

Frequently asked questions July 2020

In line with the requirements detailed in MiFID II/MiFIR, the London Metal Exchange (LME) is obligated to introduce new rules to ensure that market participants adhere to pre-trade transparency (PTT) regulatory requirements

office trading venue.

1. What is pre-trade transparency?

MiFID II / MiFIR introduced substantially expanded requirements for pre and post trade transparency in order to minimise dark pool trading venues. PTT refers to the requirement to make public all current bids, offers and actionable indications of interest which, in the office trading venue prior to trading.

2. Which trading venues are affected by PTT?

All commodity trading venues regulated under MiFID II/MiFIR Article 8(1) (for non-equity instruments) are subject to the pre-trade transparency obligations.

The open-outcry trading floor (the Ring) and the electronic trading system (LMEselect) are already considered to be compliant with these requirements. The open-outcry (telephone) market has been deemed non-compliant, the LME has decided to implement a new solution in order for pre-trade transparency to be achieved.

3. What is covered by PTT?

Based on a data submission made by the LME in 2016, ESMA defined which metals are deemed to be within scope of the PTT requirements. This determination was made under the MiFIR RTS 2 guidelines basis the contracts which were considered to be liquid. In the event that a contract is defined as illiquid, it will benefit from the use of the illiquid waiver (subject to the LME receiving approval from the regulator to apply these waivers). Using the same data, ESMA also defined a transaction size, denominated as a euro notional value per liquid time to maturity (TTM) bucket, above which PTT requirements do not apply. This is referred to as the large in scale (LIS) threshold. To be in scope for PTT, a given order must be:

- (a) a liquid product
- (b) below the LIS threshold, and
- (c) not qualify for any other approved waiver or exemption.

4. As MiFID II/MiFIR was introduced in January 2018, why is this being considered now?

The LME implemented its original solution to PTT in January 2018, by publishing all trade halves with an unmatched status on a real-time basis. In November 2018, ESMA determined that this approach did not meet the MiFIR requirements as it allowed trades to take place in the inter-office market which did not benefit from an Article 9 waiver.

5. What is the systematic fixed price auction?

The LME has determined that the systematic fixed price auction (SFPA) is its chosen solution to ensure that all relevant orders, submitted via the inter-office market achieve pre-trade transparency. The SFPA has been designed to minimise the impact on the processes and systems of market participants, whilst at the same time, meeting the necessary regulatory requirements for pre-trade transparency.

6. Can members continue to make firm quotes to customers without the need for a fixed price auction?

Inter-office market, members cannot make a firm quote for an order which would require PTT without the initiation of a fixed price auction.

Any discussions with other members or clients ahead of initiating a fixed price auction would constitute a pre-trade communication that does not amount to a bid, offer or actionable expression of interest for the purposes of MiFIR.

9. What does the illiquid waiver mean?

A contract and time to maturity bucket are deemed as liquid if both the following criteria are met:

- (a) The average daily notional amount is
- (b) The average daily number of trades is greater than or equal to 10

For contracts which are deemed as illiquid, the LME will apply an illiquid waiver (subject to receiving approval from the regulators) which will allow the trade to be waived from achieving pre-trade transparency. This will automatically be applied to trades entered into LMEsmart and will not require any action from members.

10. Which transactions can be considered as part of a packaged order?

For the purposes of PTT at the LME, spread transactions are considered to be packaged orders, if all legs are traded simultaneously and are contingent upon each other. If the legs of the packaged order straddle multiple TTM buckets, the TTM bucket with the lowest PTT requirement will apply. For example, a carry trade would be subject to the packaged order waiver if one leg of the carry is either illiquid or above the large in scale (LIS) threshold.

For the avoidance of doubt, cross market transactions (e.g. LME vs COMEX copper arbitrage transactions) would not benefit from the packaged order waiver as the legislation

order are available for trading on the same

11. What is the hedge exemption and how should it be applied?

MiFIR Article 8 (1) describes the hedging exemption and how this can be applied. In summary, this can be applied if:

- (a) The customer is a non-financial counterparty (NFC);
- (b) The customer is intending to undertake a trade which is objectively measureable as risk reducing and directly relating to its commercial activity;
- (c) The customer confirms that the trade is risk reducing.

For the avoidance of doubt, member to member business will generally not be covered by this

To use the hedge exemption, the member entering into LMEsmart will be required to select the commodity derivatives indicator. It is the member's responsibility to ensure the correct use of the hedge exemption.

12. What is the large in scale waiver and how are the LIS thresholds defined?

The large in scale (LIS) waiver permits orders which are deemed LIS (i.e. above a prescribed size threshold) to be waived from PTT requirements as per MiFIR Article 9 1(a). The LIS thresholds for liquid products are set using the higher of:

- (a) The trade size below which lies 70% of the transactions (i.e. the 70th percentile)
- (b)

In addition to this, ESMA has defined specific time to maturity (TTM) buckets per asset class. Based on data submitted by the LME, ESMA has determined LIS thresholds for each liquid metal and TTM bucket. These thresholds are updated periodically, and the LME will publish the new thresholds as and when they are updated. The latest LIS thresholds can be found on the website (LME.com/ptt)

Systematic fixed price auction

13. When will the SFPA solution be implemented?

After completing extensive market consultation throughout 2019, the LME initially decided that it will implement the SFPA solution by mid-2020. However, due to the restrictions applied during the Covid-19 pandemic, the LME delayed the implementation with a new targeted fo-live date of 30 November.

Please note that the LME reserve the right to amend this decision by way of notice in the light of changing exogenous factors and/or updates to its own analysis of regulatory requirements. What trades will be required to be made pre-trade transparent using the SFPA?

14. What trades will be required to be made pre-trade transparent using the SFPA?

A -office venue which cannot make use of one of the available waivers or exemptions (see waivers and exemptions section) will be required to be made pre-trade transparent using the SFPA mechanism.

LMEsmart will apply PTT validation criteria when the order is submitted and has met the current matching criteria for the waivers held by the LME.

15. How will the systematic fixed price auction work?

For member to member orders in inter-office market, members are required to submit a directed bid or directed offer (see below) to another member using LMEsmart.

Should a directed bid match with a directed offer, after applying the current matching criteria, a SFPA will commence automatically if PTT is required. During the auction, any member can submit additional bids or offers, at their selected volume (noting the rules for carry orders described below) into the auction at the same fixed price.

At the end of the auction period, bids and offers are matched in LMEsmart based on time priority.

16. How long will an auction run for?

The fixed price auction will run for 30 seconds.

17. What is a directed bid and directed offer?

Directed bids or directed offers are currently known as trade halves and will be the trigger to commence an SFPA once matched.

18. How will members participate in an auction?

Members can participate in an auction using the existing functionality in LMEsmart. During the 30 second window, members must enter their directed bid or offer against the AUC counterparty (the chosen three letter mnemonic in LMEsmart for PTT auctions). In addition, the public reference field should be populated with the auction ID which can be found on the PTT market data feed (see below).

If a participating member is successful in the auction, they will receive their matched trade back with the counterparty showing as AUC (FIX tag 452=17). The unique auction ID field will persist, allowing members to reconcile back to their additional bid/offer into the auction.

19. Can the initiating or additional bid/offer be cancelled?

The initiating bid and offer, as well as any additional bids and offers, can be cancelled at any point during the auction window. Once processed, a cancellation message will be sent back to the member.

In the event that a participating bid or offer is submitted outside of the auction window, a rejection message stating that the auction is closed will be sent back to the member.

20. What happens if multiple bids/offers are submitted into an auction?

In the event that there is an imbalance between participating directed bids and directed offers which are submitted into an auction, they will be matched based on time priority (this will include the initiating bid/offer if one is cancelled during the auction). Participating bids/offers which do not match at the end of an auction will be automatically cancelled. The member will receive a trade cancellation message in confirmation.

21. How will the market know when an auction has started?

The LME will publish information related to each auction on a real time basis via LMEsource. This information will include:

- (a) Auction start/end
- (b) Unique auction ID
- (c) Contract information (metal, price, prompt date, volume)
- (d) Additional bids and offers

22. Will the price of the contract change during the auction?

As the LME has decided to implement a fixed price auction solution, the price will not change during the auction period.

23. How can members register to participate in an auction?

The LME will require each member firm which wishes to participate in fixed price auctions to register in advance. The registration is by way of an application form which will include contact details of the authorised personnel from the member who are authorised to participate in the SFPA and should be signed by an authorised signatory.

The form can be found on the LME website (LME.com/ptt). For members who only intend to initiate auctions, no registration will be required (the auction will commence automatically subject to meeting the relevant criteria).

24. The PTT notice of interest registration form requests a number of key contacts. Who should this be from our company?

The contacts included on the form should be individuals from the organisation who are authorised to enter participating bids and offers into the SFPA. These contact details are required in the event that the LME needs to contact the member regarding an auction.

25. What happens at the end of the auction?

As long as the original directed bid and directed offer have not been cancelled during the auction window, these will match basis the time priority algorithm. Any additional bids or offers entered into the auction will also result in a matched trade if there is sufficient volume on each side. These orders will be matched based on time priority.

Any unmatched bids or offers will automatically be cancelled (and a cancellation message sent back to the initiating/participating member).

26. Do the participating bids and offers into an auction need to be the same volume as the initiating order?

Whilst both the initiating directed bid and offer must be for the same volume in order for an auction to commence, subsequent participating bids and offers do not need to be for the same volume. Given the variable volume, members should be aware that when submitting participating bids/offers, they may receive partial fills (or no fill) to their submitted order.

For carries greater than two legs, participating bids/offers must be in the same shape profile/same ratio as the initiating trade in order for it to be considered valid (i.e. the minimum ratio is based on the lowest common denominator across all legs).

27. Are Registered Intermediating Brokers (RIBs) required to use the SFPA?

RIB orders will initiate SFPAs where any element of a RIB order requires PTT. PTT will be considered for each individual component of bundled RIB orders. RIBs are not permitted to participate in an auction as their orders can only initiate an auction.

28. How are member to client transactions affected by the auction?

Members will enter both the bid and offer as a single entry (client cross) into LMEsmart. This bid and offer will match basis the current matching criteria, and if PTT is required, a 30 second public fixed price auction will commence.

The initiating member and other members can participate in the auction, as they would do for a member to member auction during the auction window.

For member to client transactions, it is not possible to cancel only one side of the order. In the event that the entire initiating order is cancelled during the auction window, the auction would continue until its conclusion (the end of the 30 second period). Participating bids or offers submitted into the auction would be matched where required based on the time priority algorithm.

29. What hours will the SFPA be available?

Auctions will operate during the operational hours of LMEsmart between 01:00 and 20:00 (London time). However, the last auction will commence 30 seconds prior to the closure of LMEsmart in order that this can be completed before LMEsmart closes. If the closing time of LMEsmart is extended then the auction window will extend by the same amount, and will close 30 seconds prior to the new closure time of LMEsmart.

For TOM contracts, auctions can be initiated up to 30 seconds prior to 12:30 (or a later time if the TOM deadline is extended). TOM orders requiring PTT that are traded before 12:30 and entered after 12:29:30 will be rejected, and it will be necessary for these to be processed under the exception category.

30. Will the LME charge any fees to start, or participate in an auction?

There will not be any additional fees incurred in relation to any use of the systematic fixed price auction (both commencing and participating in). For the avoidance of doubt, the existing inter-office trading fees will

Contact us

For more information about pre-trade transparency, including its implementation at the LME, please contact business.development@lme.com or visit LME.com/ptt

DISCLAIMER

© The London
Metal Exchange.

. The London Metal Exchange logo is a registered trademark of The London

only. While the LME endeavours to ensure the accuracy, reliability and completeness of the Information, neither the LME, nor any of its affiliates makes any warranty or representation, express or implied, or accepts any responsibility or liability for, the accuracy, completeness, reliability or suitability of the Information for any particular purpose. The LME accepts no liability whatsoever to any person for any loss or damage arising from any inaccuracy or omission in the Information or from any consequence, decision, action or non-action based on or in reliance upon the Information. All proposed products described in this document are subject to contract, which may or may not be entered into, and regulatory approval, which may or may not be given. Some proposals may also be subject to consultation and therefore may or may not be implemented or may be implemented in a modified form. Following the conclusion of a consultation, regulatory approval may or may not be given to any proposal put forward. The terms of these proposed products, should they be launched, may differ from the terms described in this document.

Distribution, redistribution, reproduction, modification or transmission of the Information in whole or in part, in any form or by any means are strictly prohibited without the prior written permission of the LME.

The Information does not, and is not intended to, constitute investment advice, commentary or a recommendation to make any investment decision. The LME is not acting for any person to whom it has provided the Information. Persons receiving the Information are not clients of the LME and accordingly the LME is not responsible for providing any such persons with regulatory or other protections. All persons in receipt of the Information should obtain independent investment, legal, tax and other relevant advice before making any decisions based on the Information.

LME contracts may only be offered or sold to United States foreign futures and options customers by firms registered with the Commodity Futures Trading Commission (CFTC), or firms who are permitted to solicit and accept money from US futures and options customers for trading on the LME pursuant to CFTC rule 30.10.