

To: All Members

Ref: 17/344

Classification: Consultation

Date: 18 October 2017

Subject: **DECISION NOTICE – CONSULTATION ON POLICIES REQUIRED TO BE INTRODUCED UNDER MIFID II AND ASSOCIATED DOCUMENTS**

Summary

1. This Notice (this “**Decision Notice**”) is issued following the end of the consultation period as notified to the Membership by way of Notice No. 17/297, issued on 1 September 2017. This notice consulted Members and other interested parties on a proposal to implement a number of policies required to be introduced under MiFID II.
2. The London Metal Exchange (the “**LME**”) is grateful for the comments received from the Membership in response to the consultation and has considered them carefully. This Decision Notice summarises the responses received, the LME’s comments on those responses, and how the proposal will now be implemented.
3. The effective date for each of the policies included within the proposal is set out below.

Defined Terms

4. Terms not otherwise defined in this Decision Notice shall have the meaning ascribed to them in the Rules and Regulations of the LME (the “**Rules**”, “**Rulebook**”, or “**LME Rulebook**”).

Background

5. Notice No. 17/297 set out that in advance of the implementation of MiFID II the LME had determined that it was appropriate to revise existing policies with regard to the management of error trades and the throttling of orders submitted



to LME Select. Additionally, the LME proposed to introduce new policies which governed the following:

- a) algorithmic trading;
 - b) the provision of order routing services (also known as Direct Electronic Access under MiFID II) by Members and their Clients;
 - c) order book behaviour/controls;
 - d) Unexecuted Order to Transaction Ratio (UOTR); and
 - e) Commitment of Traders Report (COTR).
6. In addition to the comments received, the LME has also made some minor amendments to the revised Matching Rules, clarifying the original wording, and those are detailed below.

Implementation and timing of proposals

7. The table below summarises the responses received to the Consultation. The LME's comments on each response are set out below.

Policy Reference	Member response	LME Comment
Policy on error trades and erroneous order submission (appendix 1 to Notice No. 17/297)	Suggestion that notification of error trades by the LME to be made to compliance, trading and operations at the relevant Member and not just compliance.	Since the error trade policy was first introduced, notification has always been to the compliance team at the relevant Member. This is due to the fact that where a Member offers DEA services to clients, neither the trading or operations teams will always be aware of the activity of their clients. Therefore, the LME is not minded to make any change to the policy.



Policy Reference	Member response	LME Comment
<p>Policy on algorithmic trading (appendix 2 to Notice No. 17/297)</p>	<p>(i) Suggestion to include a description of what constitutes algorithmic trading or link to related document.</p>	<p>(i) The term “Algorithmic Trading” has been defined in the LME Rules as: “trading in financial instruments (as such term is defined in Article 4(1)(15) of the MiFID II Directive) where a computer algorithm automatically determines individual parameters of orders such as whether to initiate the order, the timing, price or quantity of the order or how to manage the order after its submission, with limited or no human intervention, but excluding any system that is only used for the purpose of routing orders to one or more trading venues (as such term is defined in Article 4(1)(24) of the MiFID II Directive) or for the processing of orders involving no determination of any trading parameters or for the confirmation of orders or the post-trade processing of executed transactions;”</p>
	<p>(ii) Suggestion to include checklist for scenarios/attestation for testing purposes.</p>	<p>(ii) The MiFID II requirement is for firms to undertake the necessary testing, and this may vary from firm to firm and therefore the LME does not intend at</p>



Policy Reference	Member response	LME Comment
		this stage to provide a checklist.
	(iii) Comment that there may be circumstances where orders would want to be persisted after a disconnect.	(iii) Whilst the LME recognises that there may be circumstances where Members or Clients may want orders to persist in the event of a loss of connection, the MiFID II requirement is that the cancel on disconnect command be tested (RTS 7, Article 9, section 3(c) refers).
	(iv) Suggestion that certification should differentiate between proprietary and client-owned algorithms.	(iv) There is no requirement in MiFID II to make such a distinction, and therefore the LME does not propose to do so.
	(v) Request for clarification as to what “substantial update” means in Section 6.	(v) The term “substantial update” is used in MiFID II RTS 7, Article 10, Section 1, which applies to trading venues, and should be considered to be the same as “material update” which is referenced in RTS 6.
	(vi) Request for clarification of verification of conformance testing in Section 8.	(vi) The LME has reviewed the information requested in the policy and considers it to be appropriate, and is therefore not minded to amend it.



Policy Reference	Member response	LME Comment
	<p>(vii) Request to remove the requirement set out in Section 16(d) for Members to detail any limits imposed upon (DEA) Clients, whether per order, intra-day exposure or maximum position limits, and any other conditions that have been applied to the provision of the service to any particular Client, on the basis that this is an unnecessarily onerous requirement.</p>	<p>(vii) MiFID RTS 7, Article 21 requires venues to have rules and conditions that shall at least cover the specific requirements set out in Article 22 of RTS 6. RTS 6, Article 22 requires investment firms which offer DEA to ensure that the software used by Clients includes the pre-trade controls set out in RTS 6, which includes any limits imposed on such Clients. Therefore, the LME considers that its requirement that Members provide this information to it to be appropriate, and is therefore not minded to amend the policy.</p>
	<p>(viii) Request that where more than one Member is using the same algorithm that is provided by an Independent Software Vendor (ISV), it should be possible for the ISV to undertake the necessary conformance and for the relevant Members to certify that they have reviewed and approved such testing.</p>	<p>(viii) RTS 7, Article 9, section 1 requires members of trading venues to undertake conformance testing, and there is no provision for ISVs to undertake such testing, either in RTS 7 or RTS 6, which applies to firms. Further, if there is the potential for a Member to alter the configuration of an ISV-provided algorithm then this may call into question the effectiveness of the testing undertaken by the ISV. Therefore, the</p>



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		LME is not minded to make any change to the policy.
	(ix) Will the LME support sub-DEA (i.e. where a customer of a Member extends the DEA service to its own customers); and will the LME allow sponsored access?	(ix) The LME supports the provision of DEA services by its Members, but it is for the Members to determine to what extent they will permit their customers to make use of these services. The LME does not support Sponsored Access as defined by MiFID II.
Policy on order cancellation and controls (appendix 3 to Notice No. 17/297).	(i) Request for clarification on “key positions” referred to in section 26.	(i) As the type and organisational structure of Members varies considerably, so the LME considers that it is the Members themselves who are best placed to identify those positions which are key to the undertaking of business on the LME.
	(ii) Request for clarification as to how the LME will identify which are erroneous and duplicated orders prior to operating its kill switch, referred to in section 5(b), how will Members be notified of the use of the kill switch, and what is the process if the kill switch has been used in error and the Member has incurred a loss as a	(ii) The LME monitors all order activity on LME Select, and where it considers that erroneous duplicated orders have been entered into the order book, then it will seek to contact the relevant Member for an explanation. Where a Member is unable to be contacted, the LME may operate its kill switch and effectively remove the



Policy Reference	Member response	LME Comment
	result.	erroneous duplicated orders from the order book. Whether the Member has been contacted or not prior to the removal of orders from the order book, the LME will confirm to the Member after the operation of the kill switch, those orders that have been removed from the order book. In relation to any losses that may be incurred by Members, Members are reminded that the LME has no liability for the operation of the market, save where it has acted in bad faith (pursuant to section 291 of the Financial Services and Markets Act 2000); however it should be noted that the LME does have a Complaints procedure, details of which can be found at lme.com .
	(iii) How will the LME allow for the authorisation of DEA Clients to communicate with the LME, and how will their identities be validated?	(iii) When submitting the relevant information relating to those Clients to whom DEA services have been provided, Members will be requested to provide contact details for each relevant Client. The LME will put in place appropriate procedures to validate such



Policy Reference	Member response	LME Comment
		information.
Matching Rules (appendix 7 to Notice No. 17/297).	(i) Confirm that trade category “Exception” is replaced with “Exception Reportable and Exception Non-Reportable.	(i) Confirmed.
	(ii) Clarify enforcement approach with regard to give-ups not being processed by 10:00 (London time) on T+1.	(ii) The LME will monitor the processing of give-ups, and where a Member fails to process them by the deadline, will request an explanation for the failure. This may then lead to an investigation, and the potential for enforcement action where appropriate.

8. The LME has decided to implement the proposal, and set out below is the effective date for each policy. The guides to position reporting and transaction reporting, together with the LMEselect and LMEsmart testing services document will come into effect from **13 November 2017**.
- a) Error trades and erroneous order submissions policy – unchanged, effective **13 November 2017**, with the implementation of LME Select 9.2.
 - b) Algorithmic trading and order routing services policy – unchanged, effective **3 January 2018**.
 - c) Order cancellation and controls policy – unchanged, effective **13 November 2017**, with the implementation of LME Select 9.2. Members should note that this policy will result in the cancellation of orders that have breached the order throttle within LME Select.



- d) Unexecuted Order to Transaction Ratio (UOTR) – unchanged, effective **3 January 2018**.
- e) Commitment of Traders Report (COTR) – unchanged, effective **3 January 2018**. Members should note that the LME intends to introduce a parallel period whereby the current version of the COTR will continue to be published alongside that required under MiFID II. Further details relating to this parallel implementation will be published to the market by way of notice in due course.
- f) Matching Rules – effective **27 November 2017**, with the changes detailed below in addition to the changes consulted upon.

Matching Rule Reference	Description of Change
Addition (6)	Connection to LME Select to occur at 01:00 (London time), compared with 07:30 (London time) currently.
Addition (7)	Members are not required to submit trade halves immediately upon the connection with LME Select having been established (i.e. at 01:00 London time), but must have submitted them by 08:30 (London time).
11	Clarification that adjustments to Member to Client Carry trades need only be undertaken on the individual leg that requires adjustment.
18	Confirmation that Mean Cash (“MC”) and Mean 3 Month (“M3”) short price codes will be available from 27 November 2017.
24	Introduction of new “G” account – gross omnibus segregated Client account (GOSA). (Subsequent rules amended to reflect the introduction of the G account.)
34	Clarifying that position transfers may not be used to avoid or evade the Matching Rules.
Removal	Requirement for Members to flag trades where Risk Reducing Exemption has been granted by relevant NCA.



Matching Rule Reference	Description of Change
Appendix II	Removal of Give-up Clearer as a reportable transaction.
General	The publication of the Matching Rules under Notice No. 17/116, issued 4 April 2017, replaced Notice No. 00/384 : A377 : R011 Rules on Exchange for Physicals.

9. For completeness sake, all of the policies and associated documents that were published under Notice 17/297, can be found as Appendix 1-9 to this Notice.
10. With regard to Appendix 6, Guide to position reporting, Members should note the following changes to sections 2.1 and 2.2 (deletions shown in ~~strikethrough~~, additions underlined):

Section 2.1: ~~“Whilst the LME will require Members to report positions held for Clients, the LME will facilitate the direct reporting of positions to it by Clients, subject to the appropriate procedures. Where a Member has a Client who wishes to report directly, the Member should contact the LME at market-surveillance@lme.com to put in place the appropriate arrangements.”~~

Section 2.2: “Position reports must be submitted in the FIA amended ITS 4 format. Members may outsource the collation and submission of position reports to third parties, for onward submission to the LME, or put in place arrangements with its Clients for direct reporting to the LME, but the Member will remain fully responsible for discharging its obligations and ensuring that its service provider/Client submits position reports to the LME in accordance with ITS 4. The daily submission of position files in the ITS 4 format to the Universal Data Gateway.”

Additionally, it should be noted that in accordance with the regulation a position report is required to be submitted where a position moves from an actual position to nil, but not where a nil position is held from one day to another.



11. With regard to Appendix 8, Guide to transaction reporting, Members should note the following additions to sections 3.1.7 (page 16), and 3.1.14 (page 21):

Section 3.1.7

DEAL	Market Side is the Cleared Contract
	Client Side is the Client Contract
AOTC/MTCH	Where there is a 1:1 between the Market and Client Side they should be reported as a single transaction
	INTC Where there is a not a 1:1 between the Market Side and Client side then the Market Side and Client side reports are reported separately and INTC must be reported as a buyer/seller in both report to link them. It should not be used for reporting an order for one client executed in a single execution or for an order for one client executed in multiple executions.
	For all AOTC/MTCH Scenarios including INTC, Client and LMEClear are the buyer/seller with the Member reported as the executing entity. The transaction date and time of the reports must be that of the execution on the venue (taken from the Cleared Contract), with the price being that of the market execution from the cleared trade. Where there are multiple fills, the transaction date time must be that of the first market fill.

Section 3.1.14

“The LME will generate a TVTIC at the level of financial instrument traded in LME Select / registered in LME Smart.

There are however ‘Package Transactions’ that do not follow this rule.

At present, the LME will only be providing a single TVTIC (MiFID Field 3, FIX tag #1903) for Carry & Average Contract (Strips) trades as the tag is at the trade level rather than the trade leg level in the FIX message. However, the current ‘MatchingSlipID’ (FIX field tag #5442) field should be used as the transaction reporting TVTIC for those Inter Office and Ring carry trades, as this tag is at the individual leg level.

The table below details a ‘Carry’ and ‘Average Contract’ strategies where by only a **single** ‘TVTIC’ will be provided for the package:



Strategy/ Package (Multi- Instrument Transaction)	Price Type (as a Single Price)	Instruments	Instrument Price	Possible to identify ISIN for underlying Instrument from Package
Carry	Spread	Multiple Futures	Contract price per Future calculated from the spread	Futures can be identified
Average Contract (Strips of Futures)	Contract Price	Multiple Futures	Same as package price for each monthly contract	Futures in the strip can be identified

General

12. If Members or any other interested parties have any questions or requests for further clarification regarding the implementation of the proposal as described in this Decision Notice, please contact mifidtest@lme.com.

Marcos Castro
Company Secretary

cc: Board directors
Trading Committee
Ring Dealers Committee
Special Committee