

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

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Subject: **LME DISCUSSION PAPER ON RUSSIAN METAL – LME RESPONSE**

Summary

1. The London Metal Exchange (“LME”) is today publishing its response to the Discussion Paper on Russian Metal (“Discussion Paper”), summarising market feedback, as well as the LME’s considerations in respect of that feedback, and the LME’s conclusions.

Background

2. On 6 October 2022, the LME published – via Notice 22/240 – the Discussion Paper, with the aim of soliciting feedback on the ongoing acceptability of Russian metal for good delivery on the LME, following Russia’s invasion of Ukraine on 24 February 2022.
3. The period for feedback on the Discussion Paper was open for three weeks and closed on 28 October 2022.

Response to the Discussion Paper

4. Following a period of review, the LME is today publishing its response to the feedback received, as well as its considerations in respect of that feedback, and its conclusions.
5. The LME’s response to the Discussion Paper is enclosed with this notice. Please direct any queries in respect of the response to Hugo Brodie by email to hugo.brodie@lme.com.

Matthew Chamberlain
Chief Executive Officer

cc: Board Directors
All Committees



LME Discussion Paper on Russian Metal – response paper

11 November 2022



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1 EXECUTIVE SUMMARY

On 6 October 2022, the London Metal Exchange (“LME”, or the “Exchange”) published – via Notice 22/240 – a Discussion Paper on Russian Metal (“Discussion Paper”), with the aim of soliciting feedback on the ongoing acceptability of Russian metal for good delivery on the Exchange following Russia’s invasion of Ukraine on 24 February 2022. The discussion period was open for three weeks, closing on 28 October 2022.

The Discussion Paper laid out three potential paths forward – namely, maintaining the status quo (Option A), prohibiting the warranting of new Russian metal from LME warehouses (Option C), or the imposition of thresholds or similar limits on the warranting of new Russian metal (Option B).

As the LME has previously stated, its strong preference is for decisions on the acceptability of metal from Russia (or, for that matter, any other jurisdiction) on the LME to be made in accordance with the decisions of democratically elected governments, and the Exchange has (and will continue) to ensure that its rules appropriately reflect governmental sanctions and/or tariffs.

The LME has also expressed its position that the Exchange should not make or impose ethical judgments on the broader market. While the LME recognises that companies are at liberty to make their own decisions on whether or not to deal with Russian metal, a decision by the LME to restrict the usage of Russian metal would impact users of the Exchange more directly than it would impact the LME itself. Accordingly, the LME continues to believe that it should not make unilateral ethical determinations of this nature. While the LME notes questions as to whether the continued acceptance of Russian metal is consistent with its responsible sourcing policies, the Exchange does not see a contradiction in this regard – because it is for the metals community more broadly to form a consensus on whether Russian metals will be consistent with responsible sourcing norms (including, for example, the question of whether Russia will constitute a Conflict-Affected or High-Risk Area, or “CAHRA”). Given that the industry is far from having reached a view on this matter, it would be precipitate for the LME to take unilateral action on the topic under the responsible sourcing banner.

However, the LME has also been clear that it has responsibilities to ensure an ongoing orderly market. One circumstance in which an orderly market could be threatened would be if Russian metal were not sanctioned by governments, but were rejected by a sufficient number of global consumers, with the twin results that (i) its value in the market became materially depressed, and (ii) large quantities of Russian metal flowed into LME warehouses. In this circumstance, the LME price could be artificially lowered, and orderly market conditions threatened.

While the LME does not believe this circumstance has been engaged to-date, the Exchange received (over the course of August and September) a number of expressions of concern, in respect of the potential for Russian metal to be so broadly “self-sanctioned” by consumers in 2023 that the orderliness of the market could be compromised. This was the rationale for the LME publishing the Discussion Paper. While the LME recognises the view from some market participants that it is not the LME’s role to go beyond governmental sanctions (and hence that the Discussion Paper was not needed), the general view from respondents has been that the Discussion Paper was a necessary and important tool for the LME to ensure that its stance on Russian metal accords with the behaviours of its market.

The LME is also aware of market concern that the publication of the Discussion Paper could itself give rise to large inflows of Russian metal onto warrant. However, as the updated statistics in this document show, there have been no significant moves of this nature.



The LME would like to thank the 42 market participants who provided written feedback to the Discussion Paper, as well as all those who contacted the LME and provided their ideas and thoughts through meetings and calls. The LME very much appreciates the time and effort taken by all those who contributed. This response paper provides the LME's summary of the feedback received in respect of the Discussion Paper.

In summary, the LME has concluded, on the basis of feedback received, that the thesis which would underpin fears of a disorderly market (in particular, a sufficiently large proportion of global consumers refusing to accept Russian metal in 2023) is not supported by evidence at this time. Accordingly, the LME does not propose to prohibit the warranting of new Russian metal (Option C). Additionally, feedback clearly indicated that thresholds or similar limits would be too complex to be practicable (Option B). As such, the LME will proceed with the status quo in respect of Russian metal (Option A).

In reaching this conclusion, the LME recognises that stocks of Russian metal in warehouses may well rise over the coming months. Given expectations of lower growth in the global economy, it would be expected that stocks would increase in any event – and, given that at least some consumers appear to be self-sanctioning Russian material, it is feasible that Russian material may represent a larger proportion of such warehoused material than would otherwise be the case. However, having conducted the comprehensive market engagement exercise by means of the Discussion Paper, the LME believes that the market can take a degree of confidence that the deposited Russian metal will remain consumable by the market, which would not then trigger the disorderly market concerns outlined above. Additionally, the LME believes that the existing mechanisms for calculating premia above the LME's base price will be responsive to these circumstances.

Although it was not proposed in the Discussion Paper, the LME has also received a number of requests for further transparency as to the origin of metal stocks in the LME system. As set out above, the LME does not anticipate a future increase in Russian stocks as being indicative of a disorderly market (given the market feedback received to the Discussion Paper) – however, the Exchange believes that such transparency could indeed be valuable more broadly, and intends to provide this reporting as of January 2023.

Through this and other data (including the movement of metal through its licensed warehouses), the LME will keep this situation under close review. In particular, the LME will continue its policy of continuous market engagement to monitor the ongoing validity of the above analysis.



2 FEEDBACK SUMMARY

2.1 OVERVIEW

2.1.1 Summary of responses to the Discussion Paper

The LME received 42 written responses in response to the Discussion Paper. All market participants, regardless of sector, were invited to respond to the Discussion Paper – both the overarching analysis and the specific options laid out in the section on “possible action” (including Options A-C). The LME also noted its specific interest in hearing from consumers, in respect of their plans regarding accepting, or not, Russian metal currently or in the future.

The 42 respondents were from a variety of market user types across the metals value chains; however, traders / banks (11) and producers (11) represented the largest groups of respondents. The LME notes that a small number of responses were provided by industry associations (i.e. representing a larger underlying group in an official capacity), and that many replies asserted that their response represented a combination of feedback (e.g. from clients or consumers surveyed directly by the respondent). Responses were received from those representing all of the LME’s physically delivered metal categories (aluminium, cobalt, copper, lead, nickel, tin, and zinc), but those with the greatest representation were aluminium (35) and copper (33). Reflecting the LME’s global nature, replies to the Discussion Paper emanated from respondents worldwide; however, responses originating from Europe (ex-Russia) were the majority (25), with North America the next most prevalent (8). There were also responses from Asia and Russia.

Option endorsement from respondents was comparatively evenly split between two options, with 22 replies in favour of Option A, and 17 in favour of Option C, as shown in Figure 1, although as noted above, some respondents emphasised their representation of the views of numerous other parties. Only two respondents recommended Option B, and one respondent abstained from identifying their preferred option.

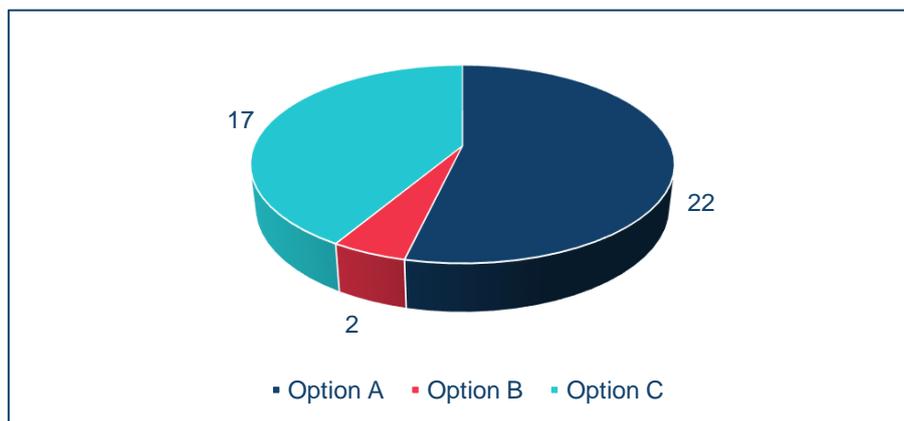


Figure 1: breakdown of responses

Option recommendations also demonstrated a degree of correlation with the respondent’s geographic location. In particular, North American based respondents tended towards the LME taking action, while Asia-based respondents tended towards the status quo. European views were more evenly divided.

In addition to some direct feedback from consumers, many producers and traders emphasised in their responses that they had conducted their own surveys of this group and presented this feedback in their responses. There were also warnings from some respondents advising caution in respect of producer feedback, given a perceived vested commercial conflict of interest.



2.1.2 Structure and overarching themes to this response paper

The LME has given careful consideration to all the responses received. The aim of this document is to provide a summary of those responses, rather than to give a verbatim report of all feedback received on each topic.

The LME has identified a set of key overarching themes that characterised the majority of responses, and has therefore structured this response paper around those themes, as follows:

- (i) The LME's right or responsibility to take action
- (ii) Views on current market conditions and anticipated market impact
- (iii) Implementation specifics

This response paper should be read in the context of the Discussion Paper, which laid out the LME's initial analysis on this topic.

2.2 THE LME'S RIGHT OR RESPONSIBILITY TO TAKE ACTION

2.2.1 The LME's role in anticipating future market behaviour

The Discussion Paper arose from the LME's stated position, namely that its preference is to follow government-issued guidance in respect of sanction-related activity, but that it also is responsible for ensuring market orderliness (which could potentially be threatened by a material inflow of unwanted Russian metal into LME warehouses). There was significant debate amongst respondents as to whether it was appropriate for the LME (as the global marketplace) to adopt this position, and (in particular) whether the LME should attempt to anticipate market behaviour. There was a clear spread of opinion between respondents that believed conducting a market discussion exercise set a dangerous precedent, and those that took the position that the LME should be prepared to act if developments threatened to create a disorderly market. Additionally, there were also respondents that believed the market already had shown itself to be disorderly and, subsequently, expressed the opinion that any LME action would not be anticipatory but responsive to current market conditions.

Respondents cautioning against the setting of precedent (through formal market engagement and possible subsequent action) mentioned current global geopolitical tensions, and questioned which future topics would also need a market discussion exercise going forward as a result. These respondents warned that examining the question of the acceptability of Russian metal now would lead to a "slippery slope," as one response suggested, meaning the market would then require similar such engagement anticipating market behaviour towards other topics, such as acceptable emissions content of metal. Certain respondents forewarned that if the LME adopts the views of a segment of the market as its own because of the possibility that these views will become a majority view, the LME could become a target for lobbying by a range of special interests groups. One respondent stated that any market discussion would always be subjective, speculative and potentially self-serving. There were also concerns associated with the LME's perceived inconsistency, shown by its stated need to take action to achieve "market certainty" for Russian brands, when it has, as claimed by one respondent, never been part of the LME's role to provide certainty about any other brands.

Conversely, many respondents welcomed the Discussion Paper and asserted that the LME was correct to engage and provide clarity, with many highlighting it was the role of the LME to investigate possible market disruption. It was argued by many in this group that the LME would be acting "too late" if it waited until either the advent of government-led sanctions, or for a high inflow of Russian metal to start impacting pricing. This group believed the level of risk to the LME was so great, that it not only justified the market discussion exercise, but also pre-emptive action.



Indeed, many respondents believed market signals were already sufficient for the LME to take action, with one respondent highlighting indications of an increasing trend of Russian origin aluminium stockpiling off-warrant, ready to be moved on-warrant quickly should sanctions be imposed or the LME choose to act.

2.2.2 The role of ethics and the environment

In the Discussion Paper, the LME was clear that while it recognised the significant ethical complexities around this issue, and respected the rights of individuals to reach their own determinations, that ethics would not be a factor in its decision-making on this topic. Instead, any decisions would be based on the Exchange's responsibilities to the broader market. Nonetheless, half of the market participants that provided feedback mentioned ethical or environmental considerations within their response.

2.2.2.1 Ethical considerations

A small proportion of the respondents that raised ethical concerns were in broad agreement with the LME, acknowledging the difficult ethical considerations present, but understanding the need for the Exchange to focus purely on market orderliness and function. In this vein, some responses argued for the exclusion of the ethical question (however unpalatable), stating that there are other human rights abuses taking place all over the world, in response to which the LME had not chosen to take action. A number of respondents provided various examples of such circumstances, including human rights abuses globally, and previous instances of war and / or invasions.

From the alternative perspective, there were multiple market stakeholders that felt the lack of action from the LME (in terms of implementing a suspension) could be construed as the Exchange actively undermining its own sustainability principles and responsible sourcing requirements. One respondent quoted the LME's responsible sourcing policy, which stated that the "LME cannot accept a situation where consumers are required to take delivery of material that is not responsibly sourced", arguing that this should be a key driver for the LME to suspend Russian metal. Another respondent stated that Options A or B would undermine the credibility of the LME's responsible sourcing efforts. Some respondents went further, with two respondents asserting that the LME's continued acceptance of Russian metal on the Exchange could be directly financing the Russian war effort in Ukraine.

A number of respondents detailed they had chosen to self-sanction due to ethical reasons, with one respondent describing taking delivery of Russian metal as "unthinkable". For some, self-sanctioning decisions were consistent with the LME's position (as outlined in the Discussion Paper) "that market participants will reach their own determinations on these matters, and respects the right of participants to do so". Some responses agreed with this stance, noting that there will always be market participants who are comfortable trading this metal, as evidenced in previous comparable scenarios; for example, Iranian metal which is freely traded in many markets by those not subject to EU and US sanctions. Further details around self-sanctioning are included under Section 2.3.1.1.

Finally, one respondent pointed out that it would be wrong to assume that the decision by some market participants not to purchase Russian metal is based on ethics alone. Instead, they noted the multiple factors that are taken into consideration when buying metal, including commercial or technical considerations, and suggested that an ethical stance could be deemed as a further such consideration, and remain an individual or company choice.

2.2.2.2 Environmental considerations

Only a handful of respondents outlined the importance of including environmental considerations within the decision-making process. These responses mainly originated from those who aligned with Option A within the Discussion Paper.



The argument centred on the strong environmental profile of a number of Russian producers, particularly within the aluminium space. Many Russian smelters and refineries benefit from 100% hydroelectric power which has helped ensure that they are focal players for the sustainable transition. One respondent emphasised that sourcing from Russian producers is vital for many consumers and downstream users who rely on the environmental credentials for their own decarbonisation strategies. Building on this view, another respondent discussed the growing demand for low carbon aluminium and that producers who are directly in competition with Russian producers would benefit from pursuing an LME ban on Russian metal, despite potentially having a less attractive product from an environmental perspective.

2.3 MARKET IMPACT

2.3.1 Current market status

2.3.1.1 Self-sanctioning

Within the Discussion Paper, the LME noted its understanding that a growing collection of international companies across multiple industries that have already opted to, or were planning to, "self-sanction" – imposing self-determined restrictions on their own activity in Russia, or with Russian companies or individuals. A range of contrasting views was raised in response to the self-sanctioning question.

Many respondents in favour of Option C shared evidence that either their own companies or their respective clients had chosen to self-sanction, or would do so soon. The timing on when to self-sanction was split, with some respondents having taken action early in 2022 and others stating that they would start this process from 2023, following an end to their existing contractual obligations with Russian counterparties. There were a number of respondents who additionally referred to market observations regarding self-sanctioning, with many claiming they believe large proportions of Western businesses will not readily accept Russian material moving into 2023.

Of the opposing viewpoint were responses, particularly from those supporting Option A, centred on similar, yet opposite cases where they had received knowledge of market participants continuing to take Russian units of metal and contracting as such for 2023. There were numerous examples cited by respondents, with one respondent stating that many jurisdictions would absorb the metal rejected elsewhere. The respondent shared that this pattern mirrors the situation within the oil industry.

In summary, the diversity of views as to the predominance of self-sanctioning (or not) was clear, with respondents from both sides of the debate providing evidence that supported their viewpoint, illustrating the extent to which the market is split on the acceptability of Russian metal moving forwards.

2.3.1.2 Access to financing / banks

Many respondents identified that access to financing should be a crucial consideration for the LME in any potential future action. A diverse group of respondent types highlighted that, as long as banks remained willing to finance warranted metal, the LME contract should continue to function as is; however, should banks decide not to, as one response stated, the contract would become "polluted". One response argued that self-sanctioning actions taken by consumers in practice had little effect on the orderliness of the LME market, but in contrast, if banks took the same decision and withdrew financing, that would create severe market disruptions. A variety of views were stated on whether access to financing currently remained liquid for Russian metal, with opposing views on the ongoing availability of such financing, but it was noted that should the LME pre-emptively move to ban Russian metal ahead of government sanctions, then it could leave financing banks in a precarious position.



Many North American and some European respondents stated in their response that it was increasingly apparent that banks are refusing to finance Russian metal for physical trade. Some respondents in the aluminium market stated that, where previously banks would insist that metal financed was “LME deliverable” they were hearing increasing instances of banks stipulating financing terms “LME registered material excluding Russian brands.” Some respondents also predicted that by the start of 2023 there would be almost no Western banks financing Russian material, even in the absence of government sanctions.

Other respondents asserted that only the “more conservative” financing banks have already started to move away from financing Russian material and many banks were still providing financing liquidity. This group emphasised that the majority of banks were following government sanctions and cautioned that as finance contracts for the purchase of metal commonly stipulate that the metal must be LME deliverable, excluding Russian metal from the LME would only serve to increase the cost of financing the acquisition of Russian metal. Crucially, they also emphasised that this would happen at a time when financial liquidity is already strained.

2.3.2 Future market considerations

This section of the response paper looks at likely future outcomes and factors to take into consideration if the LME chose to enact Option A (maintaining the current position), Option B (introduction of thresholds) or Option C (suspending the warranting of Russian metal in LME warehouses globally).

2.3.2.1 Implications for LME pricing

One of the LME’s key functions, as emphasised in the Discussion Paper, is supporting the global metals market by providing metals pricing. The Discussion Paper stressed that this price should be reliable and reflective of global market conditions. Although respondents unanimously agreed that this should be a key function of the LME, there was debate as to what the potential actions outlined in the Discussion Paper would mean for the LME’s position as the price-formation venue of choice for industrial metals globally.

Many respondents to the Discussion Paper highlighted that the absence of a suspension of Russian metal would, in practice, lead to a bifurcation of LME prices. This, they argued, would be because the material volumes of Russian stock on warrant would mean that the LME price would, in effect, represent only the price of Russian metal – in their view, the price of a product that has been rejected by a large portion of the market. These respondents predicted that the effect would be distorted market conditions in which the discounted price for Russian metal becomes the reference price for the underlying global market, while not reflecting the reality of the tradeable market place. This would, in their view, undermine the core role of the LME as a price discovery mechanism for the global physical industry. Some producers specifically cited the example of aluminium and stated that the LME maintaining the status quo would mean its aluminium price would not in actuality be representative of the intrinsic value of aluminium.

Other respondents stated that, in reality, the opposite was true and an LME suspension of Russian metal would mean that the LME price would no longer accurately reflect global supply and demand. These respondents instead warned the LME against taking a regional outlook, and suspending metal based on the preferences of Western markets alone, and encouraged the LME to maintain its inclusive worldwide focus.

Typically, respondents who warned against the LME taking further actions based on a predominantly Western perspective underlined that stakeholders of the LME are global, and the considerations of the LME should therefore reflect such global diversity.



More specifically, those responses affirming this view regularly cited that a global exchange should not have a vested interest in supporting only one region; instead, they argued, pricing should reflect the global supply and demand dynamics, and pointed out the number of markets that have taken no action against Russian metal.

Instead, these respondents emphasised the number of global industrial users who were not self-sanctioning against Russian metal, and would no longer be able to use the LME price as it would no longer conform with the global supply chain requirements of their downstream customers. In this scenario, the LME prices would, in the view of these respondents, therefore only be beneficial for a small number of users specific to a particular region and not applicable to the majority of industrial users worldwide.

Responses also varied in terms of the predicted consequences of these impacts. Some respondents argued that LME inaction would simply mean that global industrial metals pricing would move to other venues or be determined by price reporting agencies. There was particular concern related to funds, and a small number of respondents predicted that failure of the LME to take action would be deemed unacceptable to the Commodity Trading Advisor (“CTA”) community, which is seen by many as taking a stronger stance due to its environmental, social and governance (“ESG”) mandates. In the view of one respondent, this community would view LME inaction as unethical due to the continued association between LME and Russian metal.

In contrast, a number of those supporting Option A contended that LME action on Russian metal prior to any government sanctions would mean that global pricing would move to other venues. These respondents anticipated that banning Russian metal in actuality would be likely to cause the harm that the LME sought to avoid, by strengthening competitor pricing venues. It was argued that other exchanges that continued to allow physical settlement of forward contracts using Russian metals would move the liquidity of both outright pricing and spreads from the LME, as holders of units would likely move their positions. These respondents cautioned that if the market adopts alternatives to the LME, these alternatives will quickly become established by market convention, and market participants would be unlikely to return to using the LME price unless forced.

2.3.2.2 Implications for liquidity

The Discussion Paper determined that a core function of the LME was to facilitate hedging and allow participants to mitigate their exposure to price movements. To offer this service effectively, the LME requires a critical mass of liquidity across its prompt date structure. Responses to the Discussion Paper frequently differed in view as to the potential impact on such liquidity of an LME suspension on Russian metal with some stating that a suspension would decrease liquidity and others (often dependent on geographic location and user type) responded with conviction that the LME maintaining the status quo would have that effect. Markedly, many of those respondents that argued the latter were of the view that the LME’s nickel contract should be excluded from any such ban. Both sides of the debate also reiterated that the LME, as a commodities market, has a higher degree of sensitivity towards liquidity than many other markets.

Proponents of Option A argued that banning Russian origin metal would be detrimental to liquidity as long as Russian metal continues to be produced and consumed in the global market. This is because delisting Russian metal would mean that LME pricing ceased to reflect accurately global supply and demand and, as a result, those trading would have to find other venues to provide them with global pricing, thus withdrawing their liquidity. Those espousing this view also noted that there were many existing futures obligations that were intended to be completed using physical delivery of Russian origin metal. Any ban of this material would create potential issues regarding fulfilling these obligations, which would demonstrate that there was insufficient liquidity for the LME to offer physical



settlement, one of its primary services. Even some proponents of Option C acknowledged that the LME would be likely to see a further decrease in volumes traded by implementing a ban on Russian metal. However, these respondents argued that this is likely to be only in the short term and longer term a ban of Russian metals by the LME would build confidence and correspondingly, build liquidity.

In opposition to this were responses proposing that the impact of the LME not suspending Russian metal would be that LME users looking to avoid Russian metal would similarly have to avoid the LME, due to the likelihood that metal on-warrant would be of Russian origin, leading to reduced volumes. A frequent concern emphasised by this group was maintaining one of the LME's core functions of allowing its users to the ability to hedge using a liquid forward curve. One respondent stated that, with no imminent ban, demand for futures positions on the entire 123 month forward curve (using the example of aluminium) would create price distortions, and there would need to be an auction for the limited supply of eligible aluminium within the LME system. Another producer agreed with this view, claiming that their capacity to hedge would be affected due to liquidity gaps on the forward curve and force market actors to seek alternative pricing.

As stated previously, many of the strongest proponents of Option C made exceptions in respect of the LME's nickel contract. This is because, as one respondent outlined, nickel is already struggling with liquidity, and losing Russian metal could threaten the existence of the contract. One respondent argued that the LME should, in the meantime, more actively pursue nickel brands to list their metals for good delivery, while allowing Russian brands to keep their status as LME brands to protect the nickel contract liquidity. One adamant respondent in favour of an immediate LME ban, based on their belief of widespread self-sanctioning of Russian metal by consumers, stated that current indicators were that the market is not rejecting Russian nickel to the same extent it is Russian copper and aluminium.

2.3.2.3 Implications for the warehouse network and stocks

The Discussion Paper outlined that one of the primary functions of the warehouse network is to provide a market of last resort for LME-listed brands; accordingly, to store metal that is not otherwise required for physical use at that point in time. There was considerable debate amongst respondents as to whether the LME warehouse network – in the event that demand for Russian metal reduces – should stand ready to absorb that metal on behalf of the market. Respondents' views were divided between those contending that the core function of the network should be to absorb surplus Russian metal (including those anticipating that premiums would serve to maintain an orderly market), and those that predicted the warehouse network would be dominated by Russian metal. These respondents argued that this would alter the LME's role as a market of "last resort" to the market of "no resort."

In addition, a considerable number of responses focused on the potential impact of Options A and C on LME warehouse stock levels. This was in response to the Discussion Paper highlighting feedback received that if the market consensus were not to accept Russian metal, this would likely mean that the LME sees large warranting of this metal into its warehouse network, as it acts in its role as a market of last report. This would also be likely to have a concomitant impact on price, as outlined in Section 2.3.2.1.

Many Western producers and physical traders put forward the view that Option A (continuance of the status quo in the absence of government sanctions) would mean, with near certainty, that LME warehouse stocks would soon be dominated by Russian material. Equally, however, it was suggested that this would not purely be as a result of the desirability of Russian metal, but also due to weaker domestic Russian demand, reflecting a broader trend for weakening consumer demand based, in part, on an expected recessionary environment.



The “only option” for Russian producers, it was claimed, would be to deliver into the LME warehouse network (one respondent projected, for example, that over 2 million tonnes of Russian aluminium would be exported on the global market at a time when demand is contracting).

High Russian copper deliveries were particularly underlined as a risk by one respondent, as LME Russian metal already represents a high percentage of live copper stocks, and flow into Europe represents the most efficient logistics channel for the majority of Russian production. They argued that this would mean a build-up of Russian material in the location that is most actively self-sanctioning. A couple of respondents added that they had received anecdotal information that Russian aluminium (prior any LME action) was already trading below the LME price, further highlighting the commercial incentive for owners of Russian material to deliver metal into the LME warehousing network. Furthermore, as mentioned previously, respondents in this group also believed that there were considerable levels of Russian metal being stockpiled off-warrant, such that it could be warranted quickly should the LME take further action (or sanctions be announced).

Taking the opposing view, other respondents noted that live tonnage of Russian material on LME warrant had been steadily decreasing in the months leading up to the Discussion Paper, and they anticipated no slowdown in this pattern. Proponents of this view also emphasised the amount of companies across the world still contracting to accept Russian metal in 2023 – meaning that large stock deliveries were unlikely as other markets were ready to consume this material. Additionally, it was commented that Russian producers had publicly stated they would not deliver metal into LME warehouses as it made more sense commercially for such parties to reduce production rates. However, in response to this, it was reported in one reply that Russian producers have no control over current or future intentions of other parties once legal title has been transferred. Additionally, it was asserted by one respondent that the fact that some Russian metal producers appear to be campaigning so vigorously to retain LME market access strongly suggests that they want to keep open the option of making deliveries into LME warehouse.

2.4 IMPLEMENTATION SPECIFICS

2.4.1 Timings

Timings were generally referenced in responses from those who preferred Option C. Within the Discussion Paper, the LME outlined six variations of Option C, providing optionality on both timing and scope. The majority of respondents who mentioned timings were those who selected Option C1 (apply the suspension immediately, and for all Russian metal). These market stakeholders indicated that any advance notice period would allow significant amounts of warranting in the LME warehouse network. One respondent detailed that despite wanting action immediately, there was still leeway for companies to take action, with at least 22 days whilst the Discussion Paper was open to feedback and whatever the time taken was for the LME to reach a decision. This viewpoint was echoed by some respondents who opted for Option C4 (apply the suspension following a short notice period), but they argued that because the LME metal stock for some metals is still relatively low, the risk was not as high. One respondent warned the LME of the price sensitive nature of the Discussion Paper outcomes and advised the LME to commit to a path of action (regardless of which option) before the closing date of the feedback period. The respondent argued that this route would offer the highest level of certainty to the market, allowing participants to plan their next steps appropriately.

There were respondents who supported Option A and Option B, who acknowledged the potential risks of acting too late to mitigate future market impacts. However, this point was heavily caveated that the future market impacts were far from certain.



On the opposing side, there was one respondent, who also specified a preference for Option A, that argued immediate action would not be possible and the market would need a longer period of time to adjust to such a significant shift. The respondent in this case recommended 24 months.

The other aspect that a number of respondents commented on was the production date to which sanctions or suspensions would be applied. Respondents raised a range of options, including the date the LME announced its plans, metal produced after 31 December 2022, and metal produced after 24 February 2022 (the date of Russia's invasion of Ukraine).

2.4.2 Thresholds

Very few respondents (two) indicated a preference for Option B. Within the Discussion Paper, the LME detailed possible plans to introduce thresholds for warranted Russian metal. This would operate on the premise that once Russian metals reached a specified percent of stock on warrant for a particular metal, the LME would move to suspend further deliveries, at which point no further Russian metal could be warranted. The majority of feedback did not support this initiative, with most respondents believing that the action of Option B would be too complex to implement and manage, and considered it susceptible to abuse, all of which would negatively affect the Exchange's reputation. One respondent argued that if thresholds were introduced, it would create a lot of unnecessary insecurity in the market. One respondent took their viewpoint slightly further stating that if the LME chose to explore Option B, the LME would lose market share to rival exchanges.

Of the two respondents that supported thresholds, one addressed the claims of complexity often associated with introducing thresholds. The respondent contended that setting limits is perfectly reasonable and participants are often too quick to dismiss options such as this. They evidenced the fishing industry as one that operates very successfully via a threshold model and added that by implementing different variations of Option B at appropriate times would allow the LME to provide suitable controls to each metal. The other participant argued that it would be sensible for the LME to introduce specific Russian tonnage caps per location per warehouse company to limit potential impact of inflows of Russian metal into the LME network. The respondent indicated that if a threshold of 250 metric tonnes per LME warehouse company per location was introduced, this would not prohibit competition amongst warehouses and would allow the warehouse network to still function effectively as a market of last resort.

2.4.3 Rewarranting

One respondent felt that, in the event of an LME suspension, the LME should allow warranted Russian metal to be declared as re-warrantable at the LME warehouse storing those warrants, or at any other LME warehousing company or LME location. The purpose of doing this would be to avoid the potential additional disruptions for those who deal with and hold stocks at the LME warehouse network regularly – brokers, banks and trading companies. Additionally, this respondent felt that this would help to shape appropriate behaviour from the LME warehouse network by disincentivising LME warehousing companies from attracting in additional amounts of Russian brands.

2.5 OTHER CONSIDERATIONS

Respondents also specified a number of additional ideas that they felt the LME should take into consideration when making a final decision regarding Russian metal.



2.5.1 Tariffs

Two respondents provided feedback detailing the effective use-cases of tariffs. Tariffs are taxes imposed by one country on particular goods or services imported from another country. In this case, the LME would be able to play a focal role in helping to guide the governments to implement tariffs on Russian metal. One respondent contended that the money raised from tariffs could be utilised altruistically and allotted to post-war reconstruction in Ukraine. The proposed tariffs from both respondents were in the ballpark of 30-50% and they felt that these costs would represent a more effective route forward.

2.5.2 Increased transparency of Russian stock data

A number of respondents discussed the importance of transparency in the upcoming months, regardless of the route chosen, with increased transparency of Russian vs non-Russian metal on warrant being of primary focus. One market participant indicated that by having this information more readily available they could help mitigate risks associating with their business.



3 LME ANALYSIS

The LME remains grateful to all those respondents who took the time to provide their thoughts and analysis during the discussion period. These conversations and written responses have provided the LME with extensive market views, information and background data, which is invaluable for the LME in taking an informed and a balanced view.

While the LME's analysis of the advantages and disadvantages of action are outlined in the Discussion Paper, there are a number of areas on which the LME would like to add further comment, in light of the feedback received.

The first of these is in respect of ethical considerations. Although the LME was clear in the Discussion Paper that it would not be making a decision on the basis of ethical concerns, and provided the rationale behind that decision, the Exchange did want to acknowledge the number of respondents for whom this topic remains an ethical issue – either predominantly or in addition to other market concerns. It remains evident that, for many people, Russia's actions in the Ukraine have rendered further business engagement unacceptable, and the LME fully respects the rights of others to arrive at this conclusion.

While the LME does not condone Russia's actions, it remains certain that an ethical response from the LME would not be appropriate here, not least because a decision by the LME to restrict the usage of Russian metal would impact users of the Exchange more directly than it would impact the LME itself. Accordingly, the LME continues to believe that it should not make unilateral ethical determinations of this nature.

The LME accepts that a number of respondents believe that this position is out of line with the LME's sustainability principles, but would stress that its mandate in respect of sustainability – and in particular in terms of any mandatory requirements – flows from the needs of the market. In deciding to introduce mandatory responsible sourcing rules, for example, the LME was recognising a strong market preference. Further, the LME would note that the LME does not see a contradiction in respect of the continued acceptance of Russian metal and its responsible sourcing policies, because it is for the metals community more broadly to form a consensus on whether Russian metals will be consistent with responsible sourcing norms (including, for example, the question of whether Russia will constitute a Conflict-Affected or High-Risk Area, or "CAHRA"). Given that the industry is far from having reached a view on this matter, it would be precipitate for the LME to take unilateral action on the topic under the responsible sourcing banner.

The LME accepts that not all market participants will agree with this view, but the LME's position in this respect remains unchanged. The LME will, of course, remain responsive to any sanctions or tariffs imposed by governments, and will communicate with the market should those arise.

However, while the market may be divided on the role ethics should play in these considerations, there does appear to be broad consensus that the LME has a duty to the operation of a fair and orderly market. This notwithstanding, there is also a recognition that there exists no clear route forward that does not create some potential risk of market disruption.

The LME recognises that in the absence of any suspension, it is likely that additional tonnages of Russian metal will (in time, if not immediately) be warranted in the LME physical network. That said, it is worth noting that this risk has not yet materialised – Figure 2 shows the percentage of live tonnage of Russian metals on warrant at LME warehouses on the day the Discussion Paper was released, and the day the feedback period closed. Across all Russian metal on warrant, the percentages have remained stable, with marginal decreases in the percentage of Russian copper and nickel on warrant, and marginal increases in the percentage of aluminium and North American Special Aluminium Alloy Contract ("NASAAC") on warrant. Aluminium Alloy has remained consistent.



Equally, however, the LME recognises that there may exist significant tonnages stored off warrant that may be warranted at any point, which could materially change this picture.

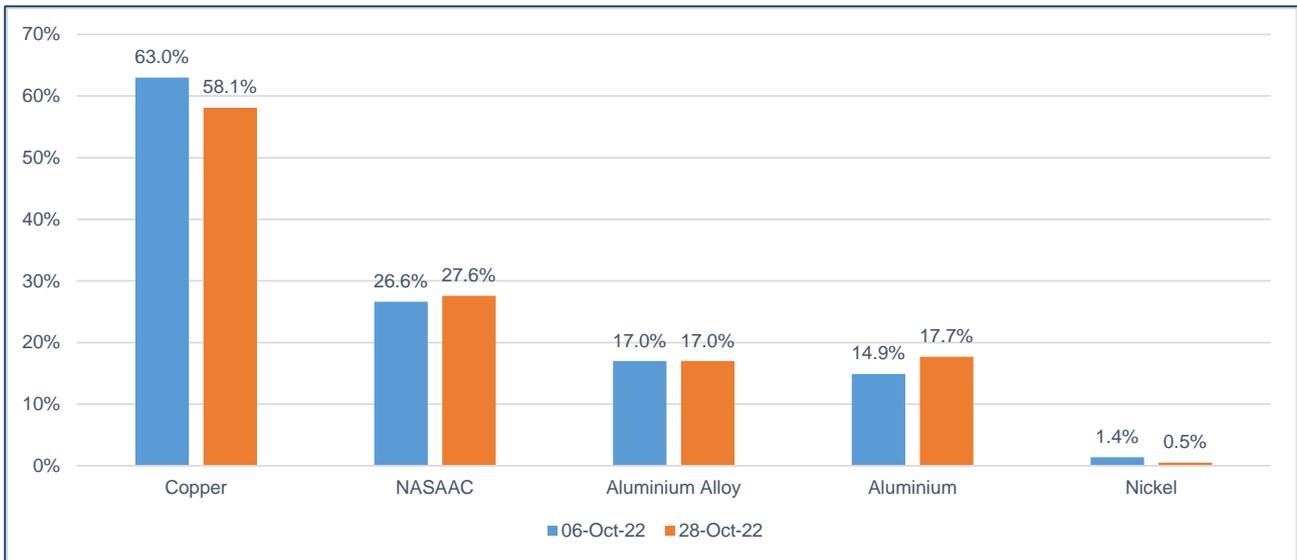


Figure 2: percentage of live tonnage of Russian brands on 6-Oct-22 vs 28-Oct-22

Further, the LME believes that these circumstances may well be exacerbated by the depressed global economic outlook – during which times (even in the normal course) the LME and its market can expect to see higher tonnages warranted than in times of global growth. These circumstances create a buyers’ market, where it will be each buyer’s choice as to metal origin; in the event that consumers prefer non-Russian metal, the LME could expect to see higher than usual proportions of Russian metal warranted.

The LME also recognises the likelihood that this has a concomitant impact on the LME price, which can be expected, under these circumstances, to converge on the price of Russian metal, itself expected to represent a discounted price versus that of non-Russian material. Key here will be the role of premia, which should adjust to reflect a larger proportion of the “all-in” or “real world” cost of metal, allowing non-Russian producers to continue to receive fair market value for their metal. While the LME recognises that this is not a defence against an artificially depressed LME price, it does also acknowledge views that suggest the market is better structured to manage a lower LME price and higher premiums, than it would be to manage a higher LME price, and a discount.

While these circumstances are not optimal, the LME does believe that this facility represents a core function of its market, and that the relevant infrastructure is in place to allow pricing to adjust to reflect these circumstances.

Instead, the LME’s greater concern is if the market reaches the point that the metal cannot be subsequently removed from warehouses. As data published in the Discussion Paper demonstrates, this issue has not yet manifested, but the LME is cognisant that it could represent a more material issue for its effective operation, and will remain alert for a change in these circumstances. Despite this concern, however, the LME agrees with the majority of market respondents who suggested that Option B (the imposition of thresholds) does not represent a strong solution – given the difficulty of calibrating thresholds, the ongoing market uncertainty as to when those thresholds might be reached, and its potential vulnerability to gaming or other unintended consequences. Further, the LME does not wish to add complexity to its existing rule set. Finally, while the LME agrees with market participants who suggested that tariffs might represent a valid option, it also notes that the LME does not have the power to implement these, and can only respond to tariffs imposed at the national or international level.



Ultimately, however, in the immediate term the LME believes that the key question it needs to address is whether consumers are taking, and will continue to take, Russian metal. The absence of feedback from consumers to the contrary during the discussion process, and indeed, the news that five European consumer groups had publicly called on the EU to avert a prospective ban on Russian aluminium¹, suggests to the LME that, for the most part, a material portion of the market is still accepting – even relying on – Russian metal, and there is insufficient evidence to conclude that this position is likely to change in the near future.

As such, the LME has taken into account all the factors outlined in the response paper above. With these in mind, it is the LME's assessment that, as things stand, there does not exist sufficient evidence for the thesis of potential market disorder which would justify an LME imposition of a suspension on Russian metal (and, indeed, such an imposition may itself create market disruption). As such, the LME will at this time take no further action, in line with Option A. The Exchange will, of course, continue to monitor the market closely in case circumstances evolve.

In reaching this conclusion, the LME recognises the likelihood that additional Russian metal will be warranted in LME-listed warehouses – but believes that, on balance, this is a preferable approach to the downsides associated with taking action at this time.

In light of market feedback on this issue, the LME is proposing to increase its transparency in this area through a monthly report on the percentage of live tonnage of Russian metal on warrant. Publication of this report will start in January 2023, to allow the LME sufficient time to operationalise the delivery and publication of such data, noting that data published to date has been produced on a best-efforts basis.

Further details on these reports will be provided in due course.

¹ See <https://www.reuters.com/markets/commodities/business-groups-say-bans-russian-aluminium-will-decimate-european-industry-2022-10-24/>



4 CONCLUSION

The LME would again like to thank all those who provided the benefit of their analysis and expertise on the Discussion Paper. It recognises that the publication of this paper has caused a degree of market uncertainty, but is grateful for the feedback that suggests the engaging the market in this way has value, and that market participants across a range of user groups have appreciated the opportunity to engage with the LME on this topic. The LME recognises that the outcome of this process is unlikely to be fully supported by all respondents, and would welcome any market participant wishing to arrange further discussion or seeking clarification in relation to the LME's response to the Discussion Paper to get in touch. The LME asks such participants to contact Hugo Brodie (hugo.brodie@lme.com) in the first instance.