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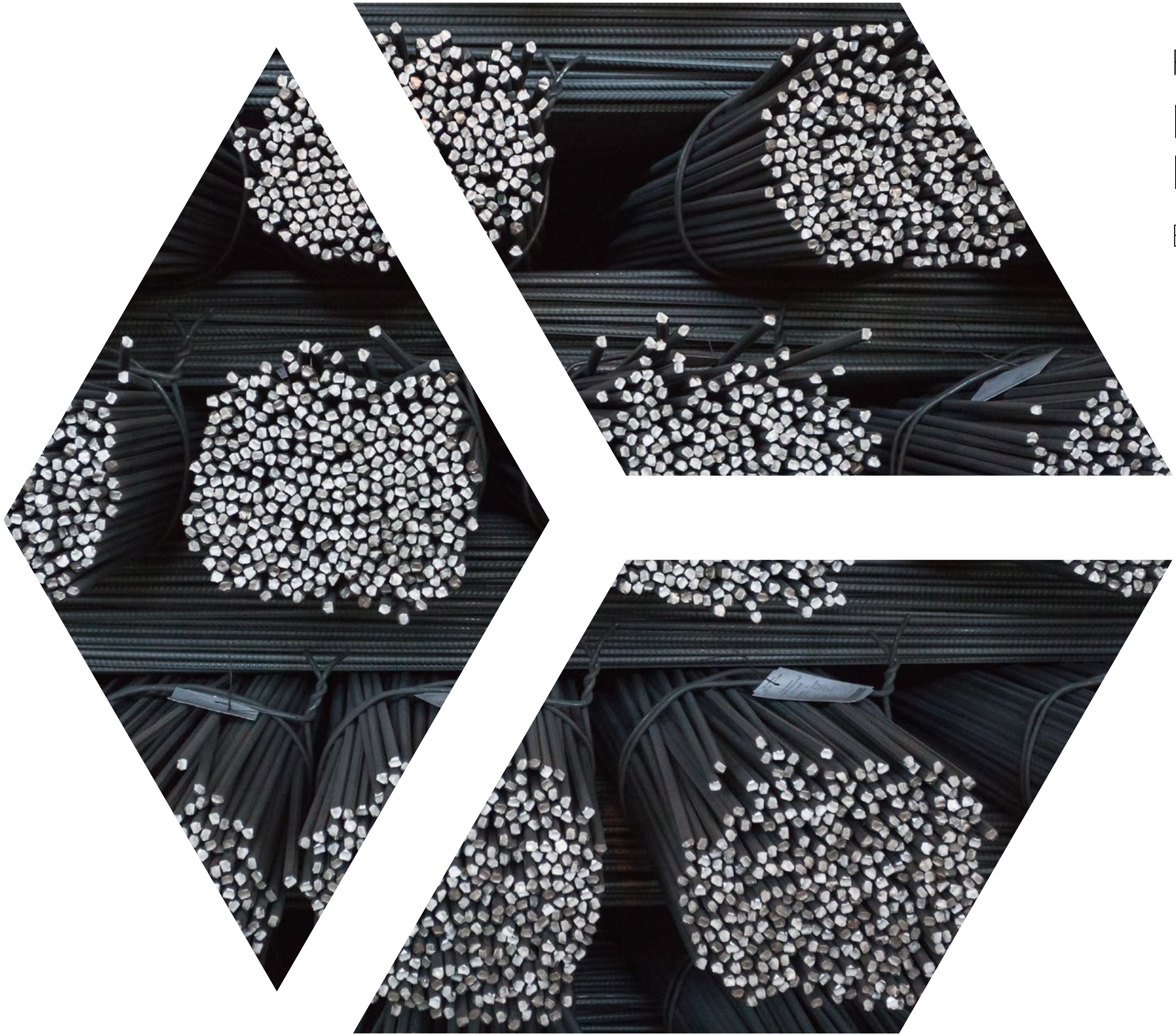

FACTSHEETS

LME CASH-SETTLED FUTURES

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a subsidiary of Mitsubishi Corporation

LME cash-settled futures

A wave of new contracts launched on the LME over the past few years as the bourse extended its product offering to ferrous and other base metals.

Settlement

When the LME launched steel scrap and rebar futures in 2015, they were the first in the Exchange's history to be cash-settled.

There are good reasons for this when it comes to steel:

- Handling and storage are challenging for steel scrap given the non-uniform nature of the product
- Steel rusts over time and the cost of storage is relatively high compared to the value of the metal
- Steel rebar and scrap are generally directly sourced and procured

More recently, the exchange added an array of new cash-settled contracts for ferrous, base and minor metals to sit alongside its core suite of physically delivered non-ferrous forwards.

Price Reporting Agencies (PRAs)

For each of these contracts, price reporting agencies (PRAs) such as Fastmarkets MB, S&P Global Platts, Argus Media and CRU publish daily spot prices for the underlying commodity, based on physical cargoes heard in the market. Each PRA has its own proprietary methodology which adheres to IOSCO principles, bringing transparency to how each of these values are calculated.

The monthly average prices published by PRAs are used as a basis of settlement for open positions in the month of a contract's expiry and in effect, ensure price convergence between physical and paper markets. We'll illustrate this concept with an example later. The indices selected by the LME as a basis of settlement are done so based on their usage in floating price arrangements for physical cargoes.

Averages

Another key feature of cash-settled products is that they are all standardised monthly futures contracts – doing away with the unique date structure adhered to by the LME's core base metals offering. For example, a June futures contract would be for the average of the month, rather than the third Wednesday in June (just like an averaging contract).

The effect is most liquidity tends to be concentrated on the front-month, unsurprising given that time periods for loading/delivery of physical material transacted today are often ear-marked for one month ahead.

Margining

Open positions for cash-settled contracts are marked daily versus the settlement price published by the LME. Unlike base metals 'forward' contracts, margins on ferrous futures are realised and settled daily. Perhaps best illustrated in the example below:

Day 1:

ABC Ltd enters into a contract with Triland Metals, to buy one lot of steel scrap for June prompt at $300/metric tonne.

Later that day:

LME steel scrap forward curve is published. June futures are priced at $305/mt.

As a result, the following occurs:

1. Triland Metals funds the initial margin, making payment to LME Clear (if the customer has a credit facility);
2. Triland Metals credits ABC Ltd's ledger balance with $50 (i.e. $5/mt x 10 tonnes); and
3. Client is issued with a new contract: long June futures at $305/mt

This continues each day, until the final working day of June when:

1. Client's latest position is long one lot June futures at $320/mt. Platts' HMS #1&2 80:20, CFR Turkey index average for June is $322/mt
2. Client's position expires; ledger balance is credited with $20/mt

Note:

The above process will result into daily settlement of profits and losses between the parties (unless there are specific terms in place to the contrary).

Summary

Despite being commonplace on many other commodity exchanges, cash-settlement is relatively new to the LME.

These new, simplified cash-settled contracts enable market participants to effectively manage risk along the value chain. In addition, price risk for regional markets can now also be managed for aluminium and HRC steel markets, respectively.

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