opportunity will be subject to more onerous warranting conditions (cost, tonnage limitations etc)

...with LME belief that concerns can be mitigated...

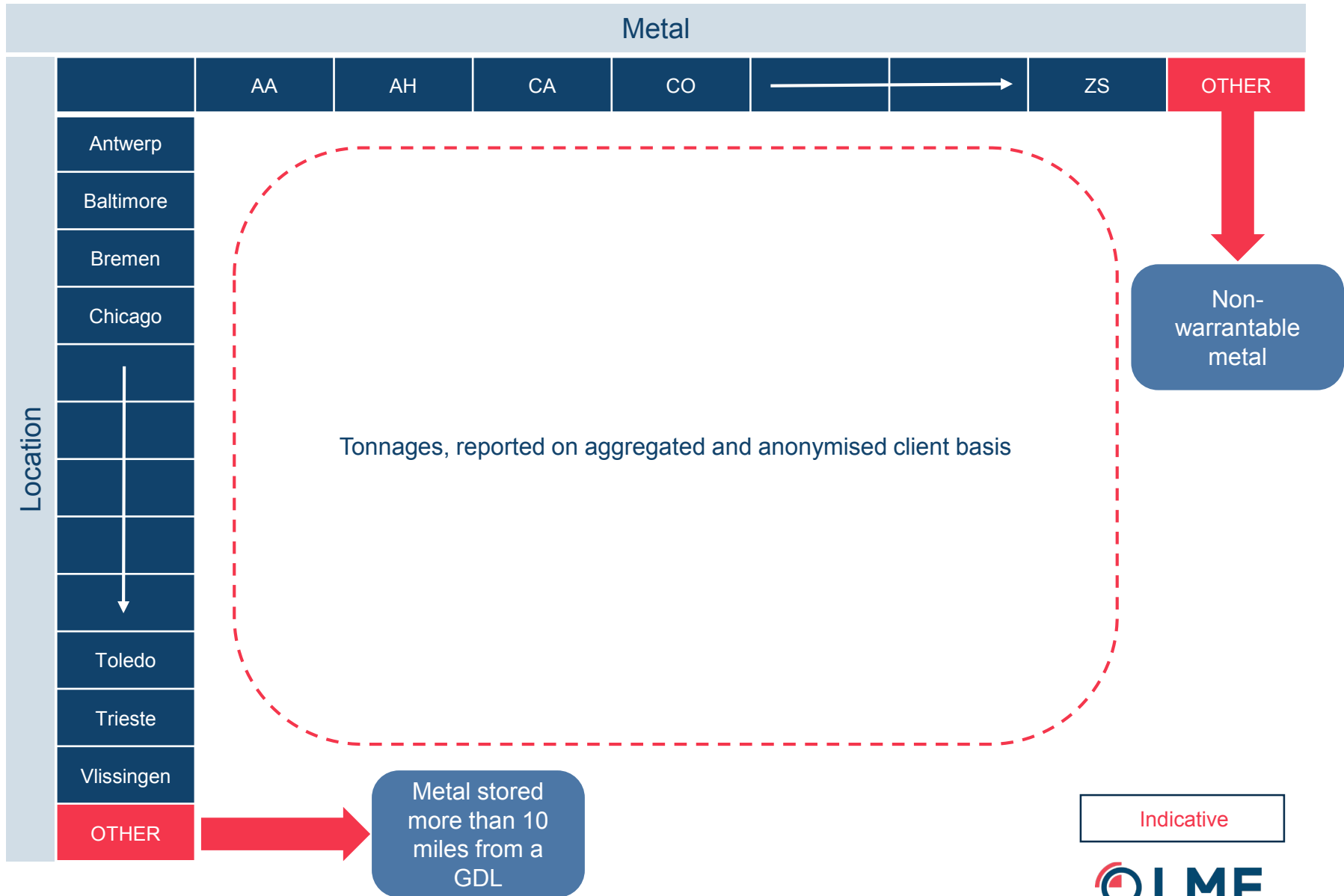
 Concern	 Response
LME's right to compel reporting	To address market concerns around stock transparency and monitor market conduct
Impact on commercial relationship between warehouse and metal owner	Private relationships not impacted – but if the LME is mentioned in contracts then the LME can impose reporting requirements
LME references may be removed from contracts to avoid reporting	Pathway to voluntary reporting
Data may not be meaningful	LME will assess data before deciding whether to publish
Loopholes / avoidance	LME will monitor rules, and use audit rights as appropriate
Reporting process	Data sets defined in Warehouse Agreement – template will be provided

...plus potential pathway to further incentivise voluntary reporting...

e.g. placing greater warranting fee on metal not reported at earliest opportunity

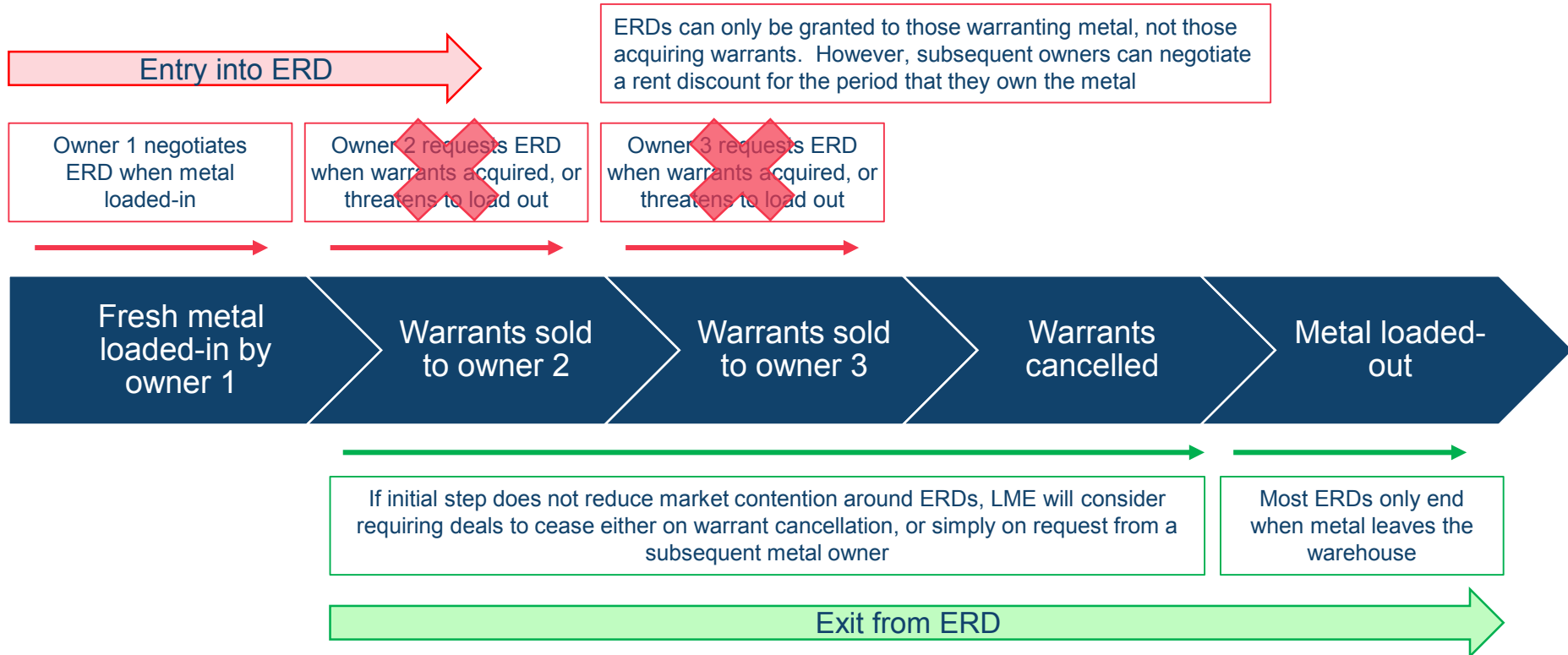


...and data defined in the Warehouse Agreement



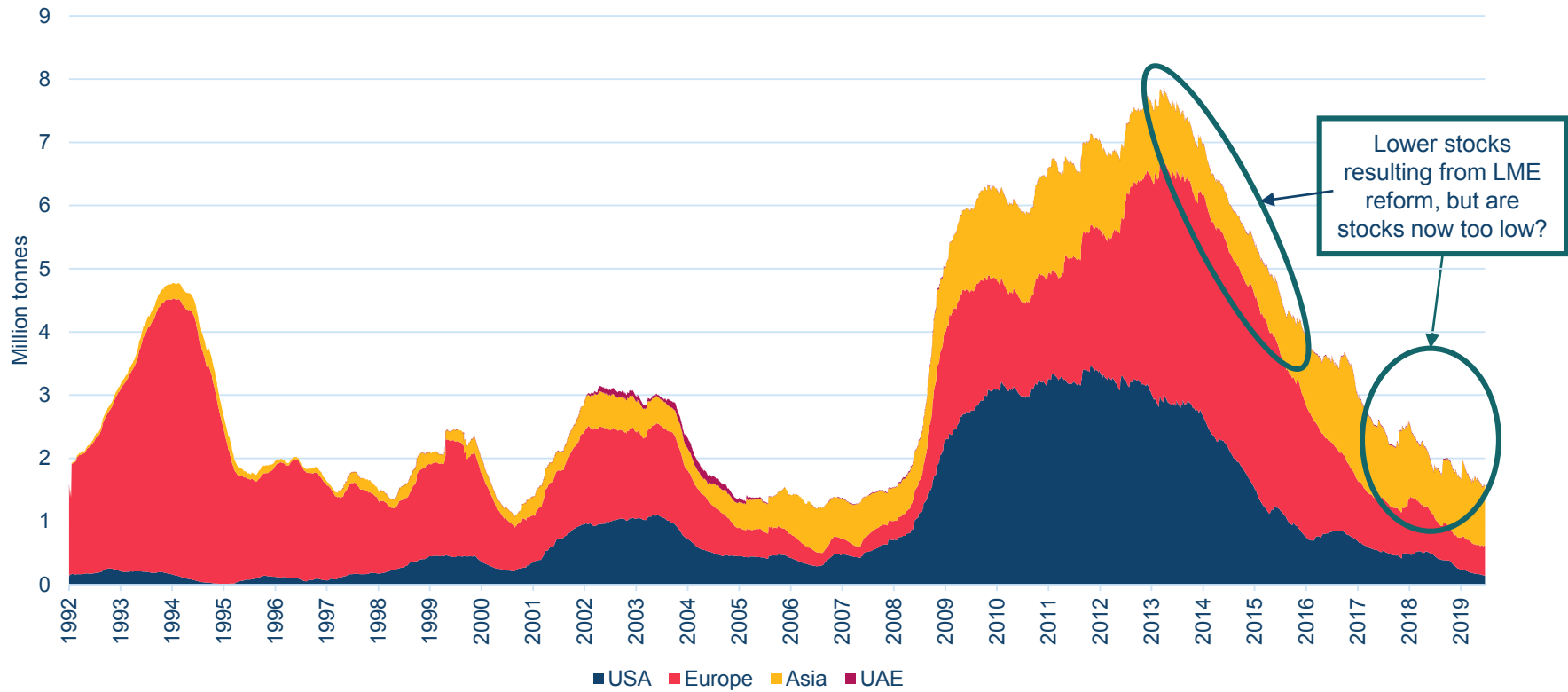
Indicative

Evergreen rent deals (“ERD”)



Appendix

Is there a problem with LME stocks?



Data as of 15-Oct-19

How can the LME attract more metal?

Logistics

On-warrant LME storage seen as “gold standard”

Model challenged by “shadow LME” storage, where warehouses provide advantages of LME storage but at lower cost. Advertised as “stored in LME registered sheds”, but not actually on LME warrant

Market fundamentals

Metal warranted to be delivered against short trading positions, particularly to facilitate sale of market oversupply, or during backwardations

Warehousing understood to be counter-cyclical; in a strong economy, metal goes to consumption and warehouses have lower stocks. In recession, warehouses absorb stock as the market of last resort

Incentives

Warehouses offer incentives to metal owners to warrant metal

Quantum reduced under LME QBRC Rule which puts a *de facto* “cap” on total metal warranted before risk of financial penalty to warehouse if all metal cancelled simultaneously. Lower stock levels limit incentives offered

LME observations

Opportunities exist for logistical improvement, but move to a solely logistics-focused network considered too risky – unclear that the LME network could ever match the low fees of private storage, and some metal owners will always choose non-visible storage regardless of other factors

Appears to have worked well, even during recent supply tightness

Opportunity to bring more metal onto warrant, provided (i) queues remain controlled and (ii) warehouse incentives do not outbid the physical market

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