

# LME consultation on warehouse reform

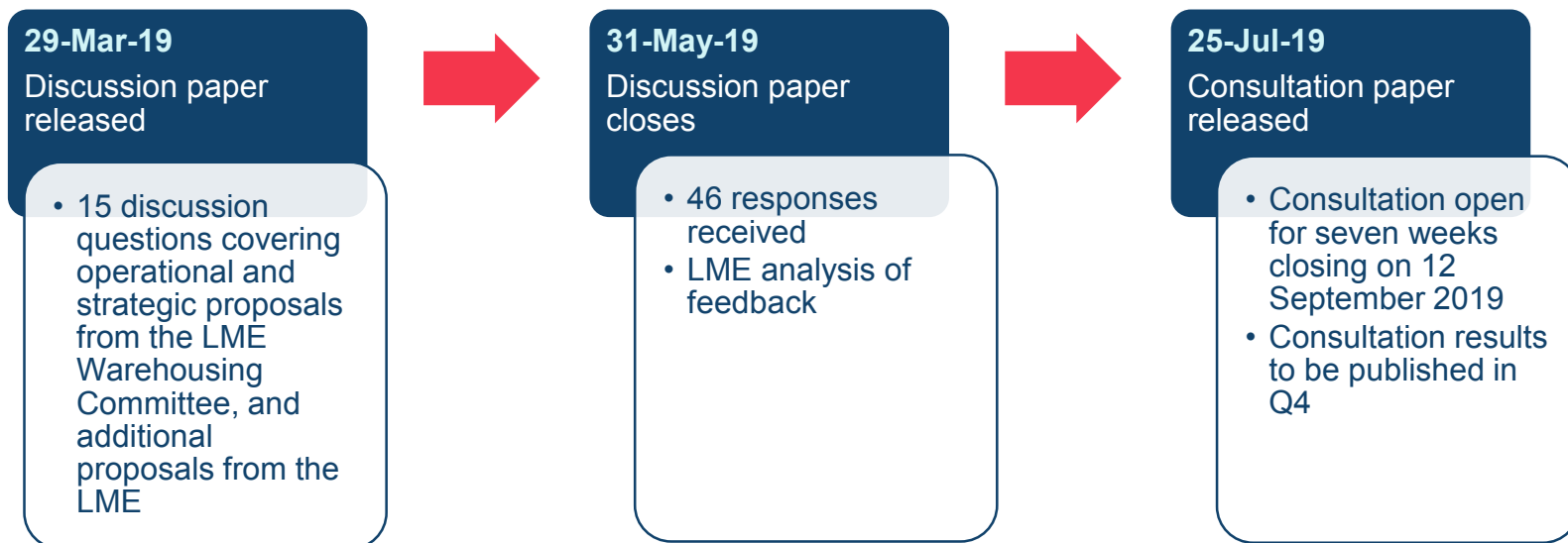
July 2019



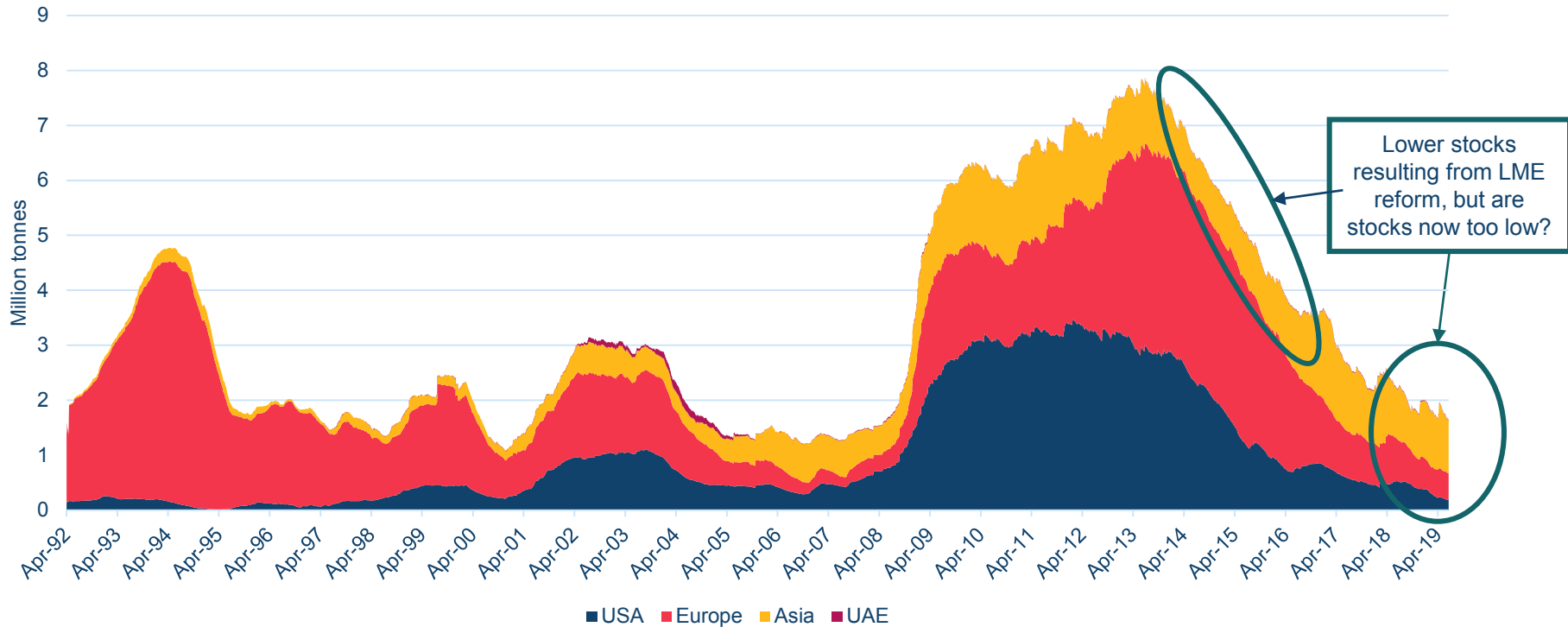
SETTING THE GLOBAL STANDARD



# Process to date



# Is there a problem with LME stocks?



- Current LME stock levels fulfil the requirements of physical delivery on the Exchange
- Agreement in market that higher stocks could achieve market-wide positive effects

Data as of 10-Jul-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

# Priorities underpinning proposed reform

## Logistical optimisation



- Proportionate restrictions on evergreen rent deals
- Freeze headline rents and free on truck charges (“FoT”)
- Definition of “load-out”
- Clarification on FoT denomination
- Door wording amendment
- Stock reporting clarification
- Probation period for new Delivery Points
- LME discretion on approving new Delivery Points
- Review period
- Specific ban on sharing queue information

## Transparency and compliance



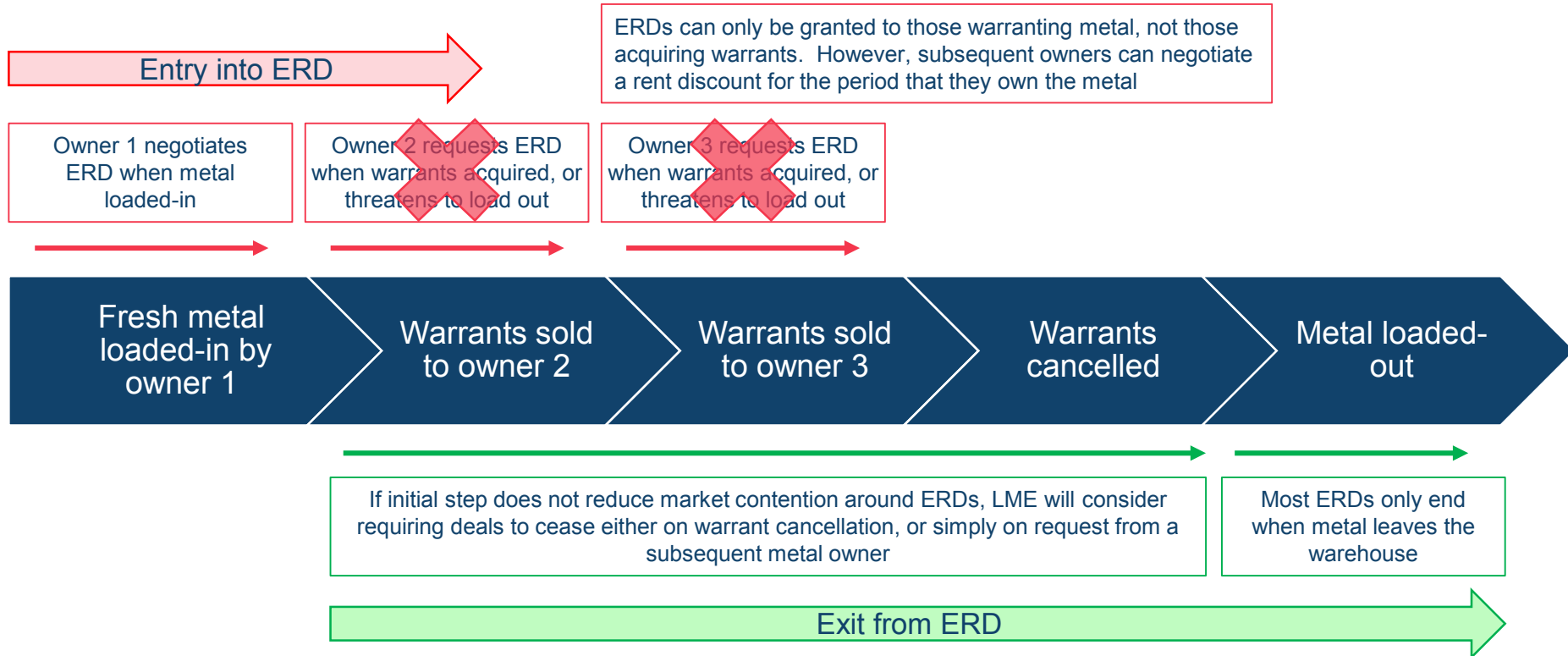
- Enhanced transparency through reporting of stocks which may become warranted
- Greater transparency over status of cancelled stocks
- Sanctions
- Greater protection for warrant holders against warehouse insolvency
- Revised Complaints Procedure
- Applicable law for warrants

## Rebalanced rules and a pathway to simplification



- QBRC parameter change
- LILO clarification and queue protection amendments
- Policy housekeeping updates
- If changes are successful, proposed migration to simpler proportional stock load-out obligation

# Evergreen rent deals (“ERD”)



# 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)

# Proposed QBRC threshold changes

Current model  
1-Nov-19\*

• Current model is 30 days @ 100% rent + 20 days @ 50% rent

1-Feb-20

• Move to 50 days @ 100% rent, then no rent due

1-May-20

• Move to 60 days @ 100% rent, then no rent due

1-Aug-20

• Move to 70 days @ 100% rent, then no rent due

1-Nov-20

• Move to 80 days @ 100% rent, then no rent due

Implementation to be stopped should new rules cause market disruption

*Potential for simplification*

Move to proportionate load-out model (%age of total stock) over time

NB: Not expected that 80 day QBRC model will allow warehouses to pay incentives above the physical market premium

\* Dates indicate potential timelines and are not guaranteed



# Disclaimer

© The London Metal Exchange (the “LME”), 2019. The London Metal Exchange logo is a registered trademark of The London Metal Exchange.

All rights reserved. All information contained within this document (the “Information”) is provided for reference purposes only. While the LME endeavours to ensure the accuracy, reliability and completeness of the Information, neither the LME, nor any of its affiliates makes any warranty or representation, express or implied, or accepts any responsibility or liability for, the accuracy, completeness, reliability or suitability of the Information for any particular purpose. The LME accepts no liability whatsoever to any person for any loss or damage arising from any inaccuracy or omission in the Information or from any consequence, decision, action or non-action based on or in reliance upon the Information. All proposed products described in this document are subject to contract, which may or may not be entered into, and regulatory approval, which may or may not be given. Some proposals may also be subject to consultation and therefore may or may not be implemented or may be implemented in a modified form. Following the conclusion of a consultation, regulatory approval may or may not be given to any proposal put forward. The terms of these proposed products, should they be launched, may differ from the terms described in this document.

Distribution, redistribution, reproduction, modification or transmission of the Information in whole or in part, in any form or by any means are strictly prohibited without the prior written permission of the LME.

The Information does not, and is not intended to, constitute investment advice, commentary or a recommendation to make any investment decision. The LME is not acting for any person to whom it has provided the Information. Persons receiving the Information are not clients of the LME and accordingly the LME is not responsible for providing any such persons with regulatory or other protections. All persons in receipt of the Information should obtain independent investment, legal, tax and other relevant advice before making any decisions based on the Information.

LME contracts may only be offered or sold to United States foreign futures and options customers by firms registered with the Commodity Futures Trading Commission (CFTC), or firms who are permitted to solicit and accept money from US futures and options customers for trading on the LME pursuant to CFTC rule 30.10.