



MiFID II: Implications for and application to non-member trading firms

Table of Contents

1	Summary	3
Part A: Things you need to do 4		
2	Enhanced information requirements	4
	2.1 Reporting and order record keeping	4
	2.2 Legal Entity Identifier (LEI)	4
	2.3 Personal details of the “investment decision maker”	4
	2.4 Details of positions held in commodity derivatives	4
3	Position limits, position management and position reporting	5
	3.1 Position limits	5
	3.2 Exemption for hedging positions	5
	3.3 Reporting	5
	3.4 LME position management rules	5
4	Algorithmic testing, direct electronic access and market making	5
5	Changes to the current exemptions from authorisation	7
6	Best execution	7



1 Summary

MiFID II will have some impact on all participants in the capital markets. It is therefore important that clients of members take time to understand the changes that MiFID II will introduce and consider the modifications to existing business practices that may be required, in order to manage the new regulatory standards. This paper offers a snapshot of key MiFID II issues which clients of LME members should know. In particular it considers:

- the additional information clients will need to provide to members
- position limits and position reporting regimes
- new obligations for firms using an “algorithmic trading” technique
- changes to the scope of the entire regulatory licencing regime including the narrowing of existing exemptions
- amendments to the best execution requirements imposed on members.



Part A: Things you need to do

2 Enhanced information requirements

2.1 Reporting and order record keeping

Members will be subject to a variety of enhanced reporting and order record keeping obligations under MiFID II in relation to orders received and trades executed on a trading venue (including the LME). This is intended to give Regulators greater opportunity to monitor the financial markets and investigate cases of suspected market abuse. Therefore, the information needed to be provided by a transaction report will greatly increase. This will, in turn, increase the volume and granularity of detail that you will be required to provide to your brokers. The key areas of impact are summarised below.

2.2 Legal Entity Identifier (LEI)

An LEI is a globally unique code used to identify individual legal entities. All allocated LEIs are included in a global data system, which allows the relevant entity to be identified irrespective of the jurisdiction in which it is located.

Members that are subject to the MiFID II reporting and order record keeping obligations will not be able to execute a trade on behalf of a client that is eligible for a LEI but does not have one. Therefore, it is important that you take steps to obtain an LEI in order to avoid any interruption to your ability to trade through a member firm.

2.3 Personal details of the “investment decision maker”

National and European regulators will be provided with significantly more information in relation to the genesis of an order/transaction. In particular, MiFID II requires that the individual(s) responsible for making investment decisions can be readily identified by regulators. This is intended to ease regulators' ability to investigate suspected manipulative or abusive behaviour in the markets.

Therefore, member firms will be requesting personal details of certain front office staff members, including first name, surname, date of birth and passport/National ID numbers details from their clients in relation to relevant individual(s) responsible for the investment decision to which a specific order relates (in cases of decisions made by committee the chair of that committee will be deemed to be the relevant individual). Where an investment decision has been made by an algorithm, details of the algorithm will be required instead.

If you use a broker outside of the EU for trades executed within the EU, the same level of information will nonetheless be required as the obligation to report will simply pass to the relevant trading venue.

2.4 Details of positions held in commodity derivatives



MiFID II introduces a new regime governing the size of positions that may be held in a commodity derivative as well as imposing daily reporting requirements in relation to the size of positions held in such instruments. Please refer to the position limits and position reporting section below for further details on these new requirements.

3 Position limits, position management and position reporting

3.1 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.

3.2 Exemption for hedging positions

If you are a non-regulated firm, you may be able to apply for an exemption from the position limit regime where you are able to demonstrate that a position in a commodity derivative is directly risk-reducing. The reporting obligations will continue to apply but the limitation on net positions will not. The Financial Conduct Authority (FCA) has suggested that firms should only apply for this exemption where they believe their positions will be approaching the preset limits.

3.3 Reporting

Clients are required to report to the relevant member details of their on-exchange long and short positions in commodity derivatives traded through that member. OTC positions are only included in certain, very limited, circumstances. Your member can advise when OTC positions will need to be reported.

3.4 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.

4 Algorithmic testing, direct electronic access and market making

MiFID II introduces a raft of obligations on trading venues and member firms intended to ensure markets continue to work efficiently and in an orderly manner. The key areas of relevance include the following:

- **Testing**

An entity wishing to employ an algorithm for trading must test this before use in a live environment. The LME's testing environment is currently live and can be found [here](#).

- **Direct Electronic Access (DEA)**

Member firms providing direct electronic access (DEA) will be subject to increased due diligence obligations and additional requirements relating to the risk controls that must be in place. Trading



venues (including the LME) will also be subject to new obligations relating to the conditions on which members are able to provide such a service.

If you receive DEA through a member, then the terms on which this is provided may change. You may also be required to provide additional details to the relevant member firm concerning your corporate structure and expected trading pattern on the venue to which they provide access.

- **Market Making**

MiFID II introduces a mandatory “market making” regime which requires any algorithmic trader pursuing a “market making strategy” to inform the trading venue on which it is pursuing such a strategy and enter into a market making agreement with that venue.

For the purposes of MiFID II, an algorithmic trading firm is considered to be pursuing a market making strategy when it:

- i. deals on own account and is present on a trading venue for at least 50% of the daily trading hours of continuous trading;
- ii. simultaneously posts two-way quotes where their size does not diverge by more than 50% from each other; and
- iii. posts two-way quotes, which are at or within the maximum bid-ask range set by the relevant venue.

Where you fulfil the above criteria in relation to your trading on the LME you will be required to notify the LME that this is the case. The LME will advise in relation to the current framework of its MiFID II market making scheme.



Part B: Things you should know

5 Changes to the current exemptions from authorisation

Currently, certain types of firms trading in commodity derivatives are not required to be authorised in order to carry out those activities as they are able to benefit from certain exemptions from the regulatory scope. Under MiFID II, the scope of those exemptions will be reduced and as such certain firms may be required to become authorised. This will be relevant in particular for commodity derivative proprietary traders and non-financial entities trading for risk-reducing purposes. If you are a trading firm and are not currently authorised, it would be appropriate to consider how your position will be affected under the new requirements.

6 Best execution

The concept of “best execution”, which exists under MiFID I, is being revised in order to address some of the weaknesses perceived to exist in the current framework. The changes impose obligations on trading venues to provide details of the price, cost, speed and likelihood of execution on their venue which is intended to offer members the opportunity to objectively determine where they can achieve best execution for their clients. Investment firms are required to provide details of the top five execution venues in terms of volumes on which they executed client orders in the previous year.

In addition, when a member firm obtains consent for their best execution policy, that firm must also ensure that the client understands how orders will be executed. Member firms may therefore begin reaching out to you in order to provide some further details on how your orders will be executed by them.

