

## Pre-trade transparency in the inter-office market

### Frequently asked questions – November 2020

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In line with the requirements detailed in MiFID II/MiFIR, the London Metal Exchange (LME) has introduced new rules in relation to pre-trade transparency (PTT) regulatory requirements which apply to certain orders and trades that are undertaken in the LME's inter-office trading venue.

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#### 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 LME's case, are negotiated via the inter-office 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 LME's open-outcry trading floor (the Ring) and the electronic trading system (LMEselect) are already considered to be compliant with these requirements. Therefore there will be no impact on LMEselect or the Ring as a result of these new requirements being introduced. As the LME's inter-office (telephone) market has been deemed non-compliant, the LME has implemented a new solution in order for pre-trade transparency to be achieved on this venue.

#### 3) What is covered by PTT?

On a daily basis, the LME is required to submit files into ESMA's Financial Instruments Transparency System which allows ESMA to determine which contracts are liquid (as determined by the methodology laid out in RTS 2). This determination is done on an annual basis and is based on data from the previous calendar year. In the event that a contract is defined as illiquid, it will benefit from the use of the illiquid contracts waiver. 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,
- (c) not be an order for the purpose of risk-reduction (hedge exemption) – see further Q 11 below, and
- (d) not qualify for any other approved waiver obtained by the LME.

#### **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?**

Following market consultation, the LME has implemented the systematic fixed price auction (SFPA) as the preferred 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 applicable regulatory requirements for pre-trade transparency.

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

For the purposes of the LME's inter-office market, members cannot agree or confirm a firm quote for an order which would require PTT, without the initiation of a fixed price auction.

If a Pre-Trade Communication would amount to a bid / offer / indication of interest that would need to be made pre-trade transparent (such as provision of a firm quote capable of acceptance by a client), then a member must initiate the fixed price auction.

#### **7) How are LME members and their clients impacted by pre-trade transparency?**

The LME has identified the SFPA as the preferred solution. This will require certain trades to go through an automatic fixed price auction in LMEsmart. This will mean that for members entering data into LMEsmart, some trades will need to go through the auction prior to being confirmed as a trade.

This will also mean that for certain orders, members cannot provide a firm price to clients until the price has been made transparent to the market by using the SFPA solution. Further information as well as an LME created information pack can be found on the [LME.com/ptt](https://www.lme.com/ptt) site.

### **Waivers and exemptions**

#### **8) Which waivers are applicable for the LME market?**

The LME has obtained regulatory approval for three waivers: illiquid, large in scale, and packaged order waivers.

There are three other waivers which the LME has deemed not applicable given the LME's trading venues and operating structure.

In relation to exemptions, the "hedge exemption" may be available to market participants trading in the inter-office market. Please see further information on this in Q 11.

## 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 greater than or equal to €10m; and
- (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 the illiquid waiver 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 states that “all components of the packaged order are available for trading on the same trading venue”.

## 11) What is the hedging exemption and how should it be applied?

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

- a) The customer is a non-financial counterparty (NFC); and
- b) The customer is intending to undertake a trade which is objectively measurable as reducing the risks directly relating to its commercial activity or treasury financing activity, or that of the group that the customer is a member of (if relevant).

For the avoidance of doubt, member to member business will generally not be covered by this exemption as the parties will generally not be NFCs.

To indicate their reliance on the hedging exemption in relation to a particular transaction, the member(s) entering into LMEsmart will be required to select the commodity derivatives indicator for that transaction. Members utilising FIX messaging should submit a “0” in FIX field 20023.

If the commodity derivatives indicator is selected, or a “0” is submitted in FIX field 20023, then a fixed price auction will not be initiated as PTT is not required given the submitting member’s reliance on the hedging exemption.

It is important that members are aware that by using the commodity derivatives indicator, they are notifying the exchange that they have determined the relevant transaction to meet the hedging exemption requirements as laid out in MiFIR Article 8(1), replicated below:

“[...] publication obligation does not apply to those derivative transactions of non-financial counterparties which are objectively measurable as reducing risks directly relating to the commercial activity or treasury financing activity of the non-financial counterparty or of that group.”

The commodity derivatives indicator / using “0” in FIX field 20023 should not be used for any other purpose. The LME has the right to audit members’ use of the commodity derivatives indicator / use of a “0” value in FIX field 20023.

## **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 70<sup>th</sup> percentile)
- (b) A threshold floor of €500,000

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](http://LME.com/ptt)).

## **Systematic fixed price auction**

### **13) When will the SFPA preferred solution be implemented?**

After completing extensive market consultation throughout 2019, the LME initially decided that it would implement the SFPA preferred solution by mid-2020. However, as a result of the impact of the Covid-19 pandemic, the LME delayed the implementation, with a new go-live date of 30 November.

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

Any trades conducted on the LME’s inter-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 are give-up trades and UNA allocations treated in regards to PTT?**

For the purpose of PTT at the LME, give-up trades will require PTT, unless they are registered to an UNA.

Give-up trades registered against counterparty UNA will not be considered for PTT auction.

### **16) How will the SFPA work?**

For member to member orders in the LME’s 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, an 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.

### **17) How long will an auction run for?**

Each fixed price auction will run for 30 seconds.

### **18) What is a directed bid and directed offer?**

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

## 19) High level examples of SFPA process

### a) Member to member

### b) Member to client

Member to member	
1	Each member may submit a “directed bid” or “directed offer” to any other member
2	Should a “directed bid” match with a “directed offer”, a 30 second public fixed price auction would be created, with all bids and offers being made pre-trade transparent. “Direct bids and offers” can be cancelled at any point during the auction window by either or both members
3	During the 30 second auction, any member can submit further bids or offers into the auction at the fixed price (i.e. the same price as the initiating order with no price improvement) for their selected volume. Submitted orders will be made pre-trade transparent. The submitted bids and offers can be cancelled at any point during the auction window
4	Upon completion of the auction, bids and offers are matched with a time priority algorithm
5	Trade arises following the final matching process

Member to client	
1	Member enters both the bid, and offer as a single entry (a “client cross”)
2	This bid and offer will match therefore creating a 30 second public fixed price auction with both the bid and offer being made pre-trade transparent. The initiating client cross can be cancelled at any point during the auction window. If on half is canceled, then both halves will be cancelled as an atomic unit
3	During the 30 second auction, any member can submit further bids or offers into the auction at the fixed price (i.e. no price improvement) for their selected volume, with all of these being made pre-trade transparent.  The submitted bids and offers can be cancelled at any point during the auction window
4	Upon completion of the auction, bids and offers are matched with a time priority algorithm
5	Trade arises following the final matching process

## 20) 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.

All auction participants will remain anonymous during the SFPA.

## 21) 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.

Cancelling one side of a member to member trade will not cancel the other, both the bid and offer must be cancelled to ensure a trade is not agreed with another auction participant.

For a PTT Initiating Pair that represents a member-client trade (where the client is not a member), if either side is cancelled, the other side will be automatically cancelled as this is considered an atomic pair.

This cancellation process is also applicable to give-up trades, as they are also treated as an atomic pair. If one side is cancelled, the other will automatically be cancelled.

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.

## 22) 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.

All bids/offers in an auction are only able to match with other bids/offers in that same auction.

## 23) 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

## 24) What trading information fields will be visible to participants during the course of an FPA?

- (a) Auction start time
- (b) Auction ID
- (c) Contract
- (d) Contract Type
- (e) Price
- (f) Prompt
- (g) Volume

## 25) 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.



## **26) 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).

## **27) 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 and multiple 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).

## **28) 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, however, as they are not Trading Members, but their orders can initiate an auction.

## **29) 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.

## **30) 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.

It is not possible to facilitate trading (where PTT is required) outside of the operational hours of LMEsmart. In these circumstances, any orders entered will be rejected by the system. These orders will be required to be entered when LMEsmart re-opens the following business day and may trigger an auction based on the defined PTT criteria.

### **31) 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 (and clearing) fees and charges will apply, as set out in the LME Group Fees and Charges Schedule.

### **32) How should we deal with administrative trades?**

It has been determined that administration trades (such as OTC bring-ons, cancellations, reversals or transfers) do not fall within the PTT requirements as they are not considered to represent “current bids, offers or actionable expressions of interest” as per the MiFIR description. Additionally, these types of transactions may relate to historic prices and, as such, do not inform current price levels or add to market price transparency.

For confirmation, only orders with a trade category of normal or give-up, with a price type of current, and the venue as inter-office will require PTT.

### **33) How are options affected by PTT?**

Based on the data used to define the liquid contracts, LME options are currently defined as illiquid and therefore are exempt from PTT.

For the avoidance of doubt, options delta hedges are not classed as a single packaged order, therefore the hedge element will require PTT through the auction (unless another waiver or exemption can be applied).

### **34) Will there be any changes to the LMEsmart FIX specification?**

Whilst there will not be any new FIX tags added to the LMEsmart API, there will be a new value of auction closed added to the existing message. This new value will be used as a rejection message where a member seeks to participate in an auction which has already closed.

### **35) Where can participant’s access pre-trade transparency data from the auctions?**

Real time data showing auction starts, additional bids/offers and auction close will be made available on the Exchange’s multicast market data platform LMEsource (specifications can be found on the LME website).

Pre-trade transparency data will also be published on a 15 minute delayed basis via xml, which will also include the auction information. For further support on accessing data directly or via data vendors, please contact [market.data@lme.com](mailto:market.data@lme.com)



## Contact us

For more information about pre-trade transparency, including its implementation at the LME, please contact [business.development@lme.com](mailto:business.development@lme.com) or visit [LME.com/ptt](https://www.lme.com/ptt)

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