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Mr. Matthew Chamberlain
CEO: matthew.chamberlain@lme.com
London Metal Exchange
10 Finsbury Square
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Dear Mr. Chamberlain:

The unprovoked Russian invasion of Ukraine, and the resulting international sanctions imposed on Russian industry, has led Alcoa to suspend its relationships with Russian customers and suppliers. Based on recent public reporting, we understand that several other industry participants have made their own decisions on this issue, including Novelis, one of the world's largest purchasers of aluminum, which announced earlier this month that it "will not accept Russian metal in potential new deals to supply its European factories in 2023," as well as Norsk Hydro and others that announced similar bans earlier in 2022. In our own commercial dealings with customers, most have stated clearly that they will not accept delivery of Russian-origin metal. Alcoa is writing to you to address the impact that the Russian invasion is having on aluminum consumers and producers and, specifically, the risk that it presents to the competitive marketplace that the LME seeks to create.

The LME has established itself as an important and reliable source of market-driven pricing information for aluminum products. The political and economic turmoil created by the Russian invasion, however, threatens to distort market pricing and raises a systemic risk to the LME aluminum contract. As 2022 supply contracts expire, historic consumers of Russian metal reportedly are not renewing contracts into 2023. Additionally, many banks have indicated they will not finance Russian metal or insure Russian shipments, likely making traders unwilling to add Rusal brand material to their physical positions. Already, Alcoa has observed that spot sales of Russian-origin aluminum can trade at discounts exceeding 10% when compared with other brands with the same chemical composition. These developments threaten to create a two-tiered market and undermine the reliability of the LME aluminum contract. Alcoa believes that it is critical for the LME to act now and delist Rusal to protect both the reputation and the viability of the LME aluminum contract.

We believe that this situation will likely worsen in the next few months. Alcoa estimates that Rusal's annual primary aluminum production is approximately 4.1 million metric tons, of which approximately half has historically been value-add products and the other half P1020A. As we move into 2023 and adjust for the announced customer sanctions against Russian-origin metal, it is easy to see a scenario where well over one million metric tons per year of Rusal metal could be put on warrant. As Russian-origin inventory increases throughout the year, along with a commensurate increase in the proportion of Russian-origin metal versus total stocks, the LME aluminum contract will be distorted because it will disproportionately reflect the discounted value of the Rusal brand rather than reflecting the broader P1020A contract.

Moreover, further distortion is likely to result from the high financing cost of tom-next warrants. The forward curve will be forced into a contango regardless of the underlying physical supply and demand balance for primary aluminum.

Given the limited demand for Russian-origin metal, Alcoa expects that Rusal will be forced to use the LME warehouses as its market of last resort, a strategy previewed in a recent Bloomberg news article: https://www.reuters.com/markets/commodities/Russian-aluminium-giant-rusal-mulls-selling-directly-lme-bloomberg-news-2022-09-20/. When this occurs, the dysfunction of the LME aluminum contract will gradually worsen as Rusal inventories increase in LME warehouses. For example, if one million metric tons of Rusal aluminum is on warrant and 300,000 mt of other brands make up the total on warrant inventory, a buyer looking to access the "good" warrants would need to spend more than $2 billion or pay an excessive premium to obtain non-Russian LME warrants. Banks will be highly unlikely to finance this trade.

We hope that the LME has been closely monitoring these developments, as others in the aluminum trading business have been, and acts quickly to delist Rusal as a deliverable brand. Without immediate action, the LME aluminum contract will be disproportionately influenced by one brand that much of the Western world has rejected and will not properly reflect the actual supply and demand dynamics of the aluminum industry. In that scenario, we do not believe that global aluminum industry participants would be willing to continue to rely upon, or invest in, the LME aluminum contract. Alcoa, for one, would have serious concerns about any pricing mechanism that no longer accurately reflects the fundamentals of the aluminum industry and the demand for non-Russian-origin metal that customers require. Alcoa urges the LME to take action to avert this impending crisis.

Sincerely,

Kelly Thomas

Kelly Thomas
EVP & Chief Commercial Officer

cc: Ms. Georgina Hallett