

To: All Members, warehouse companies and their London agents and other interested parties

Ref: 20/151

Classification: General updates

Date: 15 June 2020

Subject: **DISCUSSION PAPER ON THE PROPOSED DEMATERIALISATION OF LME WARRANTS AND ELECTRONIC WARRANTING PROCESS**

Executive Summary

1. This Notice provides market stakeholders with information about the LME's proposal to dematerialise (or, where required, immobilise) LME Warrants, move to an electronic warranting process and perform the role of Depository itself, in particular with regard to the impact on operational processes and legal considerations, and invites the views of market participants in relation to those proposals.

Defined Terms

2. Capitalised terms used but not defined in this Notice shall have the meanings given in the LME Rulebook, the LMEsword Regulations or the terms and conditions applicable to Warehouses (the "**Warehouse Terms and Conditions**"), as applicable.

Section 1 - Background

Introduction

3. The London Metal Exchange (the "**LME**") facilitates physical delivery of metals through its settlement system, LMEsword. The LME has used an external provider of depository services since the launch of LMEsword in 1999. The Depository holds the physical Warrants which are allocated to Account Holders in LMEsword. The LME has listened to feedback from Members about the process of lodgement and withdrawal of Warrants from the Depository, and has concluded that greater operational efficiency and a reduction of operational risk could be achieved, whilst ensuring the continued certainty of the settlement of LME Contracts, by:



- (a) the LME performing the role of Depository;
- (b) streamlining the lodgement and withdrawal processes by adopting a new electronic, volume insensitive, efficient processing model; and
- (c) moving to a dematerialised (or where required immobilised) Warrant structure, thereby eliminating the need for the lodgement and withdrawal of physical Warrants from the Depository by Members,

together the “**Depository Proposal**”.

Purpose of LMEsword and Warrants

4. The LME offers a number of physically settled Contracts as part of its product offering which can be traded on its three venues. The LME currently facilitates physical delivery of metals in settlement of Contracts through its settlement system, LMEsword. Contracts are settled by the debiting and crediting of Members’ Accounts in LMEsword. All Category 1, 2 and 3 Members are Account Holders in LMEsword, and Members may open one or more Customer Accounts in LMEsword to facilitate the settlement of Client Contracts and the holding of Warrants for their Clients.
5. By trading LME Contracts, Members are assured of receiving a specified quality and quantity of metal in settlement of their Contract. To ensure consistency in quality, all metal delivered into LME-approved warehouses must be an LME-approved brand and conform to specifications on quality, shape and weight, and it is only this metal that may become the subject of a Warrant. Therefore metal that is represented by a Warrant in LMEsword is of a specified quality and quantity, and available for settlement of Contracts.
6. For metal which meets the required LME specifications and at the metal owners’ request, Warehouses can instruct their nominated London Agent to create a Warrant representing the metal.
7. The LME is aware that LMEsword is not only used for the settlement of Contracts, but may also be used for the pledging or financing of Warrants as between Account Holders or between Account Holders and their Customers.
8. The Depository Proposal is not intended to alter the position described in paragraphs 4-7 above, save that the manner of creation of the Warrant by the London Agent will be electronic rather than a physical printing of the Warrant, as described in Section 2 below.



Operational Processes

9. Feedback from market stakeholders indicates that the process of lodgement and withdrawal of Warrants into and out of the Depository could be more efficient and streamlined. The following areas have been identified as areas for increased efficiency:
 - (a) In order for Warrants to be eligible to be used to meet LME delivery obligations arising from short positions on expiry day, they must be physically delivered to the Depository (usually the preceding business day), and only once they have been received by the Depository and credited to the Account Holder's Account in LMEsword can they be used for delivery. The Account Holder is required to collect the physical Warrant/s from the London Agent, sort the Warrants sequentially by Warrant identification number in batches of 200, create a lodgement instruction in LMEsword and then courier the Warrants to the Depository (together the "**Lodgement Process**").
 - (b) When withdrawing Warrants, the Account Holder is currently required to submit their instructions in batches of 200 via LMEsword. The Depository is then required to locate each individual Warrant and perform their internal due diligence prior to releasing the documents to the Member, which, in turn, presents them to the London Agent (together the "**Withdrawal Process**").
 - (c) If there is a significant increase in the number of Warrants lodged at the Depository this can result in delays due to the manual nature of the Lodgement Process and the Withdrawal Process.
 - (d) The Depository currently adheres to a 'first in first out' model when processing Member instructions. Due to the confidentiality of Member Warrant holdings, it is difficult to give Members clear anticipated timescales for completion when dealing with a third party Depository.
10. The LME's objective in implementing the Depository Proposal is to adopt a new electronic Lodgement Process and Withdrawal Process to achieve greater operational efficiency, and reduce operational risk associated with physical Warrants (including where physical movement and social contact are restricted) whilst ensuring the continued certainty of the settlement of LME Contracts.
11. To this end, the LME is currently developing processes and enhancing its systems capabilities, as well as taking legal advice to shape and support the Depository Proposal. The two key parts of this Notice are Section 2 which describes the operational proposals and Section 3 which describes the legal considerations. The former will be most of interest to those involved in LMEsword from an operational perspective, and the latter will be primarily of interest to in-house counsel.



Section 2 - Operational Proposals

12. The LME is currently working closely with the software provider for LMEsword to deliver a number of operational enhancements as part of this project.
13. Operational efficiencies will be achieved as a result of dematerialising or immobilising the Warrants (definitions of Dematerialised Warrants and Immobilised Warrants are set out in paragraph 38 below). The LME is therefore able to remove the current dependency on a third party to manage the service offering and the physical secure storage of Warrants.
14. The LME has identified a number of areas for improvement and the new Depository model will be more efficient and more transparent than before. The proposed process will be volume insensitive to ensure that one Member is not adversely affected by the activities of another. The LME has focused on achieving these improvements with minimal change to the LMEsword system to allow for maximum benefit for the LME's end users.
15. By moving to a new structure where the LME performs the role of Depository, the service will be under the full control of the LME. Due to moving away from the requirement to securely store paper Warrants, a physical vault will not be part of the service provided by the LME. The new service will provide direct oversight of the Depository function rather than third party oversight and will also provide greater control over future enhancements and for business continuity purposes. Removing physical Warrants from the process will ensure that market participants can continue to lodge and withdraw Warrants even in a situation where physical movement and/or social contact are restricted to the point where a physical process is no longer viable, for example if tighter restrictions are implemented in relation to Covid-19.
16. Clearing Members and Agents will be required to test the new GUI interface and to ensure that code changes to any systematic processes are identified in advance of the Depository Proposal being completed to ensure continuity of business.
17. The two main areas of change that will affect Members and London Agents relate to the processes for lodgement and withdrawal:

Lodgement

- (a) Members will no longer be required to lodge physical Warrants at the Depository.
- (b) The London Agent will receive an instruction to create Warrants from the Warehouse on behalf of the beneficial owner as they do today.



- (c) Instead of printing the Warrants for the Member, the London Agent will create a lodgement instruction and allege the Warrants to the Member via LMEsword. The London Agent will not be limited to a batch of 200 and could create a single instruction for up to 10,000 warrants.
- (d) Independently of LMEsword, the London Agent will provide a security code to the receiving Member which will need to be entered into LMEsword in order to view the Warrants in the instruction.
- (e) Once the instruction has been verified by the Member, they will then be able to complete the lodgement by selecting the destination account for the Warrants. The instruction will be subject to the same dual authorisation process that is in place today.
- (f) After the instruction has been authorised, the Warrants will then be lodged immediately (for jurisdictions which allow dematerialisation) or lodged once printed in the Depository (for jurisdictions which do not allow for dematerialisation, but do allow the use of Immobilised Warrants). Any Immobilised Warrants will have no value if removed from the Depository, removing the need for secure vault storage.
- (g) Under the new process, as the Warrants will not be physically printed on the Warehouse's headed paper which means that the terms and conditions will not be printed alongside the Warrant. It is proposed that the Warrants will state "Warehouse terms and conditions will be available on request from the Warehouse issuing the Warrant", and that the Warehouse will make the terms and conditions available on request.

Withdrawal

- (a) A Member will submit a withdrawal instruction via LMEsword as they do today (this will no longer be limited to a batch of 200 warrants). LMEsword will automatically split each instruction by the relevant London Agent.
- (b) Members will be able to nominate whether they are withdrawing the Warrant for cancellation or withdrawing a Warrant to be held out of LMEsword.
- (c) Independently of LMEsword, the Member will provide a confirmation to the London Agent as they do today with regards to their intentions for the material if they are withdrawing for cancellation.
- (d) If a Warrant is withdrawn for cancellation, the London Agent will print the Warrant for the first time and they will be automatically stamped as 'cancelled' by LMEsword when printed. At the same time a print will be triggered in the LME Depository if the Warrant is an Immobilised Warrant, and this will also be stamped as 'cancelled'.



(e) If the Warrant has been withdrawn to be held outside of LMEsword, the London Agent will provide the Member with a security code which they will need to present to the London Agent when collecting the Warrant. At the same time a print will be triggered in the LME Depository if the Warrant was previously immobilised, and this will be stamped as 'withdrawn'.

18. As there will be no requirement to securely store Warrants within a vault, manual processes will be eliminated as described above. There will be no need to courier physical warrants between the London Agent, Members and the Depository, which will increase efficiency for lodgement and withdrawal, and reduce operational risk.

19. The LME will set out the associated Depository fees in the 2021 Fee Schedule (which may include an increase or introduction of fees related to the Depository), and there will be no change to existing fees before 1st January 2021.

Section 3 - Legal Considerations

20. The LME has prepared the Depository Proposal with extensive input from Linklaters, in relation to the structure of the proposals and the laws of England & Wales, and also external counsel in the location of each LME warehouse:

- (a) Belgium (Altius)
- (b) England & Wales (Linklaters)
- (c) Germany (Linklaters)
- (d) Italy (Gianni, Origoni, Grippo, Cappelli & Partners)
- (e) Japan (Linklaters)
- (f) Malaysia (Adnan, Sundra & Low)
- (g) Netherlands (Linklaters)
- (h) Singapore (Linklaters)
- (i) South Korea (Bae, Kim & Lee)
- (j) Spain (Linklaters)
- (k) Sweden (Vinge)
- (l) Taiwan (Lee & Li)
- (m) United Arab Emirates (Al Tamimi & Co)



(n) US (Foley & Lardner)

21. As with all legal advice which it obtains, the LME does not propose to publish the advice as it is legally privileged and prepared solely for the attention of the LME. The contents of this Notice are not intended to be legal advice, and cannot be relied on by market participants for their own purposes. The law firms referenced in this Notice have not provided advice that may be relied upon by recipients of this Notice. The LME strongly recommends that, where they consider it necessary, each Account Holder takes their own advice as to the impact of the proposed changes on their own arrangements, which will be tailored to the specific circumstances of the individual Account Holder (for example the jurisdictions in which they operate and the specific activities they undertake (e.g. pledging/warrant financing, physical sourcing of metal, taking delivery of, and delivering, Warrants outside of LMEsword etc.)). The LME confirms it is happy for Account Holders to approach the LME's external counsel in England and Wales, Linklaters, in order to take advice if Account Holders wish to do so.
22. To further assist in enabling market participants to review the proposed changes, a description of the legal basis upon which the current structure relies (the **"Existing Legal Structure"**) and the legal basis upon which the dematerialisation or immobilisation of Warrants relies (the **"Proposed Legal Structure"**) is set out below. Questions for the market relating to the Proposed Legal Structure are included in the Discussion Questions set out in Section 6 of this Notice.

Existing Legal Structure¹

23. LMEsword provides a system for the lodging of physical Warrants with the Depository and effecting their delivery between Account Holders (whilst the physical Warrants are still held by the Depository). Warrants are transferred by the debiting and crediting of the Account Holders' Accounts and such transfers effect a delivery of constructive possession to the transferee Account Holder in respect of both the Warrant and the underlying metal specified in the Warrant.

Key elements

LMEsword Regulations

24. The LMEsword Regulations govern the operation of LMEsword and set out the respective rights and obligations of the Account Holders, the Depository, the LME and the Warehouses.

¹ Except where stated otherwise, statements of the legal position within this Notice refer to the laws of England and Wales. A diagram of the Existing Legal Structure can be found in Appendix 1.



Account structure

25. Account Holders must have at least one Account to which Warrants lodged by them or transferred to them are credited and may establish more than one Account for such purposes.
26. Customer Accounts can only be established by Account Holders who are permitted, under applicable law, to hold Warrants for Customers. In such situations, the LMEsword Regulations state that the Depository holds any Warrants to the order of the Account Holder exclusively.

Nature of Account Holder's interest

27. The LMEsword Regulations refer to the English law construct of bailment, namely a legal relationship that is created between a bailor and a bailee when a person having lawful possession (not necessarily ownership) of an asset (the bailor) delivers it to another person (the bailee) for a limited or specific purpose upon terms that the bailee will return that asset to the bailor or to someone else in accordance with the bailor's instructions once that purpose has been fulfilled.
28. The LMEsword Regulations are expressed to operate on the basis that there are two main levels of relationship, in respect of the Warrant and the metal, respectively:
 - (a) under the first, a Warrant is (physically) held by the Depository on terms that it acts as bailee, with the relevant Account Holder as bailor; and
 - (b) under the second, the underlying metal to which the Warrant relates is held by the Warehouse by virtue of the metal being deposited with the relevant Warehouse and under the terms of the relevant contract of storage.
29. In the event that an Account Holder holds Warrants on behalf of its Customer, and Warrants are to be transferred to or from a Customer Account, the LMEsword Regulations state that the Depository agrees to be sub-bailee for each Account Holder for all Warrants lodged with it held on behalf of a Customer. Each relevant Account Holder will be treated as the bailee of the Warrants on behalf of the Customer.

Warrants as documents of title

30. Warrants are typically issued under the law applicable in the location of the relevant warehouse (which is often located outside England and Wales), although they are required to be physically issued in London by Warehouses' London agents. Whether or not a Warrant constitutes a document of title falls to be determined, as a matter of the English conflicts of laws analysis, under the local



law applicable to the relevant warehouse (it is noted in this regard that the concept of a “document of title” is not one that is uniformly recognised in all jurisdictions).

31. Even on an analysis where the Warrant is not a document of title, however, transfers in LMEsword are effective due to (i) the delivery of the Warrant evidencing intention of the parties, (ii) the operation of the LMEsword Regulations (and the effect of the attornments described therein) and (iii) the operation of the Warehouse Agreement.

Transfers

32. The transfer of a Warrant within LMEsword rests on an analysis that the debiting and crediting of an Account has the same legal effect as the making of a physical delivery of a Warrant.
33. Since Warrants within LMEsword are at all times in the possession of the Depository, effective delivery of a Warrant therefore depends upon an attornment by the Depository to the effect that it holds the Warrant on behalf of the transferee.
34. In the case of a transfer of a Warrant from one Account Holder to another, the Depository simultaneously effects two attornments as follows:
- (a) as principal, to the effect that the Depository holds the Warrant (as bailee) to the order of the transferee Account Holder (as bailor) whose Account is being credited with the Warrant; and
 - (b) as agent for and on behalf of the Warehouse to the effect that the underlying metals specified in the Warrant shall, from the moment of the crediting of the Warrant to the transferee’s Account, be held by the Warehouse to the order of the transferee Account Holder, for as long as the Warrant remains credited to the Taker’s Account.
35. A transfer of a Warrant is intended to transfer:
- (a) constructive possession of the underlying metal specified in that Warrant; and
 - (b) where so intended, title to the underlying metal specified in such Warrant. It should be noted, however, that a transferee Account Holder will not generally obtain a better title to the relevant metal than the transferor Account Holder had. That aspect is unchanged by LMEsword as compared with the physical delivery of a Warrant.

Pledges

36. The LMEsword Regulations contemplate that security over Warrants can be effected by way of a pledge. This involves a delivery of possession of the Warrant



and the metal pursuant to the attornments made by the Depository (as principal and as agent for the Warehouse - see 'Transfers' above), as well as the parties to the pledge entering into a valid pledge agreement or other security arrangement.

Relevance of local law

37. The law of the location of each warehouse is relevant on the basis that:

- (a) LME Contracts and the LMEsword Regulations are governed by English law;
- (b) However, Warrants are commonly issued under the law applicable in the location of the relevant warehouse (although this may not always be the case), although Warrants are required under the Existing Structure to be physically issued by a London Agent;
- (c) In practical terms, the local law applicable to the Warrant is unlikely to be relevant to the issue of whether a transfer of a Warrant within LMEsword is effective under the Existing Structure, as disputes between Account Holders need to be referred to LME arbitration in accordance with the LME Rulebook; and
- (d) Local law will nevertheless likely be relevant to certain questions under LMEsword, including as to:
 - (i) whether the Account Holder to whose Account a Warrant is credited from time to time: is entitled to obtain delivery from the issuing Warehouse of the underlying metal to which the Warrant relates; has title to the relevant underlying metal; or can enforce security over the underlying metal; and
 - (ii) any impact of the insolvency of the relevant Warehouse.

Proposed Legal Structure²

38. Under the Proposed Legal Structure, a Warrant held by the Depository will take one of two forms:

- (a) Fully dematerialised, electronic form ("**Dematerialised Warrants**"); or
- (b) where the law of the location of the relevant warehouse does not support the existence of Dematerialised Warrants, paper form ("**Immobilised Warrants**"). The intention is that such Warrants will be expressed to be issued to bearer, and their other terms will be such that any rights attaching

² A diagram of the Proposed Legal Structure is set out in Appendix 2.



to or evidenced by the Warrant may be exercised only if, and for so long as, the Warrant is in the physical possession of the LME as Depository.

Proposed legal relationships

39. The proposed structure is designed to cater simultaneously for three separate analyses, depending upon the requirements of the law of the local jurisdiction in which the metal is located. The LME is still in the process of conducting its analysis of which jurisdiction category will apply to each Warehouse location. England and Wales will be Jurisdiction Category 1 and Jurisdiction Category 3 has been designed specifically for Warrants issued by warehouses located in the US. The remaining jurisdictions will be categorised at the time of the full LME Rulebook consultation, but the LME expects that most jurisdictions will fall into Jurisdiction Category 1.

Jurisdiction Category 1: Dematerialised

40. For jurisdictions in which the delivery of constructive possession of the metal by way of attornment is effective (or where similar local law agency analyses can be achieved), the proposed structure (subject to specific requirements under local law) will be as follows:

- (a) The metal will be held physically by the Warehouse as bailee (or other equivalent concept under local law) for the Depository;
- (b) The Depository will, in turn, act as bailee of the metal for the Account Holder (i.e. it will hold constructive possession of the metal on behalf of the Account Holder);
- (c) In addition, the Warehouse will hold the metal under the terms of the relevant contract of storage with the Account Holder;
- (d) Transfers will be effected by way of attornment (i.e. an acknowledgement, under the terms of the LMEsword Regulations) of the Depository (unaccompanied by the transfer of any physical document or constructive possession of such a document):
 - (i) as principal, to the effect that it holds (constructive) possession of the metal as bailee of the transferee from the moment of the transfer; and
 - (ii) as agent of the Warehouse, to the effect that the Warehouse acknowledges the transferee's interest in the metal;
- (e) In some jurisdictions where an attornment or the concept of bailment is not recognised the same effect may be achieved by the use of appointing one or more parties to the arrangement as an agent or other comparable



arrangement (for example, appointing the Depository as the agent of the Warehouse to acknowledge transfers).

Jurisdiction Category 2: Need for a document

41. For jurisdictions in which the delivery of constructive possession of the metal by way of attornment is not recognised as effective (unless carried out by way of transfer of possession of a document constituting or evidencing title or possession to the relevant goods), the proposed structure (subject to specific requirements under local law) will be as follows:

- (a) The metal will be held physically by the Warehouse as bailee (or other equivalent concept under local law) for the Depository;
- (b) The Depository will, in turn, act as bailee of the metal for the Account Holder (i.e. it will hold constructive possession of the metal on behalf of the Account Holder);
- (c) The Depository's rights as against the Warehouse will be constituted or evidenced by a physical document (expressed to bearer) held by the Depository (an Immobilised Warrant). That document will be held by the Depository as bailee of the Account Holder. Although the document will be a bearer document so that its physical delivery may transfer rights against the Warehouse for the delivery of the Metal, its terms will also restrict its transfer – and the transfer of the rights under it – outside the system (i.e. if the document is not in the physical possession of the Depository or its designated transferee)
- (d) Transfers will be effected by way of attornment (i.e. an acknowledgement, under the terms for the LMEsword Regulations) of the Depository:
 - (i) as principal, to the effect that it holds: (constructive) possession of the metal as bailee of the transferee from the moment of the transfer; and actual possession of the physical document as bailee of the transferee from the moment of the transfer; and
 - (ii) as agent of the Warehouse, to the effect that the Warehouse acknowledges the transferee's interest in the metal from the moment of the transfer.

Jurisdiction Category 3: Statutory regime

42. For jurisdictions in which there is a statutory regime for the recognition of electronic transfers, the system rulebook would incorporate terms catering for the recognition of such transfers under local law. It is possible that, in any such



jurisdictions, the transfer of a Dematerialised Warrant will operate as a transfer of title to the metal rather than effecting a transfer of possession.

43. It is likely that this approach will be adopted for Warrants which represent metal located in the US due to the availability of laws which support the electronic transfer of assets.

Effectiveness of Proposed Legal Structure despite loss of document of title status

44. Dematerialising Warrants (as in the case of Dematerialised Warrants) or limiting their transferability (as in the case of Immobilised Warrants) would in the LME's view likely result in such Warrants not being documents of title under English law. This is because, in the case of the Dematerialised Warrants, most dematerialisation techniques currently do not permit the creation of a digital asset that is capable of exclusive control. In the case of Immobilised Warrants, transferability of an instrument is a key consideration when determining whether such instrument should be considered a document of title.
45. As described in paragraphs 30 and 31, the efficacy of transfers in LMEsword does not rely on a Warrant being a document of title; instead, LMEsword has been established in order to ensure the efficacy of transfers even in circumstances in which the relevant Warrant is not a document of title. The LME understands that Warrants under the Proposed Legal Structure would be unlikely to be documents of title (given they will be dematerialised or subject to transfer restrictions), but that – just as under the Existing Legal Structure – this should not affect the efficacy of transfers within LMEsword.

Account structure

The expectation is that the way in which Accounts are established and maintained would work in the same way under the proposed structure as they currently do under the existing structure.

Pledges: impact of the proposed structure

46. An important difference between the Proposed Structure and the Existing Structure with regard to pledges is that, for Jurisdiction Categories 1 and 3, Dematerialised Warrants are incapable of being the object of an English law pledge. This is because it is not currently possible under the state of the law in England and Wales to pledge an intangible asset (since a pledge, being a form of bailment, relies on the transfer of possession, a concept which is not relevant to intangibles).



47. The LME understands that security can properly be granted in the relevant jurisdictions under the Proposed Structure by granting security over the Warrant or the rights constituted or evidenced by the Warrant and/or by granting security over the metal which will be determined by i) the law applicable to the relevant security interest, ii) the location or jurisdiction of incorporation of the security giver, and iii) where applicable any local law considerations in respect of the location of the warehouse where the metal is stored.
48. As with any security arrangements that have been entered into in respect of Warrants under the Existing Legal Structure, due to the nature of the underlying asset, Members may, where they are conducting relevant activities in connection with Warrants and the underlying metal, wish to obtain legal advice in the jurisdiction of the warehouses where the metal is stored. The LME has not identified any local law impediment to creating valid pledges and security interests as described above, although there may be formalities to observe such as the registration of charges, notifications between the parties involved or from a record keeping perspective.

Withdrawal

49. Under the Proposed Structure, the lodgement and withdrawal of Warrants would not be through the lodgement and withdrawal of physical Warrants. However, the LME does not propose to preclude the option to extract a Warrant in a form that could be security printed by the London Agent (an “**Extracted Warrant**”) if market participants feel that would be useful, for example in the context of financing or for evidentiary purposes. Extracted Warrants would be printed by a London Agent upon a request to extract the Warrant from LMEsword. In order to cancel the Warrant and obtain delivery of the underlying metal, Members would be required to re-lodge the Extracted Warrant in LMEsword (through the London Agent) and then cancel the Warrant before they could claim delivery of the metal. Extracted Warrants would not be eligible for delivery in respect of Contracts.

Section 4 - The Discussion Paper process, timing and steps following this Discussion Paper

50. The LME welcomes feedback for all stakeholders in its market, as to the proposals contained herein including all interested parties, including Members, Clients and Indirect Clients of Members, Affiliates of Members, London Agents, Warehouses and other market participants. Formal responses to this Notice should be submitted in writing.
51. For the avoidance of doubt, this Notice does not constitute a formal consultation (pursuant to applicable legal and / or regulatory requirements), and the LME shall not be obligated to implement any or all of the proposed changes described



herein. The proposed changes will be subject to a further LME Rulebook consultation prior to any implementation.

52. Formal responses may be submitted up until 6.00pm (London time) on **10 July 2020**. Responses made after this time shall not be taken into consideration. Although the LME will consider responses submitted in any format, it would be helpful if respondents could reply to the numbered questions set out Section 6 below.
53. Any questions regarding this Notice, as well as any formal written responses should be sent by email to DiscussionPaper@lme.com.
54. The LME may need to share responses received with regulatory authorities, members of its group including LME Clear, its legal or other professional advisers, or as required by law. Anonymised responses (verbatim or paraphrased) may be included in any notice stating the outcome of this market engagement (although the LME shall be under no obligation to produce such a notice). The LME may also share anonymised and paraphrased responses with its committees, as part of its process for defining next steps. Subject to this, all responses received will be treated in confidence (and, for the avoidance of doubt, will not be shared in non-anonymised form with any LME committee with external members).

Section 5 – Implementation Plan

55. The LME aims to deliver the Depository Proposal in Q4 2020.
56. In order to achieve a Q4 2020 implementation, following the period for responses set out in this Notice, the LME aims to commence a Rulebook Consultation during late July and August 2020. The Decision Notice for the Rulebook Consultation is currently targeted for end of September 2020, with a full Rulebook and System go-live date aimed for the end of October 2020. This timeline will be confirmed following feedback from the market, bearing in mind the importance of Member and market readiness. The LME would value feedback on this timeline as set out in the questions in Section 6 below.
57. There will be an opportunity for Members and London Agents to complete a period of testing which will take place in one of the LME's test environments for LMEsword. This testing phase is currently expected to take place during August and September 2020. Details of testing availability will be made available nearer the time.
58. The LME is currently planning the migration activities for the Depository Proposal.
59. Further details of any deadlines or reduced operating hours will be notified to Members and London Agents closer to the time.



60. Following the 'go-live' migration Members will be able to transfer or deliver warrants from their existing inventory the next business day.

Section 6 - Discussion Questions

61. The LME requests that respondents to the Discussion Paper answer the following questions set out below:

Operational Proposals

62. **Question 1** – Do market participants feel that they have enough information to understand the proposed operational changes and can therefore assess the impact to their current operating model?
63. **Question 2** – Will the changes described in Section 2 above be positive changes from your organisation's point of view?
64. **Question 3** – Do market participants feel that the proposed implementation plan covered in Section 5 gives them sufficient time to prepare for the Depository Proposal as described in this Notice (including the changes to their documentation and processes)?

Legal Questions

65. **Question 4** – In the case of Jurisdiction Category 3 (which will likely include the US), the Warrant is likely to be a negotiable instrument under relevant US law and therefore the mere transfer of a Warrant between accounts would likely result in a transfer of title (rather than a transfer of constructive possession as in Jurisdiction Category 1 and 2). This should not affect delivery (as title always passes due to the fact that the Warrant is transferred in settlement of an LME Contract (i.e. it is a delivery of possession pursuant to a contract of sale)), but may impact ex-cleared transfers if there is no intention to give title to the transferee. Do market participants see any issue with this approach?
66. **Question 5** – Do market participants routinely obtain their own legal opinions (either as a matter of English law or locally in the jurisdiction of the warehouses) regarding their own arrangements in the context of LMEsword, and will they be required to refresh those legal opinions as a result of the proposed structure being implemented? Are there any lead times in relation to this which should be taken into account for the implementation of these proposals?
67. **Question 6** - Currently, it is possible for a London Agent to create a Warrant, but for the Warrant to remain outside of the Depository until it is lodged. Do Members or other market participants see any benefit in retaining the ability of a London Agent to be able to extract a Warrant from LMEsword so that it can be held outside



of LMEsword in physical form? Please see paragraph 49 above for further details on Extracted Warrants.

68. **Question 7** - Do Warehouses see any issues that affect the storage of metal on Warrant under the Proposed Legal Structure (for example, with regard to customs treatment)?
69. **Question 8** - It is proposed that the Warrants will state “Warehouse terms and conditions will be available on request from the Warehouse issuing the Warrant”, and that the Warehouse will make the terms and conditions available on request (see paragraph 17(g) above). Do Warehouses see an issues with that approach?

Other

70. **Question 9** – Do respondents have any objection to the LME proceeding with the Depository Proposal? Do respondents have any other comments in relation to the proposals?

Section 7 - Market Engagement

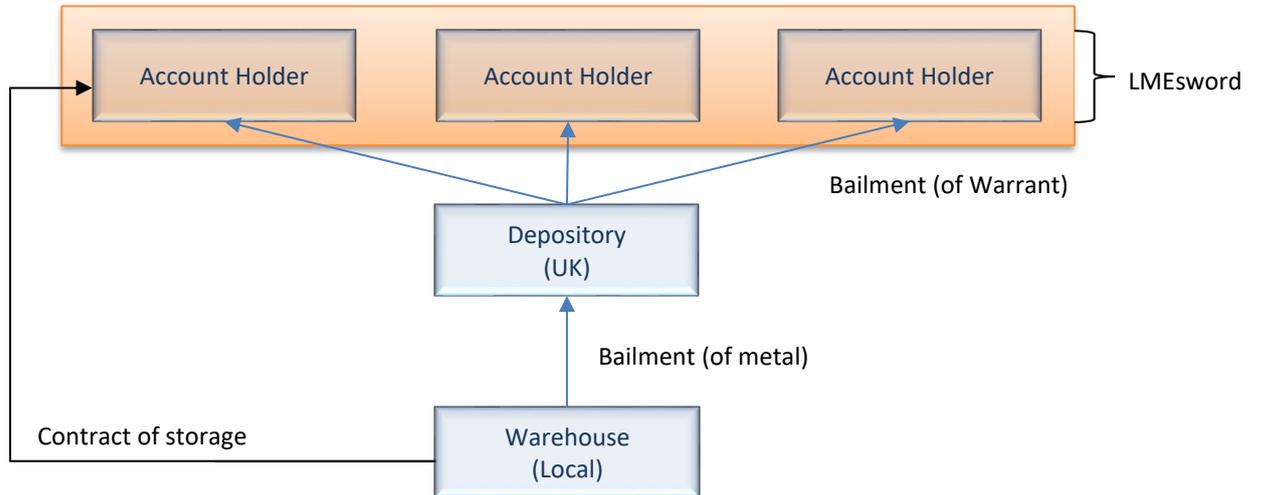
71. The LME will hold discussions at a legal working group level during the response period for this Notice. Due to the nature of the changes required, there will be a specific working group set up to discuss the legal aspects for the Depository Proposal. Members, and other parties who are interested in joining a legal working group should submit their request by email to elizabeth.monk@lme.com.
72. In addition to holding legal working group discussions, the LME will also hold bilateral discussions with members, warehouse companies and London agents to discuss the changes to the operational process. Anyone who would like to have private discussions with the LME are encouraged to contact Business.Development@lme.com.

James Cressy
Chief Operating Officer, LME Group

cc: Board directors



APPENDIX 1 Existing Structure





APPENDIX 2 Proposed Structure

