

To: All members

Ref: 16/031: A/031

Date: 28 January 2016

Subject: **LME Enforcement Process – Transitional Arrangements & Further Guidance regarding Business Processing & Reporting Rule Breaches**

## Summary

1. This Notice informs Members of a transitional period of three months from 1 February 2016 regarding enforcement action for certain business processing and reporting Rule breaches in order to allow Members to improve their business processing and reporting arrangements. From 1 June 2016, the LME will follow the guidance regarding financial penalties set out in LME Notice 16/006:A006 (the “Guidance Notice”) for business processing and reporting arrangements undertaken during May 2016 and subsequent months. The following three business processing and reporting areas will be covered by the transitional arrangements: (i) Late Input of Trades, (ii) Daily Reporting of Positions and (iii) Reporting of Option Volatilities. This Notice also sets out more information about what would be considered a Rule breach in each of these areas for the purpose of future enforcement actions.

## Background

2. The Guidance Notice sets out indicative financial penalties for Members to be attached to certain offences covered by the LME Rules. The indicative benchmark penalties represent the level of financial penalty the Exchange and Enforcement Committee consider appropriate for an offence given no aggravating or extenuating circumstances. The Guidance Notice also includes guidance on aggravating and extenuating circumstances. The Guidance Notice includes indicative financial penalties for reporting and business processing breaches, and covers, amongst other things, the following specific breaches: (i) Late Input of Trades, (ii) Daily Reporting of Positions and (iii) Reporting of Option Volatilities. It is these specific breaches which are covered by the transitional arrangements set out in this Notice.



## **Transitional Arrangements**

3. The LME will investigate and take enforcement action against Members who fail to meet the required standards as set by the LME. Enforcement action is likely to result in financial penalties as set out in the Guidance Notice<sup>1</sup>. The Rules and Administrative Procedures that the LME intend to enforce with financial penalties are not new. However, the Exchange intends to take a more robust approach to enforcement. Therefore, in order for Members to ensure they are fully compliant with the Rules and Administrative Procedures, the Exchange hereby announces a transitional period of three months from the 1 February 2016 where it will not, in the ordinary course, commence investigations or enforcement actions in respect of certain minor Rule breaches in the categories set out below. During this period, Members will be notified by the LME if they would have been subject to any investigation / enforcement action and will be required to demonstrate that they are taking the necessary actions to prevent recurrence. This Notice sets out the three areas of reporting and business processing breaches Rule breaches where such transitional arrangements will apply. Members should note, however, that the Exchange reserves the right to commence an enforcement action during the transitional period even for offences covered by this Notice where such breaches are considered to be particularly egregious or wilful or are otherwise considered by the Exchange and/or the Enforcement Committee to warrant an investigation and potential disciplinary action.
  
4. Following the transitional period, the LME will take a strict approach to business processing and reporting breaches covered by this Notice. It reserves the right to commence investigations and bring enforcement actions for such breaches, and will seek financial or other penalties in accordance with the Rules and the Guidance Notice.

### **Specific Business Process and Reporting Breaches covered by this Notice**

5. The Guidance Notice lists a number of business areas which are subject to possible sanctions by the LME, including specific business processing and reporting breaches. These are described below together with the criteria that

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<sup>1</sup> Although the penalties are not limited to financial penalties – for more details see the relevant Rules and Guidance Notice



would constitute an offence. Offences in these categories will be covered by the transitional arrangements described above.

### ***i. Late Input of Trades***

6. Regarding late input of trades, the Guidance Notice sets out an indicative fine of £1,000 for the first offence, £2,000 for the second offence, and £5,000 for each offence thereafter within a 24 month rolling period.
  
7. LME Notice 14/181:R021, Section 5 outlines the matching deadlines for LME trades. Each month Members are provided with details of their matching performance by the LME's Market Surveillance team. Members are expected to input all trades on a timely basis in accordance with the deadlines specified in the Notice. However, the LME notes that it may not always be possible to achieve 100% compliance. The LME has for the last few years been working with Members to introduce and then reduce a threshold for matching performance. LME Notice 09/397:A389 identified the threshold as 12% for current price Member-to-Member telephone late matched trades. LME Notice 16/008:A008 extended this threshold to Ring and Member to Member basis trades. The LME intends to use this as a rule-of-thumb going forwards. The LME will be likely to investigate and commence disciplinary action against Members who exceed the 12% threshold for the monthly period for either Member to Member telephone trades, Member to Member basis trades or Ring trades.

### ***ii. Daily Reporting of Positions***

8. The Guidance Notice sets out the following indicative fines regarding daily reporting of positions: 5 errors or more in a calendar month: £1,000 for first offence, £2,000 for a second offence, and £5,000 for each offence thereafter within a 24 month rolling period. An offence may include a failure to report as well as errors in what has been reported.
  
9. In accordance with regulations 9.1 of Part 2 of the LME Rules and Regulations and LME Notice 09/231:R004 Category 1, 2, 3 and 4 Members must report to the LME all Warrant and trading positions for all customer accounts and all house accounts as at the close of business each business day. These Warrant and position reports must be made electronically and must reach the LME by 08:30 on the business day following the date of the report.



10. Failing to report LMEdprs files on any given business day may be considered an offence in itself.
11. Members' reporting of LMEdprs files is expected to be error-free. Paragraph 37 of Notice 09/231:R004 states that Warrant and position reports are essential for the Exchange to monitor LME markets and failure by Members to report timely and accurately is a serious matter. Significant or persistent breaches of the reporting requirements will be considered to be a disciplinary offence and Members who are found to be in violation of the requirements may be subject to the Exchange's disciplinary process. As a rule of thumb, the LME may investigate and commence disciplinary action against Members who have 5 or more days with errors having been recorded in relation to LMEdprs, within a calendar month.
12. There is a variety of circumstances that may lead the LME to conclude that there is an error with a Member's obligation regarding the Daily Reporting of Positions. The LME considers the following non-exhaustive list likely to constitute an error for the purpose of Daily Reporting of Positions in breach of the requirement to report timely and accurately:
  - a. **Late submission of files** - Members must submit LMEdprs files so prior to 08:30 (with the exception of the Open Interest which must be submitted prior to 09:00).
  - b. **Errors in reported warrants** - Warrants must be reported in both the Large Position (LP) and Warrant Holding (WH) files.
  - c. **Errors in TOM reporting** - The LP file must include the Member's delivery obligations.
  - d. **Market Open Interest** - The Open Interest (OI) file must represent positions as at the close of business from the previous day held at the Clearing House.
  - e. **Duplicate records** - The LP and WH files must only have one record for positions of the same prompt date, account code and product. The OI file must only have a single line for positions when the metal, sub account code and prompt date are the same.



- f. **LMEdprs account codes** - All DPRS codes must be identified to Market Surveillance prior to the reporting these codes.

### **iii. Reporting of Options Volatilities**

13. The Guidance Notice sets out the following indicative fines for reporting of options volatilities: 5 errors or more in a calendar month: £1,000 for first offence, £2,000 for a second offence, and £5,000 for each offence thereafter within a 24 month rolling period. An offence may include a failure to report as well as errors in what has been reported.
14. Regulation 4.1.2 of Part 3 (Trading Regulations) of the LME Rules and Regulations and LME Notice 07/358:A351 requires Category 1 and 2 Members who trade greater than 1% of Member-to-Member options volumes to contribute to the reporting of options volatilities. As with other matters covered by this Notice, the reporting of options volatilities is essential for the Exchange to monitor LME markets and failure by Members to report timely and accurately is a serious matter. Significant or persistent breaches of the reporting requirements will be considered to be a disciplinary offence and Members who are found to be in violation of the requirements may be subject to the Exchange's disciplinary process.
15. Members' reporting of options volatilities is expected to be error free. There are a variety of circumstances that may lead the LME to conclude that there is an error with a Member's obligation regarding the reporting of option volatilities. This might include (without limitation) submitting volatilities that are significantly away from the market or which are otherwise erroneous.

### **Outsourcing of Business Process Functions**

16. Members may choose to outsource their business process functions and reporting to third parties (for example a Category 4 Member may choose to outsource clearing to its clearing Member) but the obligations set out in the LME Rules and Regulations and LME Notices referred to within this Notice remain with the Member.

### **Questions / Clarifications**

17. Should a Member require any clarification on any issues covered by this Notice, please do not hesitate to contact [market.surveillance@lme.com](mailto:market.surveillance@lme.com).



A handwritten signature in black ink, which appears to read 'James Collier', is positioned below the logo. The signature is written in a cursive style with a prominent underline.

**James Collier**  
**Head of Market Surveillance**

cc: Board directors  
Disciplinary Panel  
Appeal Panel