Warehousing: What’s in store for metals?
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Letter from the editor

The warehousing landscape has undergone dramatic changes in the past four years, becoming the target of regulatory, political and legal pressure for increased transparency and accountability. During 2008-2014, warehouse companies focused on their London Metal Exchange business, attracting millions of tonnes of metals to their sheds, where they locked them up in lucrative rent deals or used them to build queues - at one stage they stretched to more than two years in Vlissingen and Detroit. A transition period in the following years bankrupted some warehouse companies and forced others to return to basics: logistics and diversification. And that model - with no more queues, less LME business and less excess supply for all - will continue for at least three years. In this special report, Metal Bulletin looks at the past seven years of warehousing, highlighting key developments, including LME reform, and changes to come, such as higher interest rates and increased volatility in LME spreads.

Perrine Faye, Global Base Metals Editor
In December 2011, a queue began to form at the Glencore-owned Access World warehouse, which was known as Pacorini Metals, to take metal out of storage, but no-one envisioned that it would spiral as significantly as it did.

The issue of structural queues became a focus for the LME, with the elimination of the queue at Access World a high priority for the exchange.

Charles Li, Hong Kong Exchanges & Clearing’s chief executive officer, said in 2012 that he would take a “bazooka” to the delays if necessary. But in the years that followed this outburst, the queues continued to grow.

At its peak in June 2014, aluminium buyers had to wait 774 days to take delivery of the metal. At this time there was another major queue forming at the Metal International Trade Services warehouse in Detroit, with a 681-day queue for aluminium.

This was despite the LME toughening its queue-capping measures in 2013. The exchange introduced the Linked Load-In/Load-Out (LILO) rule, forcing operators with a queue to deliver at least as much as they take in.

Two years later, in June 2015, the queue in Vlissingen had fallen by 416 days, but this only reduced the waiting time to around a year.

Two months following this, there was still a 254-day wait for aluminium at the Access World warehouse and a 297-day queue in Detroit for aluminium, alongside a new 66-day queue for the metal at the Henry Bath warehouse in Rotterdam.

Slowly but surely, it looked as though the queues were starting to disappear, but as the next year began to unfold the rollercoaster continued.

Despite the waiting time dropping to 224 days in September 2015, the queue for aluminium was back to 471 days just two months later.

At the beginning of 2016, the queue began to fall again, hitting its lowest since 2013 at 116 days before rising to 349 days by August 2016 – one year before the queue would disappear.

Following this inconsistency, the LME introduced its queue-based rent capping (QBRC) rules, which intended to address the queue issue by removing the financial incentive for warehouse owners to allow structural queues to build up.

“The LME believes that the action it took in respect [to] warehousing queues, and in particular the introduction of both the LILO and QBRC rules, has protected the reputation and effectiveness of the LME market,” the LME said.

The new measure allowed the queue in Vlissingen to slowly decline, so that by the LME’s September 2017 queue report there was no longer a queue to take metal out of the Access World warehouse – for the first time in six years.

According to the latest queue data, just three queues remain at LME warehouses. These include two queues in South Korea: a 23 day queue at P Global Services in Busan for copper, lead and aluminium; and a 28-day queue for copper, lead, aluminium and nickel at the C Steinweg warehouse in Incheon.

There is also a 14-day queue at the ISTM Metals warehouse in New Orleans for copper, lead, aluminium and zinc.

The exchange has come under pressure to relax its warehousing rules since the queues began to drop, but in its recent discussion paper the exchange decided against amending the rules.

“The relaxation of the warehousing rules is not a deliverable short-to-medium-term outcome. The current state represents the outcome of significant market engagement and the LME believes it delivers an appropriate balance for all stakeholders,” the LME said, adding that, “the market will need to accept the ongoing applicability of the LILO and QBRC rules.”

ALICE MASON
Digitization and blockchain developments are touted as means to eliminate warehouse receipt fraud and boost metals trade financing but the adoption of such solutions in Asia could prove uneven.

A recent scandal involving forged Access World’s nickel-related warehouse receipts that caused ANZ Bank to lose more than $300 million remained fresh in the minds of market participants in recent industry conferences in Singapore.

“The unfortunate thing about this case is that it is not a surprise. There is a shocking amount of money involved… A paper document was copied and people were defrauded. The industry is full of paper documents like warehouse receipts, bills of lading, letters of indemnity which are manually signed,” Simon Collins, co-founder of TradeCloud Services, said at a recent FT Commodities summit in Singapore.

“It is time the industry wakes up to this issue and makes some changes. The change towards the digitization of documents is inevitable,” he said.

Rene van der Kam, managing director at Viant, echoed similar sentiments at another recent LME event in Singapore.

“Warehouse receipts must have some form of digitalization. They are impossible to recreate yet it turns out that receipts that represent millions of dollars can be copied. It doesn’t make a lot of sense. There is a need to get credibility back in documents,” he said.

Parallels had been drawn between the latest warehouse receipt forgery case and a metal financing scam uncovered in Qingdao port in China in 2014, though in this latest instance, the fraud is more contained and no nickel has physically left warehouses. It had nonetheless affected credit availability soon after as banks, perceiving heightened risk, put stricter controls in place before agreeing to issue letters of credit or enter any sale and repurchase agreements (widely referred to as repos).

Repercussions were also seen among insurers.

“Five to 10 years ago, insurance companies were more willing to accept risk. They are now pickier on which risk they want to insure. If you go to an insurance company, and you are an Asia metal trader, then all alarm bells will go ringing. That should not be the case. Traders and bankers should explain the risk and how it works. Information is key,” Jan Steven Kelder, director of marine at Aon Risk Solutions, said at the same LME event.

POSSIBLE DIGITAL SOLUTIONS
To reduce the chance of fraud and boost trade financing access in the commodities market, market participants including warehouse operators and Fintech companies have started introducing trading and financing platforms, some using...
blockchain technology.

Warehousing firm C Steinweg Group recently launched an online platform to support the digitization of metal warehouse receipts in Asia, aimed at reducing the risk of fraud associated with paper documents. The platform, named Steinweg Online, will allow existing customers to digitally create, sign off and send documents online, eliminating the need for paper, according to Steinweg's website.

Former Trafigura senior executives Simon Collins and Matthew Botell have set up TradeCloud, a digital metals trading platform aimed at facilitating deals in the metals industry, while IHS Markit has created a system to help physical trading firms track their metals inventory digitally, replacing laborious manual processes.

London Metal Exchange’s LMEshield, a central electronic register for the creation and transfer of off-warrant warehouse receipts, is another initiative that is seen as safe for warehouses because the original warehouse receipt stays in a London depository and cannot be easily copied.

Meanwhile, Aquifer Institute is launching a blockchain trade financing platform that provides non-bank financing of physical traders on a cargo-by-cargo basis using an auction system.

The technology adoption in the industry is happening now, said Yvonne Zhang, chief executive officer and founder of Aquifer.

"Incremental changes are happening…the squeeze on the trade finance line and the Kim Jung Uns in the world are making risk managers nervous," she said.

The digitization in commodities trading and financing will put pressure on service providers such as banks to keep pace, market participants said.

"Information will flow to people like it has never been. The consequence is that traders have to reinvent…The customers will push banks to cut cost and embrace technology. Trade will no longer be like it had been," said Jean-Francois Lambert, managing partner at Lambert Commodities.

Traders embracing digital solutions will force banks to do the same, TradeCloud’s Collins added.

"The current system is a 100-year-old system which is paper-based, and based on signatures of armies of people…It’s got to change and innovators will change things," he said.

UNEVEN ADOPTION
As much as digitization could be the answer to preventing warehouse receipt frauds, market participants in Asia – including China, the world’s largest consumer of metals – may not be ready for the shift, which means adoption of such technology in this region could prove uneven.

Some 95% of the metal financing business in Asia is still carried out using paper rather than electronic documentation, with most Asian participants still preferring to use endorsed warehouse receipts. This is in contrast to Europe and the United States, which are already mostly digitized on warehousing, sources pointed out.

"We are constantly looking to upgrade the documentation but really we need to look to move electronic. The problem is paper is still preferred by many Asian players. Blockchain and LMEshield are nice ideas but they have to be accepted by the market and in Asia, we are not there yet," an executive from a major LME warehousing company said.

In fact, fraud cases are linked to China because of the preference for paper documents, he added.

Traders in Asia recognize the benefits of digitization for the trading community but note that other than the Shanghai Futures Exchange’s warrant receipts, there is hardly any digitization among the rest of the warehousing companies in China because there is no major figure driving digitization in the industry.

"I don't think traders have any problems accepting digitization. It decreases costs, works faster, is safer and better than using paper documents. Traders would like this," one Shanghai-based trader said.

But digitization in the industry is something that needs to be pushed by the banks and warehouses, he said.

"Many of the banks here, even the foreign ones, still prefer paper documents. The problem is no one continued
is pushing for digitization here. Digitization among banks in China is simply not high,” he added.

Other than for SHFE warrant receipts, there are hardly any other warehouses that are using electronic receipts, another Shanghai-based trader said.

If a major warehouse, such as Zhongchu, or a state-owned warehouse in China introduces an electronic warehouse receipt system, it could work, he acknowledged.

“You need a push by major participants in the industry for something like this to happen. Like for SHFE warrant receipts, everybody trusts them,” the trader said.

“But if a smaller warehouse here introduces such a system, people will ask, ‘Why should I trust the electronic receipt?’ Many here still prefer to see a hard-copy document. I think most people would like a digital system but such a system needs to be trusted and accepted in the market first.”

Blockchain would probably be the safest way to prevent warehouse receipt fraud but the main issue is that many do not really understand blockchain and no market participants in the metals industry have embarked on this, he added.

In Singapore, there had been concerns among the trading community after news of the latest nickel-related warehouse receipt scandal broke. But concerns among some traders have eased.

“I’m not too concerned about the latest fraud case as it was an isolated incident. It’s a case whereby the fraudsters were out to cheat you. I can’t see how ANZ or Access World could have avoided it. If it’s a category II LME broker handing you a receipt, you would trust it right?” a Singapore-based trader said.

More stringent procedures were put in place since the Qingdao incident, but the latest fraud case has not resulted in any significant changes in internal procedures or policies of banking partners, a number of traders added.

“Initially our banks were concerned and said they will stop financing our cargo with Access World but eventually the warehouse company solved this issue with the banks and our credit line was not affected. The banks are still offering credit lines for off-warrant material. I don’t see any negative side effects from the latest issue,” another Singapore-based trader said.

Prudence is still the key to preventing such frauds, traders said.

“Initially there was some impact from the incident but after the banks understood that this was something done by outsiders and not a problem with warehouse management, then everything went back to normal. I think those affected by the latest incident were those who are not familiar with the process,” a third Singapore-based trader said.

Buying from trusted suppliers and using trusted warehouses are most important, the first Singapore trader said.

“There is a limit to what can be done without extra costs for traders. Trading is meant to be fluid. It’s about finding a good balance. I think ultimately you have to be careful who you buy from,” he said.

Perrine Faye in London contributed to this report.

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LME warehouse companies diversify to survive until better times return

Warehouse companies operating London Metal Exchange-listed sheds have been diversifying away from pure exchange-based business in the past two years to combat the threat of shrinking margins and dwindling stocks associated with tougher rules and controls.

“We are still committed to the LME business but we are decreasing that part of our portfolio,” one warehouse source told Metal Bulletin.

Having a broad-based portfolio of products has always been a guiding principle for warehouse companies because it allows them to maintain tonnage and turnover when one commodity market slows down or goes through a deficit cycle.

But some warehouse companies such as Henry Bath, Metro, Istim and Access World (formerly named Pacorini Metals), have been more focused on LME business, especially in the past decade.

In the past two years, however, even they have been diversifying away from LME business because it stopped generating good profits, carried too many operational costs and simply became too complicated, sources explained.

Warehouse companies have delisted 84 LME-registered sheds globally so far this year, while they listed 54. In 2016, they delisted 78 warehouses and listed 92 new ones. In total, LME warehouse space globally shrank 11.4% in the past two years, according to LME data.

The diversification has centered on three areas: more off-exchange metals business, more logistics services and more variety in commodities.

Today, LME warehousing accounts for less than 10% of Access World’s business while base metals still represent three quarters of its portfolio - a big change for a company that until recently had most of its revenue and tonnage locked in LME operations in Vlissingen, in the Netherlands.

Other warehousing companies have also reduced the ratio devoted to LME business. Istim, which only operates in LME deliverable base metals, is down to 50%, and ECTP (formerly BTG Pactual), has lowered it to 5%. For others, including Steinweg, the ratio has diminished to around 10% of total volumes, Metal Bulletin understands.

Known as the king of logistics, Steinweg has become a bit of a role model for warehouses since 2015. The Netherlands-based company, which describes itself as a services provider, is active in nearly 50 countries and 13 products including all types of metals, tobacco, sugar, ferro-alloys, forest products, plastics and soft commodities.

“The only truly diversified company that can make a living in every aspect of the market is Steinweg - everybody else, including us, is amateurs,” one source said.

“Even in metals, they operate from the root - chartering and stevedoring - and they are present globally in parts of the world where competitors are 20 years behind,” he added.

FROM METALS TO COTTON AND WATER

Access World has been aggressively diversifying since 2015, first with paper storage and a dedicated ferro-alloy terminal in Vlissingen, and a wider geographical spread with African operations around the copper belt and a new office in Peru.

More recently, the Glencore-owned warehouse company has been building a ferrous business, growing ferro-alloy activities in South Korea, Turkey and the United States, handling fertilizers in South Africa, moving grains in Baltimore and Vlissingen, and developing cotton and tobacco operations in Vietnam.

“We are building this up step by step - we have gone from having a few bags in the corner of the warehouse a few years ago to having a whole warehouse filled with cotton and tobacco today,” a company source said.

Access World has also expanded in logistics, focusing on containers. Since

continued
returning to metals warehousing in 2014, PGS - owned by the Pacorini family - has also concentrated its efforts in containerized cargoes while diversifying into non-LME operations such as concentrate grinding in Africa and into other products such as animal feed, paper and pulp, steel and pipe, granite, antique cars and water.

Henry Bath, partly owned by Mercuria, has also been trying to broaden its services but diversification is neither quick nor easy, sources said.

“There will be a change in the landscape. Warehouses want to diversify. But the reality is different, the knowledge is not really there and returns are very small,” a source at a logistics company said. “Logistics and diversification pay the bills, but only if you have the know-how and the ability to control your overheads,” he added.

This complexity saw traditional logistics companies having a go at metals in past years. For example, family-owned Verbrugge Terminals has expanded outside its core wood pulp business to do more aluminium storage and treatment of copper, lead and zinc concentrates in the Netherlands, with base metals now accounting for 15% of its business.

In September, T Parker Host, a family-owned US shipping and stevedoring company, hired Anton Posner from CWT Commodities to expand into metals logistics and warehousing.

Operations are already up and running on the former Bethlehem steel mill site in Baltimore, with Host moving break-bulk shipments of aluminium, zinc calcines and coal, Metal Bulletin understands.

CWT Commodities, under new Chinese owner HNA Group, is pushing ahead with ambitious growth plans in metals and other products outside the Singapore hub.

CYCLICAL BUSINESS
It is not the first time LME warehousing has been viewed as unattractive. The storage of base metals is cyclical and varies according to supply and demand - less supply typically equals less business for warehouse operators, as was the case in the years 2002-2007 and how it will be in the next three years or so.

“The LME business is like the cherry on the cake - there are years you get the cherry and the icing and other years you just live on other things,” a market participant noted.

The difference this time is that, because of the strict set of rules imposed by the LME, some warehouse companies are making changes for the long run rather than simply implementing counter-cyclical strategies.

“We are adding commodities for the long term,” another warehousing source said.

“The LME business is definitely a changing target as we go forward,” a third warehousing source said. “With the exception of Asia, next year it will be close to zero for everybody.”

Asia will continue to see excess supply of base metals looking for a home next year but Europe and the US will be much tighter across the sector, market participants agreed.

The next three years will be tougher for LME warehouses than the past 10. The smartest will survive, albeit with lower revenues, but there will probably be casualties, in the same way that Trafigura-owned Impala withdrew entirely from LME metals storage in late 2015.

New entrants, such as Reuben Brothers’ Metro and WWS under the new ownership of Golden Dragon Resources, will have to battle competition from more established industry participants to prove there is still room for them in the crowded space of LME warehousing. Maybe it is time for fresh faces in the industry. But one thing is certain: Those who focus their business on LME warehousing alone have fewer chances of survival.

PERRINE FAYE

“We are building this up step by step - we have gone from having a few bags in the corner of the warehouse a few years ago to having a whole warehouse filled with cotton and tobacco today.”

–Access World source
It would be inappropriate of the exchange to try to have as much metal as possible on LME warrant, Chamberlain told Metal Bulletin in an interview.

“In exactly the same way I accept that people might want to trade over-the-counter rather than on-exchange, I think we have to accept metal owners have their reasons and rights to keep their metal off-warrant,” he said.

The exchange benefits financially from having metal on warrant, its contracts trade in greater volumes because of it and it enhances the attractiveness of LME warehousing, making its warehousing partners keener to work with the exchange, he acknowledged.

“But just because we like it doesn’t mean we can make it a policy aim to keep as much metal on warrant as possible. I don’t think that would be right and I think in many ways it would be an abuse of our position in the market if we brought in policies specifically aimed at forcing metal on warrant," he said.

There has been some concern that the LME rule changes have made the movement or placement of material off-warrant more attractive, perhaps hindering the role of the warehouse system as a market of last resort.

Total stocks in LME-listed warehouses are just above 2.1 million tonnes, down from their peak of 7.6 million tonnes in July 2013, with aluminium accounting for roughly half of that amount. When the exchange announced its warehouse reform package in November 2013, LME aluminium stocks alone totaled 5.4 million tonnes, with estimates for as much or more being stored off-warrant.

But the biggest reason that LME stocks have fallen over the past couple of years is that warehouses are doing a good job of proposing an off-warrant storage market, which the exchange supports, Chamberlain said.

“We don’t have a problem with this at all – we’re absolutely aware warehouses register with the LME not because they expect to get huge warranted stocks but because it’s an important credential for them to compete in the off-warrant stocks market,” he noted.

“I could sit here and say, ‘This is totally unfair, it’s misusing the LME certification,’ but I’m not going to say that. We want our warehouse operators to have strong business models, the market to have a good range of solutions to store metal,” he added. “We want a permissive regime.”

Similarly, the exchange cannot force warrant holders to maintain stocks in warehouses to ensure the system is the market of last resort, Chamberlain said.

“The question I would pose is: Would you rather there are 10 million tonnes on warrant that takes two years to get out because it’s stuck in a queue or 1 million tonnes that is readily accessible?” he added.

There has also been criticism of rolling warehouse rent agreements, known as evergreen deals. Since these motivate warehouses to cut prices in fear of losing metal to competitors, they have lowered the cost of storage.

But the LME has no plans to ban them, Chamberlain told Metal Bulletin, adding that the exchange has discussed them in several consultations and it does not view the deals as promoting disorderly markets.

“There is no clear view for the whole market that banning evergreen rent deals would bring more metal on warrant,” he said.

But the LME may prevent metal from being taken off-warrant in one warehouse and placed back on warrant in a competitor’s warehouse in the same location if members overwhelming support this,
Chamberlain said.

“What we can’t do is advantage some warehouse operators while disadvantaging other warehouse operators. If it’s about keeping half the room happy and half the room unhappy, again, we aren’t going to do that unless there’s an overriding regulatory requirement,” he added.

WAREHOUSE REFORMS COMPLETE, NO FURTHER CHANGES PLANNED

The exchange is happy about the outcome of the warehouse reform package, Chamberlain said. Popular or not, things could have been very different had the LME not acted.

The real danger would have been the enactment of laws or regulations that specifically targeted the LME market and its physical delivery network, he noted.

“That would have been the worst possible outcome, and it’s a matter of public record that we came close to that, we really did. It was only by taking the action that we did and engaging the way we did that we were able to get to where we are now,” Chamberlain said.

The key rule changes were announced in November 2013, following a three-month market-wide consultation, when the LME launched a warehouse reform package with 12 key elements. All of these elements have now been implemented; there are no further changes in the works.

“Our philosophy on warehouses is that we will act if we feel that there is consensus in the market that it’s the right thing to do or if there’s a regulatory responsibility to act,” Chamberlain said.

TWEAKING RULES?

There has been some inevitable criticism of the rules, in particular that the LME went too far in certain areas and should consider tweaking or rolling back some of its reforms. In particular, the focus of attention has fallen on the load-out rate increase (LORI), the load-in, load-out (LILO) regime and queue-based rent capping (QBRC).

While the exchange was sympathetic to views highlighted in its recent discussion paper that “most warehouse operators” would like those rules to be repealed or reduced in scope, Chamberlain said other market participants were opposed.

“The response was really very clear, particularly from consumers, that they do not feel we have demonstrated a long enough period of operating without issues that we could consider reducing the protections we offer to the market;” he said.

“Much as the LME might like to do this, we have to accept that as a market we got it wrong by allowing these queues to form,” he noted.

The LME is nonetheless confident that its rules make a queue-based warehousing business model unattractive. Operational load-out queues could arise, Chamberlain said, but a structural queue problem is unlikely. He noted that the LME is in a “very good position” on warehousing with the regulatory bodies, including the Financial Conduct Authority.

As recently as October, a surge in warrant cancellations in South Korea led to the emergence of new warehouse queues, according to data released by the LME on November 10.

LME EYES CASH-SETTLED CONTRACTS

On new contracts, Chamberlain said the LME has more or less exhausted the list of physically delivered metals contracts it can launch.

So it has recently launched products that are cash-settled rather than physically delivered, such as steel scrap and steel rebar, or that are outside the traditional exchange warehouse network, such as precious metals.

This is not a reaction to the problems that faced the warehousing world in the last five years but “very simply because we’ve pretty much done all the physically delivered products that we can,” he said.

“We tried to physically settle aluminium premiums because of all the benefits that we think apply to physical settlement but the market preferred cash-settled premiums,” he noted, referring to CME Group’s suite of aluminium premiums contracts, which have gained significantly more traction than the LME’s product offering.

“It’s nothing to do with the LME’s view of warehousing or its experience in the past five years - it’s purely about what’s the appropriate method of settlement for each contract,” he added.

On warehouse fraud, the exchange is active, Chamberlain insists. It operates LMEshield, a central electronic register providing global off-warrant commodity receipting. But uptake has been slow.

“We’ve been open that there’s a very small amount of metal on LMEshield and I think that’s really because people are determining the best way to go in terms of their storage arrangements;” he noted.

“They mainly are very happy with the off-warrant services they get from their LME-approved warehouses and we’re not trying to compete or break that up.”

ANDREA HOTTER
Is LME warehousing still attractive?

With plummeting London Metal Exchange stocks and registered-warehouse space dwindling, some market participants would say that LME warehousing is no longer an attractive prospect.

Sources note that there is still a desire to have the LME stamp of approval because it provides insurance and an easier route to financing – but LME business is no longer a main warehousing priority.

“The LME business is not dead but it’s no longer attractive. The numbers don’t make sense, warehouses end up getting squeezed and the deals we are having to make are not worth taking on,” a source said.

“LME warehousing is simply not attractive anymore. It does not work,” another source added.

Stocks at LME-listed warehouses have been rapidly declining since the LME introduced its Linked Load-In/Load-Out (LILO) policy in 2013 and queue-based rent capping (QBRC) rules in 2015.

In July 2013, before any changes were made to the LME warehousing network, total stocks in LME warehouses were over 7 million tonnes. Today, total stocks sit at just over 2 million tonnes.

On-warrant aluminium stocks in LME warehouses are at a nine-year low while Shanghai Futures Exchange aluminium stocks continue to register record highs. Tin stocks remain at their lowest since the 1980s, with total stocks hitting a low of 1,635 tonnes in July 2017.

Zinc has also taken a significant hit in recent years. Before LILO was put in place more than 100,000 tonnes of metal was stored in LME-listed warehouses; around 22,000 tonnes remain.

The initiatives were put in place to bring an end to structural queues, and although they have achieved their aim they have also had a big effect on the warehousing community and left a line of destruction behind them.

“[The introduction of QBRC] was the breaking point. Warehousing is struggling with all these rules in place. I think people struggle sometimes to think of the positives related to being an LME warehouse now – it is not a priority,” a trader said.

“QBRC accelerated what LILO would have achieved, it was unnecessary and very punitive,” a warehousing source added.

Over the last few months, market participants have asked the LME to consider relaxing their warehouse initiatives in order to make storing metal in LME warehouses attractive again.

The LME warehousing network has less than 600 approved warehouses and storage facilities in 34 locations across the United States, Europe and Asia – compared to more than 700 approved warehouse in 2013.

A majority of warehouse space is still owned by just two operators – Steinweg and Access World. But their...
warehouse numbers are declining, with Access World delisting 15 warehouses in the past three months.

Some companies have disappeared from the list of LME-registered operators during the past year, including Impala Terminals and Scale Distribution. And while there are new participants coming into the warehousing industry, there is little positivity surrounding their arrival.

“The new entrants won’t make any money, they are very naive,” one source said.

“It’s a harder market than people realize. Even if you have experience, things have changed and I don’t think it’s an industry you can jump back into and make money straight away,” another market source said.

Other market participants say there is still a strong need for the LME’s stamp of approval in order to meet certain requirements.

“We still need the LME registration as a guarantee because we are a smaller operation – the approval makes it easier to get financing from banks,” a warehousing source said.

The approval is still looked upon favorably for traders and producers, providing new opportunities on the exchange.

“Producers who list brands on the LME earn greater optionality for their customers and carry a globally recognized symbol for production quality,” Oliver Nugent, base metals market specialist at the LME, said in a recent commodity insight article.

“Whilst metals financing might occur inside or outside of the LME’s warehousing network, the option of delivering such metal into the LME will typically earn the most preferential treatment for the lending rates against the metal’s value,” he added.

While some market participants are happy to voice their opinions on the diminishing role of LME warehousing in their business strategies, it is safe to say that the LME still holds a vital role for other businesses in the short-to-medium term. But many are united in their call for the LME to re-evaluate its warehousing rules to bring stock back onto the exchange.

Perrine Faye in London contributed to this report.

ALICE MASON

Wide variance between on- and off-warrant rents likely to remain

The wide cost differential between storing material on-warrant in London Metal Exchange warehouses versus off-warrant appears to be here to stay, at least for now.

The attraction of putting material off-warrant stems from market participants’ ability to find more affordable options to store metal off-warrant against listing metal on-warrant at LME-affiliated warehouses.

On-warrant warehousing costs have trekked higher over the past two years, to 54 cents per tonne per day for 2017-18 from an average of 49.6 cents per tonne per day in 2015-16, according to LME-listed warehouse rates.

But off-warrant storage is more cost effective with a more competitive market. Participants can rent for a month at prices that are less than what the LME warehouses charge for a day in some facilities.

“Whether rents are at 24 [cents] a day per tonne or 25 [cents], it won’t change the fact that the majority of our business is non-LME,” one source said, adding that LME warehousing is not viewed as lucrative.

On average, off-warrant storage costs in the United States are around 5-10 cents per tonne per day for aluminium, according to some sources, with land costs generally cheaper than those in Europe and Asia. Still, there are some isolated deals heard as low as 25 cents for the entire month at certain facilities.

In Europe, warehousing sources say costs average around 9-10 cents per tonne per day for aluminium, but again there are some isolated cases of some operators charging even less in an effort to increase market share.

Finally, costs in much of Asia average around 10-15 cents per tonne per day for aluminium.

Likewise, when it comes to remaining competitive in the physical market, material is often to be kept off-warrant due to the differential in...
The LME officially published FOTs in Europe, for example, at an average of around €32 (about $37-38 per tonne) in Dutch ports. Meanwhile, for off-warrant aluminium, for example, most holders are able to secure FOTs at around €14-15 per tonne - a 50% reduction on the published rate - and some have recently been heard at less than €10.

Similarly, aluminium off-warrant FOTs in Asia are often heard around $15-20 per tonne in key ports for storage in areas such as South Korea, whereas official LME FOTs are closer to $43-45 per tonne converted from the South Korean Won.

**IMPASSE**

There is an opportunity for off-warrant and on-warrant rents to converge if warehouse operators and the LME can reach an agreement.

Despite the high rental costs for on-warrant storage, warehouse operators have said they are willing to reduce fees to a certain degree.

“We told the LME we would be ready to consider lowering our rents and FOTs [if] - and only if - the LME changed the framework and amended the set of rules,” another source said.

Operators are keen to see penalties on long queues relaxed. The LME toughened its queue-capping measures in 2013 when it introduced the Linked Load-In/Load-Out (Lilo) rule, forcing operators with a queue to deliver at least as much metal as they take in.

And queue-based rent capping rules, which were implemented in May 2016, were even more punitive. They were intended to remove the financial incentive for warehouse owners to allow “structural” queues to build up, which means queues should be limited to operational ones.

The rules specifically targeted queues at Detroit and Vlissingen warehouses, where aluminium buyers had to wait 774 days to take delivery of metal in summer 2014.

But those measures increase logistics and operations costs for warehouse companies because it forces them to commit to punctual delivery times.

“(Queue-based rent capping) hangs as a sword over everybody’s heads,” the source said.

Even though there are clamors for change, the LME told Metal Bulletin in a recent interview that it has no plans to change any rules regarding the queue.

**FUNDAMENTAL SHIFT**

The current economic landscape is making metals, especially aluminium, attractive to keep in off-warrant storage. Meanwhile, the LME-sanctioned warehouses’ inability to reduce rents could maintain the divergence between on- and off-warrant storage options.

LME warehouses currently hold around 2.1 million tonnes of metal, down from a peak of 7.6 million tonnes in July 2013. Aluminium accounted for half of that amount.

While aluminium inventory has dwindled on the LME, it has remained strong off-exchange. Sources told Metal Bulletin in October that off-warrant aluminium volumes were closer to 6 million tonnes.

Holders of aluminium have a financial incentive to move material off-warrant and keep it there for now. The return of a contango to nearby spreads has - to some extent - contributed to increased material remaining off-warrant.

In September, the contango on benchmark cash to three-month LME spreads moved out to the widest level seen in around two years, at $32-33 per tonne.

With a $20-plus contango (or around $6-7 per month), many traders are able to fully finance their metal in off-warrant storage without incurring any costs and sell the material forward to lock in the profit. As a result, this removes any pressure to sell at low premiums or warrant on the LME against an incentive.

-warehouse operator

IAN WALKER AND JUSTIN YANG
Relaxation of governmental controls raises hopes for China-based LME warehouse network

The establishment of a warehouse network in China has not yet come to fruition many years after the idea was first mooted, but the continued opening up of the country suggests it is a case of “when” rather than “if.”

When Hong Kong Exchanges & Clearing (HKEX) bought the London Metal Exchange five years ago, one of the most attractive parts of its offer was its strong connection with China. As well as higher liquidity from Chinese participants, exchange members anticipated a smoother path to the LME establishing registered warehouses in the country.

But while HKEX has not stopped lobbying Beijing on the point and has publicly expressed its willingness to cooperate with domestic commodity exchanges to ensure a level playing field, it has foundered. This is not only because of a sense of unwillingness from its Chinese peers but also because of Beijing’s retention of strict controls over currency exchange and warehousing.

Although the LME is the most traded platform for base metals, liquidity provided by China - the world’s largest consumer of metals - is capped by currency controls.

That has put its it main rival in China - the Shanghai Futures Exchange (SHFE) - at a competitive advantage. The SHFE’s copper contract is making inroads, especially over the past two years, given the more sophisticated structure of participants involved in the market.

Trading volume of SHFE copper futures was 52.79 million lots during the first six months of 2017, with turnover of 12.35 trillion yuan ($1.86 trillion).

Given the similar contracts on the LME and the SHFE, the establishment of a warehousing network in China would make the competition between the LME and the SHFE even more direct. LME and SHFE prices are likely to move closer together. In such circumstances, the SHFE, as the smaller of the two exchanges, might find itself at a disadvantage.

But logistics should become easier if the exchange can establish a warehouse network there, making premiums less volatile.

And a large proportion of stocks in the Shanghai bonded area will be transferred to LME warehouses, removing an element of opacity from the market.

**QME AS ALTERNATIVE?**

HKEX has also tried to approach the issue of warehousing from within - it said it would look to create reliable warehousing infrastructure to support its Qianhai Mercantile Exchange (QME) venture.

HKEX has high hopes for the Chinese spot trading platform, seeing it as a bridge between China’s physical and financial markets. It will ultimately link to the LME and perhaps other exchanges on the Chinese mainland.

But while the rollout of the exchange was planned for the first half of 2017, a crackdown on illegal platforms by local authorities has caused a delay. Its launch date remains unclear.

HKEX chief executive officer Charles Li told investors in 2016 that the exchange would set up a warehousing network in Qianhai, a commercial development in Shenzhen in Shandong province, but HKEX has been largely silent on the topic since then.

But hope is not lost, not least of all because the country continues to explore new ways to embrace globalization.

Chinese Vice Premier Wang Yang recently called for the opening of free trade ports, which followed a speech from Chairman Xi Jinping in which he said more powers will be granted to pilot free-trade zones to conduct reform.

A more open environment should give overseas entities more optimism about building up a presence in China either directly or through partnerships with Chinese companies.

“We’d love to be in China and we also respect that our Chinese partners will want to move at the right pace for them,” London Metal Exchange CEO Matt Chamberlain told Metal Bulletin.

“We’ve looked at some work around [electronic warehouse receipt system] Shield in China, which is actively being progressed; I think [electronic warrant transfer system] Sword in China is probably further down the road. When China is ready for that next step, we’ll be here as its supportive partner,” he added.

Andrea Hotter in New York contributed to this report.

KIKI KANG
I think people are expecting massive noise but that’s not what we’re about. We are going to build our business up but not set off fireworks,” Dunn told Metal Bulletin in an interview.

“Some people may call us naive, or think that we do not know what we are doing, but only time will tell if our venture works out. We are confident and excited about this business,” he added.

Previously owned by Noble Group, the warehousing company was sold to Australia-backed and Singapore-based Golden Dragon Resources Pte Ltd in June 2017.

Dunn admitted that the transition has been tougher than expected, but the company is finally at the stage it thought it would be six months ago.

“We underestimated how hard it would be to pull the company out and go alone. WWS was originally just a support function for Noble and it was embedded into the company,” Dunn said.

Dunn explained that WWS did not have its own bank accounts or IT license and there were multiple aspects of the company that had to be built up from scratch.

“We had a long period of restructuring when we first acquired WWS,” he said. “Now we are finally at the end of that period and where we thought we’d be when we bought the company.”

WWS has 18 warehouses that are registered to handle metals traded on the London Metal Exchange in the United States, Europe and Asia, and it also has a shed listed on the CME in the US.

“We intend to remain LME-listed, we have no problem with the exchange,” Dunn said.

Some in the warehousing industry have posed questions over the LME’s attitude toward warehousing. With the structural queues now gone from all LME warehouse locations, there is a call for the exchange to cut back on some of the rules it put in place – such as Load In/Load Out and queue-based rent capping.

But Dunn says he has trust in the exchange. “The LME is a smart body with smart people running it and I’m sure they will listen to industry feedback and act accordingly,” he added.

Chief executive officer Marco Cumbo Nacheli left WWS in October after more than six years with the company, and questions were raised over the lack of experienced personnel left at the warehousing company. But Dunn says the company will have more experience coming through its doors.

“Marco was great. He stayed for six months once we took over and helped us with the transition. We have someone with a lot of experience in the industry who we hope will take over the role,” Dunn said.

“We acquired the business but I certainly won’t be running the warehouses-experienced industry people will,” he added.

WWS’ business model is to be an independent, niche warehouse, Dunn explained. With the company not trying to grow too big or “rock the boat.”

“We are not looking to increase our warehouse capacity but just to adapt our geographical footprint over time,” Dunn said.

Eventually WWS wants to venture into China, but Dunn says this will be a project more suited to 2019. The coming 12 months will be about filling up current warehousing space and developing the company further, with a prime focus on the US to start.

“We are in the business for the long haul and we will build it patiently,” Dunn said.

Perrine Faye in London contributed to this report.

ALICE MASON
More volatility likely in LME spreads in 2018 on low stocks, strict warehouse rules

London Metal Exchange benchmark spreads have had a rollercoaster year in 2017 and next year is not looking any calmer given the low level of registered stocks and sustained strict LME warehouse rules, which could prompt frequent backwardations similar to what zinc is experiencing.

Zinc’s cash/three-month spread reached a $91-per tonne-backwardation on October 12, its widest backwardation in more than 10 years, before easing back to around $30 per tonne following LME stock re-warranting in New Orleans. “I think zinc recently has set the tone of what to expect across the [LME base metals] complex next year,” an industry source said. “I don’t think the impact of the new warehouse rules has been fully felt due to the low price volatility but if even a little volatility emerges in the underlying market - like zinc has - then the warehouse stock reaction magnifies that, which in turn causes a volatile feedback loop,” he added.

The LME toughened its warehousing reform in 2015 when it implemented its load-in/load-out (LILO) rule, which forced operators with queues to deliver more tonnage than they take in. In 2016, it got even stricter with increased load-out requirements, queue-based rent capping (QBRC) - which made storage at queue locations rent-free after 50 days - and reporting rules on warehouse incentives. And this year, rent and free-on-truck charge caps were imposed.

These rules fast-tracked the decline of queues – the queue in Vlissingen ended in September after six years - but they also increased operational costs and reduced warehouses’ revenues, making them less eager to put metal on LME warrant. “The new rules go some way to exacerbating a persistent backwardation which does not help metals with low inventory,” a trader said. “Warehouses don’t want to take material on warrant.”

The number of LME-listed warehouses has dropped to 600 from more than 700 in 2013, and LME stocks have fallen to 2.1 million tonnes this month, of which 164,000 tonnes is still up for grabs. Low LME stocks means less deliverable warrants against LME contracts and the potential for more volatility around the front end of the forward curve in the form of recurring backwardations, when the nearby price is higher than the forward price.

Low LME stocks also make it easier for a market participant to become a dominant long position holder - because one needs less tonnage and thus less money to control a larger percentage of total stocks - and this can further increase spread volatility.

**ALL METALS AFFECTED, BAR NICKEL**

Aluminium’s LME nearby spreads have regularly moved into backwardation since mid-2014. The benchmark cash/three-month spread was recently in a contango of $16.50 per tonne, which just about covers financing costs, but it was in backwardation in February, March and August.
this year, in June, November and December 2016, as well as most of the first four months of 2016, and in April, May and December 2015. This caused numerous trading houses to complain of revenue losses.

The LME tin market has been in and out of backwardation since 2015, when the cash/threes reached a record high of $510 per tonne, and this year has stayed in backwardation since March while LME stocks plummeted to their lowest level since the 1980s in July at 1,635 tonnes.

The lead market was in backwardation in January, February, April and October this year and again in March 2016, with stocks regularly shifting between on- and off-warrant locations since the massive cancellation of nearly 100,000 tonnes in March 2015 when stocks moved from Europe to South Korea.

Nickel has largely remained in contango amid still-high LME stocks, and copper has been more or less spared from spread tightness since mid-2016 because the market has been in surplus and LME stocks have not fallen too much due to a widely reported battle between two large Switzerland-based trading companies canceling and re-warranting inventory.

Yet, as a trader pointed out, “the ups and downs in LME stocks seemed to have provoked backwardations at certain moments.”

This was the case in September this year when the nearby cash/one-month LME spread jumped to a $17 backwardation before reverting to a contango a day later following a large stock warranting.

Typically, tight nearby spreads will encourage holders of off-warrant stocks to lend into the backwardation and deliver metal to the shorts, bringing stocks back on LME warrant and allowing spreads to return to a contango.

But if warehouse companies do not accept the tonnage because they view LME rules as too restrictive, or if stock holders do not see a financial interest in delivering metal to the LME because their off-warrant deals make them more money, then there is a risk that backwardations could become a permanent feature of the market.

“If it continues this way, there won’t be any physical delivery in a few years’ time. Unless [they] can find ways to make money, they won’t use the LME warehousing network and warehouses won’t facilitate it,” a warehouse source said.

PERRINE FAYE
Verbrugge family makes solo push into metal warehousing, new concentrates terminal

Family-owned Verbrugge Terminals is expanding its standalone presence in base metals warehousing with a new terminal in Vlissingen for handling and storing copper, lead and zinc concentrates, director Anton Verbrugge told Metal Bulletin.

The new concentrates terminal, in operation for more than four months, can handle 300,000 tonnes of concentrates per year but has “massive expansion capacities,” Verbrugge said in an interview.

Verbrugge Terminals, whose small presence in base metals in the past seven years was largely centered on aluminium in the Netherlands in partnership with Access World (formerly Pacorini Metals), has decided to build on its strong logistics expertise to expand solo in the sector in Europe and globally.

The new Scaldia terminal in Vlissingen can treat all sorts of concentrates - its warehouses are under negative pressure, which is a requirement for lead concentrates storage, for instance - and has a state-of-the-art setup for weighing and blending.

The 60-year-old company is sourcing the concentrates from top mining countries Chile and Peru and has secured a long-term contract with a German smelter for the handling of lead concentrates.

The concentrates market for copper and especially zinc and lead is very tightly supplied, with strong demand for material in China and Europe and multiyear low treatment charges (TCs) - lead TCs are trading at a premium to LME prices for the first time since records began, according to Metal Bulletin’s assessments.

Verbrugge Terminals is also pushing ahead with aluminium storage in Vlissingen, although it is now focusing on physical units rather than London Metal Exchange-related business. It still has two LME-registered sheds in Vlissingen.

“We will stay active in LME warehousing but this is a cyclical business and nothing is going on right now. Our focus now is on physical tenders,” Verbrugge said.

Verbrugge spent three years in the aluminium department at Glencore and some years in Latin America before joining the family business in early 2016. He was promoted to director a month ago to work alongside his father, Martin.

VERBRUGGE FAMILY MAKES SOLO PUSH INTO METAL WAREHOUSING, NEW CONCENTRATES TERMINAL

Verbrugge Terminals also has bold ambitions to make Vlissingen the new warehousing and logistics hub in northern Europe instead of Rotterdam.

“It’s an uphill battle because Rotterdam is well established and will fight back competitors, but I believe we can do better in Vlissingen,” Verbrugge said.

The terminals in Vlissingen are located in the economic heart of northwest Europe: on the North Sea, at the entrance of the Western Scheldt estuary. It is an ideal location for handling volumes of deep-sea cargo and transshipments that are bound for the rest of Europe, the company says on its website.

“The location is great but we also have better collaboration with port authorities and unions, cheaper rent and labor, and we have our own trucking line and barge, agency and customs department,” the director said.

The company, which owns 50% of the land and 100% of its warehouses in the Dutch city, still rents sheds to Access World but is now also competing with the Glencore-owned company. It is through this partnership that Verbrugge got hold of its first aluminium cargo from Russian producer Rusal in 2010.

With 1,200 employees, Verbrugge Terminals also has warehouses in the ports of Terneuzen in the Netherlands and Zeebrugge in Belgium and has ambitions in Shanghai for both wood pulp and metals, which could come to fruition in the next 18 months.

Base metals represent 15% of Verbrugge’s business. Wood pulp accounts for 35% and the rest is shared among fertilizers, minerals, paper, steel, tobacco and an offshore wind project.

PERRINE FAYE
The CME has seen significant growth in volumes from its non-US clients over the past year, global head of metals products Young-Jin Chang said at a press roundtable during LME Week.

While the exchange did not lay out concrete plans to expand its warehousing offerings, it did hint at areas in which it might be looking to establish new contracts - specifically precious metals and its new copper premium contract based on Metal Bulletin’s assessment of the physical premium for Grade A copper delivered to Shanghai. The CME also highlighted its approach to how it would consider its growth options. “We’re letting the customer dictate to us what they want to see us do,” according to Derek Sammann, CME senior managing director and global head of commodities and options products. Sammann characterized the exchange’s approach to growth as “incremental” and “careful.”

A spokesman for the CME did not respond to requests for comment on its warehousing plans. But if the growth in the exchange’s aluminium futures volumes are any indication, the CME is sizing up its options. The CME reported an all-time high of 25,766 open-interest lots for its US Midwest transaction contract as of November 21, while 13,889 open-interest lots were reported for its European aluminium premium contract.

The CME said last year that it would begin to list copper warehouses in Asia.

Meanwhile, the LME is focused on streamlining its warehousing operations. According to an LME spokeswoman, the exchange delisted 83 warehouses in 2017 while 54 were listed. In 2016, 92 warehouses were listed and 78 delisted. Additionally, the LME has focused on reducing its warehouse queues, with only three of its warehouses reporting wait times for metal.

In general, the LME said that its focus is to reduce its structural queues to zero as part of its reform program. “We are now working with warehouse operators to consider ways to enhance the attractiveness of LME-warranted storage,” the LME spokeswoman said on November 20.

The LME ran into issues in 2011 involving alleged warehouse manipulation to artificially inflate aluminium prices and premiums. Since then, the exchange has made a series of changes to restore the market’s confidence in the LME’s warehousing system.

Aluminium stocks at LME-listed warehouses in mid-November hit their lowest level since the first quarter of 2008.

KIRK MALTAIS
By using the existing contango - the positive price difference between two contract months, such as December 2017 and March 2018 - a trader can assess whether the spread between those prices is sufficient to gain a profit.

Warehousing costs, borrowing fees, logistical quagmires and the base cost of metal are the main components when traders assess whether a cash-and-carry trade is possible.

On the borrowing side, since the United States Federal Reserve lowered interest rates effectively to 0%, the cost of financing has been drastically lowered, and this has helped to produce these types of trades.

Why is it called cash-and-carry? Because at the purchase of the commodity, the buyer provides cash and at the selling point receives it back, plus whatever profit he earned.

How exactly does this work? Let’s say that Carl the copper trader sees the spread between the current spot market value of copper at $3 per lb and the March futures contract at $3.05 per lb.

After crunching the numbers, Carl believes he can buy copper today and store material in a warehouse for the next three months for an all-in cost of $3.02 per lb. This is a critical component, and the trade is only viable if the futures position exceeds the acquisition cost plus the cost of carrying the base metal for a set period of time.

But beware: As Carl buys the spot month and effectively sells the future month, the spread between those prices can narrow and make subsequent purchases less profitable.

**COST COMPONENTS**

One of the major price inputs in a cash-and-carry deal is the cost of warehousing. A common tactic for traders that benefits both them and warehouse owners is to negotiate lower monthly rates in exchange for a guaranteed storage period.

This provides the trader with higher ensured profits, while also allowing the warehouse owner to know exactly how much material he will store on a month-to-month basis.

But remember, this type of trade is only sustainable if the spot price is lower than the futures price. Luckily for traders, that has been the case throughout 2017, with a 2-cent contango leading Chicago Mercantile Exchange copper stocks to grow to their highest point since 2004.

CME copper stocks recently stood at 209,224 short tons, an increase of 150% compared with the corresponding month last year. While weak demand and even softer US copper premiums contribute to the warehousing buildup, without the existing contango those warrants would not be moving into warehouse sheds.

**MOVING FORWARD**

While cash-and-carry methodology is not vulnerable in 2018, the exact model is. Since this time last year, the Federal Reserve has raised its rates three times and is forecast to raise the Fed Funds borrowing rate next month to 1.50%.

Combined with increased freight costs, traders will see their input costs rise in 2018 and will need favorable warehouse rents or a wider contango to effectively administrate the trade.

Nevertheless, this primary trading strategy will adjust and continue as traders contend with new challenges, but buying low and selling high is not going to disappear.

DALTON BARKER
CWT Commodities to grow metals operations post-HNA acquisition

Warehouse and logistics company CWT Commodities is pushing ahead with ambitious growth plans in its metals products, among others, following its acquisition by Chinese conglomerate HNA Group, Metal Bulletin has learned.

“HNA bought CWT because of the ‘One Belt, One Road’ initiative and they are looking to grow that part of the business considerably,” a source close to the company said.

HNA’s subsidiary, HNA Holding Group Co Ltd, completed the purchase of Singapore-based logistics firm CWT Ltd on September 27 after a three-year negotiation deal was agreed and valued at more than $1 billion.

CWT Ltd includes CWT Commodities as well as commodity marketing company MRI Trading and financial services provider Straits Financial.

“They want to grow the business fourfold in five years, spread equally across the three companies,” the source said.

CWT Ltd declined to comment.

But, demonstrating its commitment to CWT, HNA announced on November 12 that HNA Holding Group would rebrand as CWT International and CWT’s activities would become core businesses following the acquisition, which Chinese state news agency Xinhua recently described as a “small but beautiful” deal.

“The board considers the proposed change to the company name will better reflect and align with the business and development strategy of the group,” HNA executive director Xu Haohao said in the filing.

For CWT Commodities, it is a green light to keep expanding the warehousing and logistics business outside the Singapore hub, Metal Bulletin understands.

As of November 1, the total warehouse space used for metals and other commodities reached 9.5 million square feet. This includes 6.3 million sq ft in Singapore, following the completion of a new mega integrated logistics hub that added up to 1.4 million sq ft.

CWT has also expanded its presence in Europe and the United Kingdom as well as Africa, especially in the southeast of the continent, with further expansion plans in the works worldwide.

“They have substantially increased their handling of metals in the last one to two years,” the source said.

The group closed its London office in October 2016, with Simon Maddocks and James Newman leaving the firm, but European operations are still growing.

In June, CWT Ltd acquired the remaining 30% shares in CWT Europe BV for nearly €13 million ($15.33 million) to fully own the subsidiary, which provides warehousing and logistics services for metals and soft commodities in the UK, the Netherlands, Belgium, Ivory Coast, Ghana and Turkey.

CWT Ltd has increased the size of its Rotterdam warehouses threefold to support its metals business.

The company remains committed to growing its business in the United States, potentially in cooperation with ex-joint venture partners Anton Posner and Margo Brock, who left CWT Commodities (USA) LLC in September to join T Parker Host, a US-based shipping agent and stevedores company looking to expand into metals logistics and warehousing.

With 10 warehouses approved to handle metals traded on the London Metal Exchange, CWT remains committed to its LME business, although LME warehousing is “no longer attractive” at present, the source said.

Currently, base metals account for around 50% of CWT Commodities’ product base and 84% of MRI’s business.

CWT Ltd’s revenues increased 27% on an annual basis to $8.3 billion ($6.2 billion) for the nine months ended September 30, mainly due to higher commodity prices. Revenues dropped slightly in 2016 to $9.252 billion versus $9.932 billion in 2015 and a peak of $14.194 billion in 2014.

PERRINE FAYE
Rising US interest rates not expected to impact metals financing

The benchmark interest rate in the US stands at 1.1.25%, with the Federal Open Market Committee's (FOMC) next vote on a rate increase expected during its mid-December meeting. The FOMC is widely expected to raise rates again.

The main reason why rising interest rates would not have an impact is because they are only a small portion of the total cost of financing metal, market participants said. If metal were to be taken off-warrant because of cost, rent would likely be the culprit, as well as the spot price and insurance.

“No interest rate is going to overcome the difference between the rent of London Metal Exchange on-warrant and off-warrant,” one banking source said.

One warehousing company was “forced” to decrease the amount of LME business it did due to the fees, a source from the company in question told American Metal Market.

“We are now more focused on off-warrant metals and logistics as well as other commodities. Base metals are still three quarters of our portfolio, but the LME is less than 10%,” he added.

Even if interest rates rise or remain steady, “unless somebody needs [metal] on-warrant, there’s no reason to hold it on-warrant,” a second warehousing source said, noting that increasing amounts of metal are moving out of LME warehouses in order to be held off-warrant at a cheaper price.

The financial benefits of putting material on-warrant, if there was a backwardation in the market for example, are not likely to outweigh the cost of moving material back on-warrant and the rent fees, one metals trader said. “The gains might not be enough to put it back on-warrant,” the trader added.

The interest rate has been taken into account by some companies, since it does contribute to the cost of financing material, one producer said, but, “any price increase of significance is a deterrent to maintaining or expanding warehouse usage,” he noted.

If costs do rise, the aforementioned producer’s company will make an effort to, “slow warehouse shipments and accelerate customer deliveries,” the source said.

Indeed, the LME has acknowledged the flow of material to off-exchange platforms and is hoping that an over-the-counter booking fee will help limit the movement.

Another reason for higher rates’ minimal impact: While rates go up, “the spreads tend to widen to reflect the higher cost of financing [and] the market adjusts for higher rates by the contango moving out,” INTL FCStone metals analyst Edward Meir said.

Stock movements will be more affected by the arbitrage between different markets and market fundamentals, such as general supply and demand variables and the interplay between the mine level and the refined level, Meir said.

Another factor that will hold sway is the Chinese traders’ advantage over traders in western markets. Chinese traders have an edge due to the high frequency of domestic trades taking place in China.

The contango would reflect any movements in the interest rate, the first warehousing source agreed, noting that, “in theory, nothing should change.”

But rising interest rates are an indication that the economy is performing well, which should lead to an uptick in metal consumption and therefore less metal being stored, the same source said, adding, “it’s better to not hold metal when the economy is doing well.”

MILLICENT DENT
Logisminsa gets bonded warehouse approval, will build underground lead concentrates storage

Peru’s first independent metal concentrates warehouse and blending facility is targeting growth and a new storage space for lead in 2018, senior consultant Victor Way said in an interview with Metal Bulletin.

Part of the Miscon Group, Logisminsa opened for business in March, providing alternative warehousing services beyond the Trafigura-Glencore-Louis Dreyfus triumvirate in Callao, Peru’s main trading port. Some medium-size traders have already run trials of blends at the plant.

While environmental legislation becomes stricter in Peru, the additional ability to house lead concentrates should make an often opaque industry more transparent, Way said.

“This year we are just at the beginning. Out of the 15 main traders, we have signed already with eight. We expect to start receiving bulk minerals in January 2018, but in the meantime we are preparing our offering as a legally protected warehouse,” he said.

Located in Ventanilla, which is 14 km from Callao, Logisminsa was given approval to be registered as a custom bonded warehouse on November 22, meaning that material can be stored and exported without having to be transferred to other terminals in advance.

“There was a need for us to provide our clients the security - not only the quality of services but also legal security. The authorities are initiating a campaign [to inspect] all the warehouses in Callao, so that means that the matter is serious,” Way said.

DIGGING IN

Storing and blending lead concentrates requires an individual building to ensure no environmental contamination takes place. This is ordinarily done by constructing a hermetically sealed warehouse and applying pressure to lock material in.

But Logisminsa is applying a different method, digging an underground vault and letting gravity at high altitude - the operation is located in a ring of hills - to maintain appropriate conditions.

“We are approved to store copper, zinc and lead, but lead needs a special building,” Way said.

Construction will start early next year and will take four to six months to complete.

“This new design has less of a negative environmental impact, so we expect it to be approved in a short time,” Way said.

The ability to blend and store lead concentrates at source could lead to more competitive terms for base metal concentrates in Peru, several sources told Metal Bulletin in August.

Treatment charges (TCs) for zinc and lead concentrates are at the lowest in recent memory - a tender for Volcan high-silver lead concentrates went at a negative TC (or premium) of $50 per tonne in September.

REGULATION GETTING STRICTER

Logisminsa intends to expand to capacity of 220,000 tonnes next year from current capacity of almost 150,000 tonnes.

This reflects the recognition that facilities that store concentrates, which can be highly poisonous, are unlikely to be permitted to remain in the increasingly urbanized Callao.

“The quality regarding environmental and social standards are low, so now we are building with high quality and improving the technology to provide more efficient services,” Way said.

“The authorities are trying to put some order into the industry, and in a few years [older firms may] have to relocate - this is the reason why we are thinking [for the] long term,” he added.

Peruvian authorities are also starting to crack down on illegal storage and on the blending of concentrates outside prescribed warehouses with the proper permits.

“We expect when miners and traders see we have the legality and technical know-how we will receive more material,” Way said.

ARCHIE HUNTER
Decades of change in LME warehousing

Since the 2008 financial crisis and the influx of aluminium into warehouses for financing purposes, LME-approved warehouses have cashed in on the queues that have built up.

Complaints about soaring premiums and long wait times to receive metal prompted parent company HKEX’ chief executive officer, Charles, Li to take a “bazooka” to the queues in 2012.

After a flow of new regulations, consultations and legal tussles, several trading houses walked away from the LME warehousing business, to be replaced with new names.

This year marked the disappearance of the queues to take metal out of LME warehouses in Vlissingen for the first time in six years. While the wait time has evaporated, so too have stocks held on the exchange, posing a new challenge to attract material back to registered sheds.

Below is a list of key events shaping the past, present and future of the LME warehousing industry:

LATE 1980S
LME ring-dealer Metallgesellschaft acquires fellow ring-dealer and warehouse Henry Bath and Co from Australia’s Mount Isa Mines (MIM)

2000
Enron plc, part of US giant Enron Corp, buys trader MG plc, the UK-listed former Metallgesellschaft. The deal includes the warehousing operation

JANUARY 2002
Sempra Energy agrees to pay about $145 million for Enron Metals, which was liquidated after the Enron Corp scandal. Again, the deal includes Henry Bath

APRIL 2008
Royal Bank of Scotland (RBS) and Sempra Energy form commodities-marketing joint venture RBS Sempra Commodities

SEPTEMBER 2008
Lehman Brothers collapse ushers in the era of virtually zero interest rates and cheap money that unlocks the potential to finance vast tonnages of warehouse metal profitably
LME aluminium stocks total 1.33 million tonnes. Detroit holds 199,000 tonnes, Vlissingen 52,600 tonnes. The cash aluminium contract is at $2,390 per tonne

FEBRUARY 2010
Goldman Sachs buys US-based warehouse and logistics company Metro International Trade Services for about $550 million. Detroit is its main location - it accounts for 883,000 tonnes of the total LME stockpile of 4.55 million tonnes of aluminium

MARCH 2010
Commodities trader Trafigura acquires metal warehousing company NEMS Ltd
Waiting time to remove aluminium under cancelled LME warrants in Detroit is around four months

AUGUST 2010
Glencore International AG acquires the metals warehousing business of Italy’s B Pacorini Srl. The firm’s Vlissingen location holds 62,250 tonnes out of a total 4.48 million tonnes of aluminium

OCTOBER 2010
LME, under CEO Martin Abbott, commissions independent consultancy Europe Economics to carry out far-reaching study of its warehousing system.
Cash aluminium is at $2,300 per tonne, while the key US Midwest physical premium stands at $145 per tonne

MAY 2011
LME says it will change the minimum amount of metal that a warehouse is obliged to deliver out following Europe Economics’ review. Proposals are due for formal approval at its June board meeting and set for April 2012 implementation
LME aluminium stocks total 4.68 million tonnes, with 1.15 million tonnes in Detroit and 303,000 tonnes in Vlissingen

JUNE 2011
US-based law firm Hagens Berman Sobol Shapiro LLP which specializes in class-action litigation, solicits potential claims against the owners of large warehousing companies. It looks at whether antitrust laws are being violated and whether warehouse owners’ activities constitute aluminium price manipulation
LME board mandates revised load-out rates: they stay at 1,500 tonnes for warehouse companies holding less than 300,000 tonnes of metal in one location, rise to 2,000 tonnes from those holding between 300,000 and 600,000 tonnes and climb to 2,500 tonnes for those holding between 600,000 tonnes to 900,000 tonnes. Above 900,000 tonnes the new rate is 3,000 tonnes. LME board rejects Europe Economics’ recommendation of a 6,000-tonne daily rate

JUNE 2011
The queue in Detroit for delivery of cancelled warrant aluminium is some six months

AUGUST 2011
UK warehouse operator Eurus Metals approved to store LME-registered metals at Hull in the United Kingdom

JANUARY 2012
Detroit queue for aluminium is seven months; for Vlissingen it is 10 months

APRIL 2012
LME amendments come into force. LME warehouses hold 5.07 million tonnes of aluminium, with 1.42 million tonnes in Detroit and a queuing time of 10 months.
There are 1.04 million tonnes in Vlissingen and a 14-month queue. Aluminium cash price is $2,095 per tonne. US physical premium is $210 per tonne

JULY 2012
LME shareholders vote to accept £1.388 billion ($2.15 billion) bid from Hong Kong Exchanges and Clearing Ltd (HKEX)
Trafigura’s Impala Terminals lists nine new LME warehouses in Antwerp between July and September 2012

OCTOBER 2012
HKEX CEO Charles Li says he will take a “bazooka” to warehousing issue if required

NOVEMBER 2012
Reports circulate that the European Commission plans to discuss warehousing with its Internal Market and Services Directorate General (DG MARKT).
LME says it has not been notified

FEBRUARY 2013
Brussels-based European Aluminium Association (EAA) says it is looking at ways of increasing market visibility

DECEMBER 2017
In a second lawsuit, aluminium user Master Screens accuses LME, alongside Glencore Xstrata, JPMorgan Chase & Co and Goldman Sachs, of market manipulation and anti-competitive practices. LME says the suits are without merit and it will contest them.

Viva Railings and Regal Recycling file a class action, alleging that Goldman Sachs hoarded aluminium in its Metro International warehouses to inflate prices artificially.

September 2013
Russell UC Rusal calls on LME to postpone warehousing changes, saying these could distort the market.

Further lawsuits filed in US, including by door and glass enclosure manufacturer Peterson Industries and aluminium extruder Talan Products.

Garry Jones takes over as LME CEO on September 30.

US physical premium is at $220 per tonne at the end of September, while the cash aluminium contract is $1,803 per tonne. Detroit holds 1.46 million tonnes of aluminium, with a 15.5-month queue, while there are 2.03 million tonnes in Vlissingen and a similarly static 17-month queue. Total LME stocks stand at 5.38 million tonnes.

November 2013
After a lengthy consultation period on how best to tackle warehouse queues, the LME says it will implement a load-in/load-out (LILO) policy. Under the rule changes, all metal loaded into a warehouse over a three-month period is measured. If there is a queue of more than 50 calendar days, the affected warehouse would be expected to deliver out additional metal based on a formula.

December 2013
Rusal seeks to challenge LME’s decision to change its warehousing policy, alleging that the consultation was unfair and procedurally flawed, that the proposed changes are irrational and disproportionate and that Rusal’s human rights had been breached.

Metro founder Bill Whelan applies to rejoin LME warehousing network. The newly formed company is named ISTIM.
intensive legal scrutiny to ensure consultation into QBRC to capping (QBRC). The exchange introduce queue-based rent approved warehouses and to for metal stored in exchange-

consultation on recommendations LME launches a market-wide

JULY 2015 warehousing reforms level of influence over LME says it has not yet made a decision on the capping of rents for metal stored in listed warehouses

FEBRUARY 2015 LME says it will introduce fresh regulations and carry out further discussions with the market concerning the storage of metal

MARCH 2015 LME says it has not yet made a decision on the capping of rents for metal stored in listed warehouses

APRIL 2015 CFTC officially defers an application from the LME to register as a foreign board of trade (FBOT), citing worries that the exchange has not yet made enough progress on warehouse reforms

JUNE 2015 Alcoa asks CFTC for documents that relate to the regulator's level of influence over LME warehousing reforms

JULY 2015 LME launches a market-wide consultation on recommendations to load-out rate increase (LORI) for metal stored in exchange-approved warehouses and to introduce queue-based rent capping (QBRC). The exchange submitted its proposed consultation into QBRC to intensive legal scrutiny to ensure that it could stand up in court

FEBRUARY 2016 Two warehouse operators reduce their proposed 2016-2017 LME fees, lowering the average increase in warehouse rent among LME-registered warehouses to 7% from the previous average of 10%. After the LME offers a “one-off” two-week window to do so

MARCH 2016 Warehouse operators registered with the LME brace for an extended struggle with the exchange over its proposal to implement CC on rents and fots

APRIL 2016 Market participants warn that the current ease with which LME price spreads can be squeezed into backworkings will be exacerbated if the exchange implements its proposed reforms. As well, aluminium stock levels in the LME warehouse system could slump. LME might struggle to get approval for and then implement its proposed changes to a system where the rent charge is met by the seller rather than the buyer. In the same month, LMEcushiohn, an electronic warehouse receipt system for the global commodities market, is introduced

MAY 2016 LME “anticipates” a further fall in aluminium stocks in listed warehouses this year after the introduction of QBRC and does not feel this will affect price discovery

JULY 2016 Glencore-owned Pacorini Metals changes its name to Access World. LME will not consult on fot conversion as part of its warehouse reform due to lack of appetite. Market participants did not expect the exchange to push ahead with changes.

LME initiates a market-wide consultation proposing to control warehouse costs by imposing caps on maximum charges from April 1, 2017. The exchange proposes to set the initial schedule of maximum rates for warehouse rents and fots charges by calculating the average of the highest published charges for the years 2015-16 and 2016-17 on a per-metal and per-country basis.

Metro International agrees to pay a $10 million settlement to the LME for alleged breaches of the exchange’s warehouse agreement. The alleged breaches were in relation to transactions made over September 2010-2013

SEPTEMBER 2016 LME decides to implement CC measures for warehouse operators as the final part of its reform program. The schedule of charge caps will be frozen for five years, during which time “real-world” prices are expected to converge closer with the frozen published rates. After that, the maximum prices will be updated annually, based on the per-country CPI

SEPTEMBER 2016 LME says it understands that some market participants see its new warehouse regulations as too complex but it also worries that future attempts to streamline them might muddly the waters further

JANUARY 2017 Jones retires as LME CEO

APRIL 2017 Matthew Chamberlain is appointed LME CEO.

CC comes into effect

Access World agrees to pay $1.4 million plus costs to settle disciplinary issue

Chamberlain says nothing more need done in warehousing reform terms and that warehouses have passed through their “painful period” despite stocks falling in some cases to their lowest since 2002

JUNE 2017 Noble Group sells bulk of its non-ferrous metal warehouse business WWS to Golden Dragon Resources for $4.7 million

JULY 2017 LME tin stocks plummet to 1,635 tonnes on July 5, their lowest since the 1980s

SEPTEMBER 2017 Queue to take aluminium and other metals out of LME warehouses in Vlissingen vanishes for the first time in six years

OCTOBER 2017 Aluminium stocks at LME-listed warehouses hit their lowest since the first quarter of 2008
The biggest warehouse frauds of recent times

In the detailed timeline below, Metal Bulletin reviews key dates and events related to the 2014 Qingdao scandal and the nickel warehouse receipts forgery that broke out this year.

The Qingdao scandal in China, which involved the fraudulent use of warehouse receipts multiple times to raise finance, led to significant changes to the way the metals industry operates.

Credit became tighter and several upgrades to security features on warehouse receipts were made.

Even so, another warehouse fraud in Asia has since shaken the metals industry, this time involving Access World nickel warehouse receipts.

QINGDAO SCANDAL

**JUNE 2014**
Qingdao blocks the shipment of some material while investigating the allegedly fraudulent use of warehouse receipts multiple times to raise finance.

The investigation into allegations of missing material and double- or triple-pledged metal in Qingdao is focused on bonded warehouses in the Dagang port terminal rather than other non-bonded and bonded areas.

Several western banks, including Standard Bank, Standard Chartered and Citi, say they are monitoring or reviewing their financing activities in Qingdao.

**JULY 2014**
Chinese state-owned company Citic Resources Holdings files a claim in the Qingdao Maritime Court against the operator of a bonded warehouse at Qingdao port in an attempt to recover its alumina and copper.

In Shanghai, copper premiums and prices firm in response to a tightness that was partly the result of the postponement or rerouting of shipments.

**AUGUST 2014**
Glencore’s warehousing division sues Qingdao Port over undelivered aluminium. The port is also named as a party in a lawsuit brought by ABN Amro.

Shanxi Coal Import & Export, a Shanxi Coal International unit, files a claim against a subsidiary of Citic Resources Holdings for $89.75 million plus interest for undelivered aluminium ingots.

**SEPTEMBER 2014**
Qingdao Port International says about 400,000 tonnes of material, including 300,000 tonnes of alumina, 20,000 tonnes of copper and 80,000 tonnes of aluminium ingots, are involved in the fraud.

**DECEMBER 2014**
The arguments from banking firm Citi and trading company Mercuria over who should face the $270-million exposure from financing deals linked to metal held at Qingdao have now been heard.

**MARCH 2015**
Impala Warehousing & Logistics (Shanghai) Co Ltd and Wanxiang Resources (Singapore) Pte Ltd battle it out in UK courts after Impala Shanghai brings a claim against Wanxiang to have a mandatory anti-suit injunction imposed.

Impala Shanghai is granted in principle the anti-suit injunction to prevent Wanxiang from pursuing proceedings against Impala in Shanghai.

**MAY 2015**
UK High Court makes a judgment in in the dispute between Citibank and Mercuria Energy over missing metal in Qingdao.

**AUGUST 2015**
The People’s Bank of China (PBoC) slashes interest rates four times between November 2014 and July 2015, during which time it also lowers the bank deposit reserve ratio requirement, alongside other efforts to inject funds into the banking system to beef up the local economy.

Many Chinese metal companies are struggling to secure credit in the aftermath of the Qingdao scandal.

**OCTOBER 2015**
London Metal Exchange offers a new electronic audit system for warehouse receipts called LMEShield that can in due course be used by warehouses that need not be LME-registered.

But access to China is crucial for LMEShield to gain traction.

**NOVEMBER 2017**
C Steinweg Group launches a new online platform to support the digitization of metal warehouse receipts in Asia aimed at reducing the risk of fraud associated with paper documents.

**DECEMBER 2017**
C Steinweg Group launches a new online platform to support the digitization of metal warehouse receipts in Asia aimed at reducing the risk of fraud associated with paper documents.
Glencore-owned warehouse company Access World revealed at the end of January 2017 that forged warehouse receipts bearing its name were in circulation in South Korea and Malaysia.

While there were initial concerns that this could be a widespread fraud, it became clear that it was relatively contained in Asia, affecting only nickel stocks held by Access World.

No nickel has physically been delivered against the forged receipts, which is a key difference from the Qingdao scandal.

But the banks that agreed to finance the fake copies were again the main financial victims, with known financial losses exceeding $300 million.

The Access World nickel receipt forgery relates to complex transactions including Chinese asset monetization, repurchase agreements (known as repos), receipt endorsement and financing deals.

It also has multiple people involved in numerous locations, with its trail leading from warehouse companies in Malaysia, South Korea and Singapore to trading companies in Hong Kong and California, an asset owner in China, and banks and brokers in London and Australia.

Here is Metal Bulletin’s review of the timeline of key events linked to this fraud:

**JUNE 2016**

Straits (Singapore) Pte Ltd, the trade facilitation arm of Straits Financial Group, which itself is wholly owned by CWT Group, is issued with the original legitimate nickel warehouse receipts by Access World.

At some stage between 2016 and January 2017, copies of Straits’ nickel warehouse receipts are illegally made by unidentified parties and used to raise finance from banks.

Such fake copies, of which Metal Bulletin obtained samples in March 2017, showed Straits (Singapore) Pte Ltd in the first endorsement box dated early June 2016 and a Hong-Kong based entity in the second endorsement box three days later.

**JANUARY 2017**

A receipt brought in by London-based Marex Spectron failed authentication from Access World, revealing the forgery to the industry and prompting more receipt holders to come forward to check whether their documents were genuine or not.

Access World reveals that forged warehouse receipts bearing its name are in circulation in Asia, with issues reported in Korea and Malaysia.

The London Metal Exchange then calls on warehouse operators not to warrant metal where ownership could be disputed, including any possible links to forged warehouse receipts such as those reported by Access World.

**FEBRUARY 2017**

Straits Singapore confirms that it held the original Access World nickel warehouse receipts that were copied illegally.

**MARCH 2017**

Australia’s ANZ and France’s Natixis are identified as being among the banks that agreed to provide cash against the forged warehouse receipts.

Amid the heightened risk awareness, it becomes even harder for metal traders to secure fresh finance.

Brokerage companies Marex Spectron and EDF Man are caught up in the scheme, sounding the alarm for base metal brokers active in brokering repos and other financing deals.

**MAY 2017**

Legal proceedings begin, with Natixis filing a lawsuit against Marex Spectron to recover $32 million in losses related to the fraud.

The case pertains to five spot purchase contracts - three of them done in a joint trade - between November 22, 2016 and January 10, 2017, covering a total of 16 receipts for nickel stored in Access World warehouses in Gwangyang, Korea, and Johor, Malaysia, all of which were found to be forgeries, Natixis says.

**JUNE 2017**

Marex Spectron files a defense, claiming no liability in the case filed by Natixis and dragging warehouse operator Access World into the lawsuit for having allegedly incorrectly authenticated forged documents as genuine.

ANZ initiates separate legal proceedings in the United States, Hong Kong and Singapore to try to gather information and find the culprits of the fraud.

The claims pertain to 31 transactions concluded with London-based brokerage EDF Man Capital Markets Ltd between May 5, 2016 and October 11, 2016, covering a total of 84 nickel receipts stored in Access World warehouses in Singapore, Johor and Busan, of which 83 are believed to be forgeries.

In turn, EDF Man Capital Markets received those 83 receipts from two Hong Kong companies. The sole genuine receipt had as the first order party the US-based consultancy Genesis Resources Inc.

ANZ and EDF Man Capital Markets subsequently reach an out-of-court settlement outside the court. According to ANZ, any forgery would have taken place prior to the receipts being delivered to EDF Man.

**JULY 2017**

IHS Markit launches a digital tracking system for physical metals inventory, intended to update the way in which trading companies reconcile their inventories, which is currently a manual process.

**OCTOBER 2017**

Access World says in court documents it is not liable for damages in the $32-million nickel fraud lawsuit between Marex Spectron and Natixis.
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