



U.S. COMMODITY FUTURES TRADING COMMISSION

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Aluminum Futures Market CFTC Staff Report

This document and the attached Aluminum Futures Market CFTC Staff Report is responsive to Congressional Directives of Division A - Agriculture, Rural Development, Food and Drug Administration, and related Agencies Appropriations Act 2022, accompanying H.R. 2471, the Consolidated Appropriations Act 2022, (P.L. 117-103). Specifically, within 180 days of enactment of this Act, the CFTC is directed to issue a public report on factors affecting the aluminum commodities market.¹

This Aluminum Futures Market CFTC Staff Report and the attached slides do not contain data or information that would separately disclose the business transactions or market positions of any person and trade secrets or names of customers. *Cf.* Section 8(a) and 8(e) of the Commodity Exchange Act (“CEA”), 7 U.S.C. § 12(a), (e). This Aluminum Futures Market CFTC Staff Report is based upon cash and futures market information available to staff as of June 30, 2022, and any different, changed, or omitted facts or circumstances may require additional analysis. Staff also notes that access to proprietary data and premium calculations or trade methods could bring different observations. Every effort has been made to ensure data accuracy.

Background

For non-ferrous metals like aluminum, the Shanghai Futures Exchange (“SHFE”) and LME are the leading futures exchanges. The LME is a registered FBOT with the CFTC, which allows participants located in the United States direct access to electronic order entry and trade matching systems (see section on CFTC’s Authority below). The COMEX lists various aluminum futures contracts for market participants including end users and producers.²

The London Metals Exchange’s (“LME”) aluminum contracts are a primary price discovery market for global aluminum prices. LME’s registered Foreign Board of Trade (“FBOT”) status gives U.S. customers direct electronic access to its markets. All-in reference prices in the U.S. are derived by adding a location differential to the LME price. Price Reporting Agencies (“PRAs”) publish price

¹ “Market surveillance oversight.—Last year, the Committee requested CFTC to look into the aluminum futures market. The Committee remains interested in CFTC’s review of aluminum futures markets and its impact on pricing for aluminum end users and directs CFTC to provide a report to the House and Senate Committees on Appropriations within 60 days of the review’s completion. The Committee expects CFTC’s market surveillance branch to take prompt action, if warranted, to ensure that aluminum end users are protected from fraud, manipulation and abusive practices that are prohibited by the Commodity Exchange Act.” H.R. Rep. 116-446 (2020).

² COMEX lists one physically delivered aluminum future, plus various financially settled contracts. *See* <https://www.emegroup.com/trading/metals/aluminum-futures.html> for more information on these products.

assessments for location differentials. In the U.S., the predominant aluminum differential is the Midwest Premium (“MWP”). Futures trading in U.S. aluminum futures contracts is primarily in the Chicago Mercantile Exchange’s Commodity Exchange (“COMEX”) MWP futures contract.

Reference points for prices for physical metals that are traded globally, such as aluminum, consist of two components: a global benchmark price plus a locality differential. The differential is designed to reflect changes in price due to local supply-demand conditions, such as transportation costs, and directly affects the all-in reference price for delivered metal. In the U.S., the predominant locality differential is the MWP.

Several PRAs publish spot or price assessments for a variety of commodities. S&P Global Platts, a division of S&P Global Inc (“Platts”), and Harbor Aluminum Intelligence Unit LLC (“Harbor”) are two PRAs that publish aluminum MWPs. The COMEX lists the Aluminum MW U.S. Transaction Premium Platts (25MT) (“COMEX MWP”), financially settled futures contract where the final settlement value is based on the Platts MWP.

COMEX contracts, including the COMEX MWP, represent less than 1% of global aluminum financial markets in notional value. According to the LME, daily volume for LME aluminum futures averages 200,000 contracts per day.³ Based on COMEX data submitted to the CFTC, the average daily volume across all of COMEX’s aluminum futures for the calendar month May 2021 was 1,088 contracts per day.

The CFTC’s Authority

The CFTC holds primary regulatory authority over Designated Contract Markets (“DCMs”) and Swap Execution Facilities (“SEFs”). These markets are registered with the CFTC and required to comply with many core principles and associated CFTC regulations that govern the operation of their facilities.⁴ All DCMs and SEFs are required to either self-certify to the Commission that new contracts comply with the CEA and CFTC regulations or submit those contracts to the CFTC for review and approval before offering them for trading.⁵ Particularly relevant here, Core Principle 3 for both DCMs and SEFs requires that these entities list only contracts that are not readily susceptible to manipulation.⁶ In addition, Appendix C to Part 38 of the CFTC’s regulations provides non-binding guidance for use in determining whether a contract is readily susceptible to manipulation.⁷

The Appendix C guidance states that when evaluating the susceptibility of a cash-settled contract, such as the COMEX MWP, to manipulation, the DCM should consider the size and liquidity of the underlying cash market and design the terms and conditions of the contract to avoid any impediments to convergence. 17 C.F.R. pt. 38 App. C. For cash-settled contracts, Appendix C notes

³ For additional information on LME aluminum, see <https://www.lme.com/-/media/Files/Education-and-events/Online-resources/Brochures/Non-ferrous/LME-Aluminium-factsheet.pdf?la=en-GB>

⁴ For DCMs, see CEA section 5(d), 7 U.S.C. § 7(d) and 17 C.F.R. Part 38; for SEFs, see CEA section 5h(f), 7 U.S.C. § 7b-3(f); 17 C.F.R. Part 37.

⁵ 17 C.F.R. §§ 40.2-40.3.

⁶ For DCMs, see CEA section 5(d)(3), 7 U.S.C. §5(d)(3); 17 C.F.R. § 38.200 (2012). For SEFs, see CEA section 5h(f)(3), 7 U.S.C. § 7b-3(f)(3); 17 C.F.R. § 37.300 (2013).

⁷ 17 C.F.R. Part 38, Appendix C. CFTC regulation 37.301 notes that this guidance is also applicable to SEFs. 17 C.F.R. § 37.301.

that DCMs should give appropriate consideration to the commercial acceptability and robustness of the cash price series. Also, each cash-settled contract's price series should be based on publicly available prices and should be available on a timely basis for calculating the cash settlement price at the expiration of the commodity contract.

The CFTC's Division of Enforcement furthers the CFTC's mission to protect market users and the public from fraud, manipulation, and abusive practices that are prohibited by the CEA. In addition, analysts within the Market Surveillance Unit of the Division of Enforcement work to detect potential violations, which are then referred to an investigative team within Enforcement. While the CFTC does not have direct regulatory authority over cash metals markets, it does have authority to address fraud or manipulation in those markets.

LME is regulated by the Financial Conduct Authority ("FCA") in the U.K. It is registered with the CFTC as an FBOT only for the purpose of permitting direct access trading for U.S. persons, and the CFTC's oversight of LME is limited to the aspects of this direct access.⁸ LME has been able to offer its aluminum contract for direct access trading since receiving a staff no-action relief letter on March 12, 2001 (CFTC Letter No. 01-11). That letter was superseded by an Order of Registration issued pursuant to CEA section 4(b)(1) and Part 48 of the CFTC's regulations on October 31, 2016. Should it be deemed necessary, the CFTC, under Part 48, can impose additional requirements and conditions on the direct access trading and could, under the worst scenario, revoke the Order, thereby prohibiting trading by direct access.⁹ It should be noted that prohibiting direct access trading does just that, and U.S. persons could continue to trade LME contracts by other means.

The CFTC and the FCA are both signatories to the International Organization of Securities Commissions (IOSCO) Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information (MMoU), revised May 2012, and the IOSCO Enhanced MMoU (EMMoU), dated 2016. The MMoU and EMMoU enable the CFTC to request the FCA's assistance in obtaining data from the LME in connection with enforcement investigations.

Neither commodity warehouses nor PRAs, such as Platts or Harbor, are registered with the CFTC in any category of registration or oversight. The CFTC, therefore, has no direct regulatory authority over warehouses, wherever located, or their provision of commodity information. Nor does the CFTC have direct authority over the PRAs such as Platts or Harbor. However, as noted above, the CFTC has enforcement authority for commodities in interstate commerce and can bring actions, as appropriate, for manipulative activity, including false reporting, and fraud.—Further, CFTC-registered DCMs and SEFs may have contractual arrangements with both warehouses and PRAs in connection with their marketplaces. If such arrangements were to impact the ability of a DCM or SEF

⁸ CFTC Regulation 48.2(c) defines direct access as "an explicit grant of authority by a [FBOT] to an identified member or other participant located in the United States to enter trades directly into the trade matching system of the [FBOT]." 17 C.F.R. § 48.2(c).

⁹ In 2014-15, CFTC staff held frequent dialogue with LME's senior leadership, as well as with UK regulatory authorities to understand LME's perspective on aluminum contract and warehouse issues, and to assess LME's proposals for resolving such issues. Within the limits of its jurisdiction over LME as an FBOT, CFTC staff made recommendations for addressing issues in the aluminum contract and related warehouse practices, and encouraged LME to move promptly to address problem areas. CFTC staff monitored market conditions, LME's implementation of responsive measures, and legal developments in UK courts that impacted the scope and timing of any responsive measures to be undertaken by LME.

to comply with its respective regulatory obligations, such compliance issues would come within the CFTC's authority and oversight responsibility.

Contacts

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