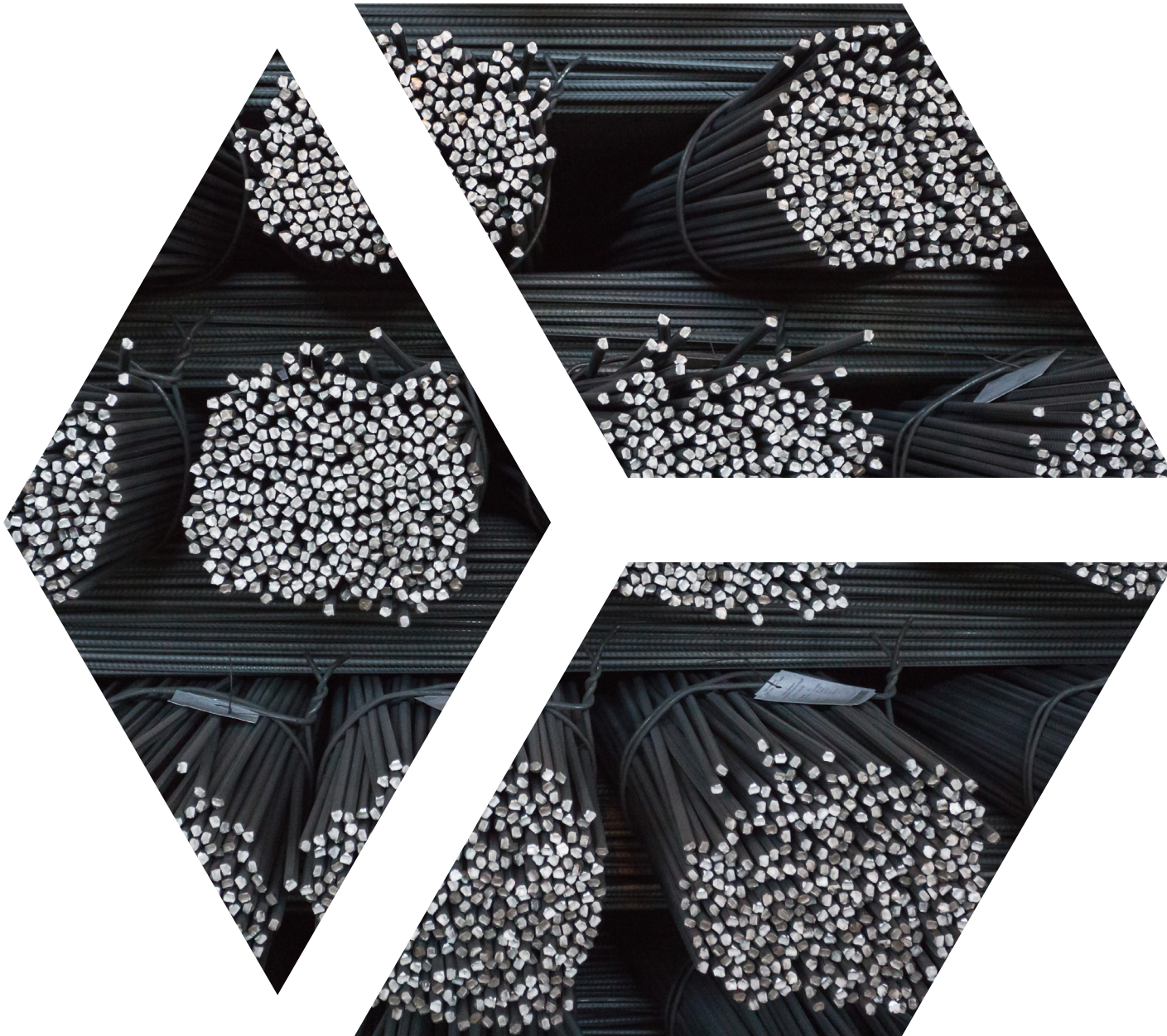


EXPERT GUIDE

LME CASH-SETTLED FUTURES

Brought to you in plain English by Triland Metals



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.

Disclaimer:

The material in this document (the 'Material') has been issued in the United Kingdom by Triland Metals Limited ('Triland') which is incorporated in England & Wales with company number 1011637. Its registered office is at MidCity Place, 71 High Holborn, London WC1V 6BA. Triland is authorised and regulated by the Financial Conduct Authority, 12 Endeavour Square, London, E20 1JN ('FCA').

Triland (or any director or employee of Triland) may trade for its own account as principal, may have long or short positions in commodities or instruments or any related instrument mentioned in the Material. Brokerage or fees may be earned by Triland or persons associated with it in respect of any business transacted by it in all or any of the commodities or instruments referred to in the Material. The commodities or instruments referred to herein are not suitable for all investors and involve the risk of loss. Futures, in particular, are a leveraged investment and carry a substantial risk of loss. The "gearing" or "leverage" often obtainable in futures means that a small deposit or down payment can lead to large losses and that a relatively small movement can lead to a proportionately much larger movement in the value of an investment, and this can work against the investor.

The Material is being made available for information purposes only. It must not be copied or further distributed to any other persons or for any purpose. The Material is neither an offer to buy or sell, nor the solicitation of an offer to buy, sell or subscribe for any investment or any commodity referred to in the Material. Any trademarks, logos, trade names, product names, copyrights and any other intellectual property rights (whether registered or unregistered) displayed in this publication (together, the 'IP Rights') are the property of Triland or their respective owners. The use or exploitation of any nature of any of the IP Rights is strictly prohibited and all rights in the IP Rights are reserved by Triland or their respective owners (as applicable).

The Material is not intended to be a financial promotion and does not constitute, and should not be construed as, investment advice, an offer, invitation, solicitation or a recommendation to buy or sell or to exercise any rights in relation to any investment or any commodity referred to in the Material and it does not take into account any objectives, financial situation or needs of any person or entity. Neither this publication nor anything in it shall form the basis of any contract or commitment. The provision of any services by Triland to any person or entity is subject to Triland's client acceptance procedures and the client entering into a legally binding agreement with Triland in relation to those services. Any recipient of this publication should make its own independent assessment and investigation in respect of the matters contained in this publication, after seeking advice from such professional advisers as such recipient deems necessary and appropriate.

The Material is derived from sources Triland believes to be reliable but which have not been independently verified. Triland makes no guarantee of the accuracy and completeness of factual or analytical data and is not responsible for errors of transmission or reception, nor shall Triland be liable arising out of any person's reliance upon this information. All charts and graphs are from publicly available sources or proprietary data. No representation or warranty, express or implied, is made in relation to the fairness, accuracy, correctness, completeness or reliability of the information, opinions or conclusions expressed herein or otherwise forming part of this publication. Any views expressed in this publication are those of the author and those views may differ from the views of Triland. Neither Triland nor any director or employee of Triland assumes any responsibility or liability of whatever nature for any error, omission, inconsistency or inaccuracy of whatever nature contained in this publication or for any damages or losses arising out of any person's reliance on the information contained in this publication.

The information and opinions in the Material are given by Triland as part of its internal research activity and not as manager or adviser of any assets or investments. The Material constitutes marketing communication. The Material further constitutes non-independent research and has not been prepared in accordance with any legal requirements designed to promote the independence of investment research and is not subject to any prohibition on dealing ahead of the dissemination of the investment research.

The Material is not intended for the use of and Triland does not provide services or transact with: (i) any person or entity in any jurisdiction that is not a "professional client" or an "eligible counterparty" (as such terms are defined in the relevant rules issued by the FCA from time to time); (ii) any person or entity in the United States of America that is not an "eligible contract participant" within the meaning of the Commodity Exchange Act (as amended by the Commodity Futures Modernization Act of 2000); or (iii) any person or entity in the Republic of Singapore that is not an "accredited investor", an "expert investor" or an "institutional investor" (as such terms are defined in the Securities and Futures Act (Chapter 289) of Singapore). This publication is not intended for distribution to any person or entity that does not satisfy the criteria for the foregoing classifications (as applicable).

Important Notice:

In the event you are authorised to disseminate the Material to any other person, the Material may only be passed on to any person if that person is of a kind described in Article 19 of the Financial Services and Markets Act 2000 (Financial Promotions) Order 2005 or otherwise pursuant to exemptions in Section 21 of the Financial Services and Markets Act 2000 ('FSMA'). Triland does not provide services to retail clients. In addition, no person who is a person authorised under FSMA may issue or pass on this document, or otherwise promote Triland, to any person in the United Kingdom other than under the rules of the Financial Conduct Authority applicable to such authorised persons.