



LME WAREHOUSE REFORMS COME INTO EFFECT

The London Metal Exchange (LME) has been on a path of reform since 2013. Its initial focus was on infrastructure and operational efficiency. More recently, it turned its attention to reducing stock levels in LME-listed warehouses. Its latest reforms came into effect on 1 February 2020.

“The period of transition will be closely monitored and the impact of these changes over the next year will likely be a key topic for discussion.”

Background

In March 2019, the LME published a Discussion Paper, inviting feedback on proposals from both the Warehousing Committee and the LME. These covered three areas in particular:

1. Logistical optimisation
2. Transparency and compliance
3. Rebalanced rules and a pathway to simplification

The LME described them as offering “*the optimum combination of enhancements to encourage more stocks in to LME warehouses, provide greater transparency as to global levels of inventory, and bring market-wide positive effects*”¹.

A Consultation Paper followed on 25 July 2019 with feedback released in November. The resulting new LME measures came into effect on 1 February 2020 (although the new Complaints Procedure took effect from 15 November 2019).

The reforms that prompted most feedback were:

1. Restrictions on evergreen rent deals
2. New Off-warrant stock reporting obligation

3. Queue-Based Rent Capping (QBRC) parameter change.

1. Evergreen rent deals²

These are “incentives” permitting metal owners to retain a future interest in warehouse rent on warrants which they have previously sold.

These deals are not without controversy: whilst they can act as an incentive to place metal on warrant, they can also prevent warehouses from keeping metal on warrant, leading to a great deal of on-and off-warrant stock movement.

In view of this and in an attempt to strike a balance between reducing the overuse of this arrangement and removing the incentive altogether, the reforms:

- restrict the ability to enter into a revenue sharing deal with a warehouse to metal owners who place metal on warrant (i.e. not metal owners who have purchased metal that is already warranted).
- reserve the LME’s right to extend the restriction to require an evergreen rent deal to terminate upon cancellation of the warrant or upon a metal owner expressing

their wish to terminate in writing to the warehouse.

2. Off-warrant stock reporting³

This reform generated the most - and the most varied - feedback. It relates to a new reporting obligation of “eligible”/off-warrant stocks stored in LME-registered sheds. The intention is to increase transparency and improve visibility of stock availability in the market, in view of a recent shift from on-warrant to off-warrant storage.

Reporting will be required in any of the following circumstances:

- The storage agreement states that the metal must be held in a LME-registered shed.
- The storage agreement states that the metal can be warranted on request by the owner.
- The metal owner requests that the stock be disclosed voluntarily.

Although the new rule took effect on 1 February 2020, the reporting obligation only triggered from **10 March 2020** (as it relates to stocks held on the final day of the preceding month).

Feedback on this reform included concerns as to how the new

1 Press release dated 1 November 2019 (<https://www.lme.com/en-GB/News/Press-room/Press-releases/Press-releases/2019/10/LME-proceeds-with-warehouse-reform-proposals>).

2 See para 3.1 in the Consultation Paper, available on the following link: <https://www.lme.com/Trading/Warehousing/2019-warehouse-reform>.

3 See para 3.11 in the Consultation Paper.



requirement would work in practice, in response to which the LME has said that it will publish further guidance, including a template form, in advance of the obligation arising under the new rule.

3. Queue based rent capping (QBRC)⁴

The QBRC rules are intended to disincentivise the build-up of structural warehouse queues by limiting the rent that warehouses can charge on metal units in the queue. Previously, rent was due for the first 30 days of queuing, reduced by 50% for the period between 31 and 50 days, and finally reduced to nil after the 50-day period. The new, looser rule will remove the phased reduction, and extend the period during which full rent is payable to 80 days. After the 80-day period, no rent will be due.

The LME's load in/load out (LIFO) rule, under which warehouses with delivery queues of 50 days or more are required to load out more metal than they load in over a three-month period, should guard against an increase in structural queues under the new measures.

The LME has confirmed that the change will be introduced gradually over a period of 9 months, in order to closely monitor the market's response and give the LME the flexibility to adapt the new rule at its discretion. The rent-reduction period will therefore be increased by 10 days every trimester starting from 1 February 2020, with the first 10-day increase coming into effect on **1 May 2020**. However, the removal of the phased reduction has taken immediate effect, i.e. full rent will be due for the full 50-day period from **1 February 2020**⁵.

Conclusion

The LME's proposed changes to its rules met with some resistance, but they appear to have been extensively discussed, reviewed and adapted in light of concerns raised, with further guidance offered in order to address potential ambiguities. Minor amendments to the LME Warehouse Agreement and LME Policy on the Approval and Operation of Warehouses have also been released.

The period of transition will be closely monitored and the impact of these changes over the next year will likely be a key topic for discussion.

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⁴ See para 3.17 in the Consultation Paper.

⁵ A helpful diagram summarising the changes and their phased introduction can be found at page 7 of the LME's "Overview presentation on warehouse reform" available on the following link: <https://www.lme.com/Trading/Warehousing/2019-warehouse-reform>.

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