



GUIDE TO LENDING GUIDANCE FOR DOMINANT POSITION HOLDERS ON THE LONDON METAL EXCHANGE

Introduction

The LME rules do not limit the size of warrant or trading positions. However, the LME has rules in place to ensure that holders of dominant warrant or trading positions do not attempt to 'squeeze' or 'corner' the market. These rules take the form of "Lending Guidance" and set out the practical procedures to be followed by those with dominant positions. In essence the Lending Guidance requires holders of dominant long positions in LME contracts to roll their positions for a day ('lend') at pre-defined premium levels on the prevailing cash price.

This summary is not a substitute for the LME rules or guidance on those rules issued by the LME. A more detailed explanation of the Lending Guidance is set out in LME notice 05/377 dated 15 December 2005.

Calculation of dominant positions

A position affected by the Guidance is the aggregate for each LME contract (except the cash-settled contracts: LMEMinis and LMEX) of a party's existing warrant holdings, *Tom* and *cash* positions. This aggregate is then divided by the total number of *live warrants* listed by the LME thereby providing the size of the dominant position expressed as a percentage of the relevant metal or plastic on LME warrant. Live warrant data can be found on Reuters (individual metals) and Bloomberg (LME Global Metal Stocks) pages.

Positions are comprised and calculated as follows:

- Every day, LME Members send electronic reports to the LME of the warrant holdings and on-exchange net trading positions for each prompt date for all their customers and House positions as of the close of the previous day. Based on that information, the LME runs reports showing each LME Member's proprietary positions as well as each customer's positions across all Members. When multiple accounts are related the LME will aggregate the data for those accounts across all Members in calculating a dominant position. For example, if account A is related to account B, the LME will aggregate all the positions of account A and account B across all LME Members;
- Holdings are reported by Members to the Exchange by 08:30. The requirement to comply with the Lending Guidance takes effect at 09:00 when the LME stock figures are published;
- Calculations are based on LME warrant holdings, *Tom* positions and *cash* positions as at close of business on the previous day; and
- The Lending Guidance requires dominant position holders to respond to demand from those wishing to borrow the *Tom/next* spread. Any *Tom/next* lending done by the dominant position holder before 09:00 at premiums greater than those required by the Lending Guidance must be readjusted to the Lending Guidance requirement.

'Triggering' the Guidance

Dominant position obligations are imposed on any LME Member or non-member (including customers) with holdings of Warrants, *Tom* or *cash* positions (or any aggregate of these) of 50% or above of the total relevant LME metal or plastic live warrants. There are different systems for plastics and for metals. The Plastics Lending Guidance requires those with dominant positions of 50% or above to lend at no more than 0.25% of the previous day's *cash* price. The Plastics Lending Guidance only applies to the six regional plastics contracts and not to the two global plastics contracts (see LME notice 07/118, dated 15 May 2007). The Metals Lending Guidance has a banding system, such that the more dominant the position, the lower the premium that person must lend at. The holder of the dominant position would then have to be prepared to lend, for a day (or more), in accordance with the following bandings:

Percentage band	Maximum premium	Numbers of Lots to lend
< 50%	Lending Guidance not applicable	
50% to 79.99%	0.5% of Cash price*	(in sufficient quantity to reduce position below 50%)
80% to 89.99%	0.25% of Cash price*	(in sufficient quantity to reduce position below 80%)
90% to 100%	Level (no premium)	(in sufficient quantity to reduce position below 90%)

* LME official cash settlement price from the previous day

In each case, the dominant position holder is only required to lend in sufficient quantity at each premium level to reduce the position to the next level. Once enough metal has been lent to reduce the position below the 50% threshold no further lending is mandated. The same applies under the Plastics Lending Guidance: there is no obligation to lend once a position has been reduced below 50%.

Note also that the obligation to lend is only applicable if the market backwardation for *Tom/next* is below the maximum premium. For example, if the dominant position triggered the holder to lend at no more than \$10 back and the market is trading at \$5, there is no obligation for the holder of the dominant position to lend. But if the market moves to \$10, then the obligation kicks in.

Complying with the Guidance

- Interpreting "if asked"

This means that a dominant position holder must respond to demand in the market for borrowing. The demand to lend can be done via LME Select, via telephone request for the *Tom/next* spread, or during the open outcry session before 12:30, i.e. the relevant First Ring. 12:30 is the last trading time to trade for the *Tom* prompt date.

- Assessing lending obligations
 - Where a dominant position exists, the dominant holder (be it a Member or non-Member) will be contacted by the LME Compliance Department to confirm figures and discuss any measures to be taken.
 - If the dominant position holder is a non-Member, the non-Member will be required to lend by giving appropriate instructions to one or more of his brokers.
 - Due to the fact that stock levels are not published until 09:00, the dominant holder is allowed to wait until this time before being obliged to comply with the requests to lend. However they are expected to be able to anticipate the application of guidance and should not allow a disorderly market to develop.

- Dominant positions are calculated on the basis of positions as at the close of business the previous day and not as at 09:00 on the relevant day. Any *Tom/next* trade executed by the holder of the dominant position prior to 09:00, on LME Select or over the telephone, which is done at premiums greater than those required by the Lending Guidance must be readjusted to the Lending Guidance requirement..
- Responding to lending obligations
 - Lending must be executed in the correct order (i.e. the holder of the dominant position is required to lend the required lots at the lowest premium first).
 - Lending must be executed in chronological order.
 - Dominant position holders must be prepared to respond in all three trading forums.

Special considerations for LME Select

The dominant position holder must respond to all valid bids 'posted' on Select. If there is a bid that is at a higher price than that prescribed by the Guidance, they must trade with that person (for identification purposes) and subsequently adjust the price in line with the Guidance. Adjustments must be agreed with the counterpart as telephone trades and registered in the LME's matching system.

Note: LME suggests that *"...if the circumstances suggest that bids for Tom/next borrowing on LME Select will be higher than the backwardation premiums at which the dominant position holder will be obliged to lend, the dominant position holder should behave prudently and consider placing offers on LME Select to anticipate bidding. This will avoid the need for adjustment trades."*

This is not strictly a requirement, rather a practicable suggestion on how to manage a dominant position on Select. Should the situation ever arise however and you choose not to anticipate with a required offer, you must ensure that you make the necessary adjustment when matching the executed trade.

Summary

- Lending Guidance exists to prevent holders of dominant long positions from being able to abuse that position;
- A position is calculated as the aggregate of warrants, net *Tom* positions and net *cash* position of a given party (customer or LME member);
- Lending is required on all holdings of 50% or above of total LME live warrants. There is a single premium band for plastics and a three band system for metals;
- The LME endeavours to notify firms if they have a lending obligation under the guidance;
- For a full text of the Guidance see http://www.lme.co.uk/what_regulation.asp.