MiFID II: Impact on the LME

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1 Summary

The Markets in Financial Instruments Directive (MiFID) and Markets in Financial Instruments Regulation (MiFIR) (together MiFID II) form the largest consolidated package of financial services legislation to govern the European financial markets.

MiFID II reaches all participants in the capital markets including market infrastructure providers. The LME and LME Clear are therefore subject to direct obligations under MiFID II and it is important that all users of our market understand the changes that we will be making as part of our implementation programme. This note is intended to offer a high level overview of those areas of change.

2 Position limits, position reporting and position management

2.1 Position limits

MiFID introduces limits on the maximum size of a net position that entities and groups can take in commodity derivatives traded on an EEA trading venue and in Over The Counter (OTC) contracts deemed to be equivalent economically. In case of a breach of the prescribed limit, the regulator will contact the position holder directly to ensure that it reduces its position.

2.2 LME position management rules

The LME's lending rules and position management will continue to apply and will complement the requirements of the MiFID II position limit regime.

2.3 Position reporting

Details of long and short positions held on the LME will need to be reported directly to the LME (and positions held on other venues will need to be reported to those venues). Members are also required to provide details of the long and short positions held on the exchange by their clients (and their clients' clients where applicable). Reports of OTC positions are only required in certain, very limited, circumstances and must be submitted directly to the regulator.

2.4 Commitment of Traders Report

The LME will be subject to a further reporting obligation to publish the weekly Commitment of Traders Report (CoTR). This will specify the total long and short positions in each metal. The obligation to publish this information does not impose any further reporting obligations on members.

3 Market microstructure

In addition to the requirements that apply directly to investment firms, MiFID II also introduces various obligations on market infrastructure providers, including the LME. In many cases this will require the LME to introduce changes to its own rules. It is therefore important for members to remain aware of these areas of proposed change to ensure continued compliance with our rules.

3.1 Prevention of disorderly trading conditions

MiFID II harmonises the safeguards that trading venues are required to have in place in order to manage the risk of "disorderly trading". This includes the ability to do the following:

- cancel unexecuted orders
- suspend a member's or trader's access to the venue
- cancel or revoke transactions
- manage order throttling arrangements
- impose pre-trade controls that can block orders, which are either outside of pre-set price limits, have uncommonly large order values or uncommonly large order size.

3.2 Member due diligence

The LME's current member due diligence programme will be enhanced in order to take account of the specific areas required under MiFID. All new and existing members using LMEselect will be subject to annual due diligence requirements, which will cover the members' arrangements in relation to:

- pre-trade controls on price, volume and value of orders
- qualifications of senior staff
- conformance testing
- kill functionality
- direct electronic access and the conditions under which it is granted.

3.3 Conformance testing

Members will be required to undertake conformance testing prior to the initial use of a new trading algorithm, trading strategy or trading system. Further details of testing on the LME can be found here.

4 Transparency and order record keeping requirements

One of the underlying objectives of MiFID II is to increase market transparency through the harmonisation of reporting and the facilitation of access to market data publications across all asset classes and trading venues. Therefore, whilst LME will continue to provide its current data packages, it will also be publishing supplementary data in satisfaction of the MiFID II transparency requirements. The data will be available through LMEwire or a data vendor and will be made available free of charge 15 minutes after first publication.

4.1 Pre-trade transparency

The LME will be required to publish details of the quotes advertised on its venues on a "continuous basis". The requirements broadly mandate that venues publish the range of bids and offers and depth of trading interests at those prices. For LME quotes, the exact details to be published will be dependent on whether the quote relates to a potential trade on the Ring, through the inter-office market or on LMEselect.

4.2 Post-trade transparency

The LME will be required to publish a separate post-trade file, which will include details such as trading time and date, ISIN (see below for further details) and notional amount. The trade data currently published through LMEselectMD will continue to be published but does not constitute the MiFID II compliant data feed. This will be published every ten minutes using a new LME File Transfer Protocol.

4.3 Order record keeping

The LME will be subject to order record keeping requirements in relation to all orders sent and received through its systems. The obligations mandate that the records include a granular level of detail including personal information of the member of staff who is considered to be a “decision maker” in relation to the relevant transaction and the Legal Entity Identifier (LEI) of the client.

4.4 International Securities Identification Number (ISIN)

MiFID II introduces the requirement for trading venues to identify instruments traded on its venue with ISINs. LME will purchase ISINs from the LSE Group (the designated UK National Numbering Agency). An ISIN will be assigned to individual instruments by prompt date and option strike price. The LME will create a tradeable instruments file twice daily, once at the opening of electronic trading and once at the end of trade registration each day. This file will be accessible through LMEselectMD and on lme.com.

5 Clock synchronisation

Under MiFID II, market infrastructure providers are required to timestamp all reportable events to a level of granularity that is dependent on the gateway to gateway latency of that market. In addition, venues are required to synchronise their business clocks to Coordinated Universal Time (UTC) with the maximum divergence from this time also dependent on gateway to gateway latency. In the case of the LME, both the maximum permitted divergence and the granularity of timestamps for LMEselect is no greater than one millisecond. The inter-office market and the Ring are permitted time stamps and divergence limits of one second.

Members are subject to an equivalent obligation that mandates the granularity of time stamp and divergence from UTC depending on the type of activity undertaken. For example, activities undertaken using high frequency algorithmic techniques are subject to the highest level of accuracy (time stamps of one microsecond or better with a divergence no greater than 100 microseconds), whereas activities undertaken on a voice trading platform are subject to broader levels of accuracy (time stamping to one second granularity with up to one second divergence from UTC).

6 Mandatory clearing and straight through processing

MiFID II introduces mandatory clearing for on-exchange traded derivatives, a requirement that complements the mandatory clearing requirement for OTC derivatives introduced under the European Market Infrastructure Regulation.

This obligation is supported by the general requirement for “straight through processing” of cleared derivative instruments. It requires that on-exchange derivative contracts are either accepted for clearing “automatically and immediately” or strict time limits will apply in relation to the speed with which details of trades are submitted for matching and clearing purposes. In order to prevent members being subject to these onerous time limits, the LME and LME Clear have elected to change the way in which LME contracts are formed, processed and cleared. Specifically, LME Clear now operates an open offer model of clearing as opposed to the novation model, which it had previously utilised.

7 Best execution

The concept of "best execution" exists under the current MiFID 1 requirements. MiFID II seeks to address some of the perceived weaknesses believed to exist within the current obligations. The changes will impose a new obligation on the LME (and all trading venues) to publish data relating to "quality of execution" on their venues. This includes details of price, cost, speed and likelihood of execution. This is intended to enable brokers to make an objective assessment of the most suitable venue for their clients' orders.