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To:	All Members and other interested parties
Ref:	20/283
Classification:	Consultation Rulebook
Date:	18 December 2020
Subject:	**DECISION NOTICE – DEACTIVATION OF DISCRETIONARY AND ICEBERG ORDER TYPES FOR SPECIFIED CONTRACTS**

Summary

1. This Notice (the "**Decision Notice**") follows Notice 20/254, dated 13 November 2020 (the "**Consultation Notice**"). The Consultation Notice set out the LME's intention to introduce a rule-based prohibition (the "**Prohibition**") on the use of the discretionary order type for all tradeable Contracts and the iceberg order type for Cash-Settled Futures Contracts, and sought the view of Members and interested parties on the proposed approach to introducing the Prohibition.

Background

2. The LME is grateful for the comments received in response to the consultation and has considered them carefully. This Decision Notice summarises and provides comments in relation to those responses, and sets out the LME's decision regarding the Consultation Notice proposals.

Defined terms

3. Terms defined in this Decision Notice shall have the meaning ascribed to them in the rules and regulations of the LME ("**LME Rules**"), unless stated otherwise.

Decision

4. The LME has decided to implement the Prohibition, initially, by way of the rule-based approach described in the Consultation Notice, with the modifications outlined in paragraph 7 below, and in accordance with the confirmed scope set out in paragraph 9 below. The LME has taken careful account of the feedback received, and notes in particular that a number of respondents would prefer a system-based solution. The LME acknowledges that, all factors being equal, a system-based solution would be preferable. However, the LME has to consider the length of time which a system-based solution would take to implement. The LME is under a regulatory obligation to ensure compliance with all of its relevant regulatory requirements, including those contained within MiFID II. Where an issue is identified, the LME is under an obligation to remediate it as soon as reasonably practicable. Any system-based solution is likely to take at least a number of months, which is too long from the LME's regulatory-compliance perspective, and therefore the LME has no option but to implement the

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rule-based approach initially. The question then is whether it would be preferable to implement amendments to the current version of LMEselect, v9, or to wait until v10, the design of which will address the pre-trade transparency issue. The LME's view is that implementing amendments to v9 would take several months, draw resources from v10, have significant cost attached and requires Members to allocate resource to testing (irrespective of whether systems changes are limited to LMEselect v9 or whether they also include a new GUI roll-out). The LME therefore considers that the preferred approach would be to use the rules-based approach until the implementation of LMEselect v10. Further information on the factors that the LME has considered are set out in the **Appendix** to this Notice.

Responses

5. The LME has taken account of all responses received before the consultation deadline. Overall, the feedback took the form of comments relating to the implementation timeline and the LME's expectations regarding compliance arrangements, and clarificatory questions regarding the LME Contracts that are in scope of the Prohibition, and the meaning of the term "native" LMEselect functionality.

6. This feedback (in summarised form, by broad theme) and the LME's comments in response, are set out in the **Appendix** to this Decision Notice.

Scope of the Prohibition

7. The Prohibition shall apply to the use of native discretionary orders in relation to all LME Contracts, and native iceberg orders in relation to Cash-Settled Futures Contracts, as set out in each case in the Consultation Notice. However, in the light of the feedback received from respondents, the LME will extend the implementation deadline to market open on 25 January 2021 (the "**Effective Date**"). Additionally, the LME will extend the Prohibition relating to iceberg orders to include all Monthly Average Futures Contracts ("**MAFs**") and to all LMEmini Contracts (in addition to Cash-Settled Futures, mentioned in the Consultation Notice). During the period from the date of this Notice until the Effective Date, the LME expects Member to assess their usage of the relevant native order types and use this period to implement appropriate compliance controls. In parallel with this, the LME will collate usage statistics and will communicate periodically with Members that continue to submit these order types by way of native functionality during this period.

8. The LME has also provided further information below (see consultation feedback summary item 6 in the **Appendix**), in response to consultation feedback, regarding its approach to enforcement of the Prohibition.

9. For ease of reference, the confirmed scope of the Prohibition is set out below:

- **LME Contracts[1] subject to the Prohibition:**
  - Discretionary orders – All Contracts (all tradeable Prompt Dates)
  - Iceberg orders – In relation to the following Contracts:

    - Cash-Settled Futures –

| Contract Name | Contract Code |

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[1] For the avoidance of doubt, the Prohibition shall apply to all Contracts that are tradeable on LMEselect as at the date of this Decision Notice, as well as to relevant products that may be launched in the future, unless specified otherwise by the LME.

LME Steel Scrap	SC
LME Steel Rebar	SR
LME Alumina (CRU/Fastmarkets MB)	AM
LME Aluminium Premium Duty Unpaid European (Fastmarkets MB)	EA
LME Aluminium Premium Duty Paid US Midwest (Platts)	UP
LME Steel HRC FOB China (Argus)	HC
LME Steel HRC N. America (Platts)	HU
LME Cobalt (Fastmarkets MB)	CB
LME Molybdenum (Platts)	MD

- MAFs –

Contract Name	Contract Code
Primary Aluminium Monthly Average Future	OA
Copper Monthly Average Future	OC
Aluminium Alloy Monthly Average Future	OL
NASAAC Monthly Average Future	OM
Primary Nickel Monthly Average Future	ON
Lead Monthly Average Future	OP
Tin Monthly Average Future	OS
Zinc Monthly Average Future	OZ

- LMEminis –

Contract Name	Contract Code
Primary Aluminium LMEmini	MA
Copper LMEmini	MC
Zinc LMEmini	MZ

- **Order submission methods subject to the Prohibition:** Discretionary order functionality and iceberg order functionality (in the Contracts listed above) that is native to LMEselect, or that interacts with LMEselect native functionality, where the term "native" refers to the following:
    - o FIX-entered orders – Orders containing the following FIX tags, as set out more fully in the LMEselect FIX Specification, available on the LME website (as updated from time to time):
        - FIX tags 389 and 841 in relation to discretionary orders
        - FIX tag 111 in relation to iceberg orders; and
    - o GUI-entered orders – Discretionary order and iceberg order functionality in the GUI, described more fully in the LMEselect 9.4 User Guide, available on the LME website (as updated from time to time)
- **Implementation Date:** Market open on 25 January 2021.

Enforcement approach

10. Members who contravene the Prohibition shall be deemed to have failed to comply with the LME Rules. The LME expects Members to implement appropriate controls to facilitate compliance with the Prohibition. Failure to comply with the Prohibition or failure to implement appropriate controls may result in a Member being subject to an investigation and disciplinary action by the LME. Further information on the LME's enforcement approach is set out in consultation feedback item 6 in the **Appendix** to the Decision Notice. The LME will monitor activity on LMEselect for indications that orders have been placed in contravention of the Prohibition. This monitoring activity

will help the LME to ensure that it can effectively enforce the Prohibition but should not be relied on as a replacement for Members implementing appropriate arrangements to comply with the Prohibition.

11. Where orders subject to the Prohibition are identified by the LME, the LME shall have the power to cancel, or require that a Member cancel, the relevant order or (where applicable) arrange for their DEA Client to do so. The LME expects cancellations to be effected as soon as reasonably practicable. For the avoidance of doubt, and taking into account the LME's obligations to maintain an orderly market, the LME shall not cancel, or require Members to cancel, trades that result from an order that is submitted using an order type that is subject to the Prohibition. In these circumstances, the LME will contact the Member to understand the relevant circumstances in the first instance and may ultimately open an investigation and take enforcement action.

Updated market documentation

12. To support compliance with the Prohibition, the LME has updated the following documents current version of which are available on the LME website:

- LMEselect User Guide[2]
- LMEselect 9.4 FIX Specification[3]
- Guide to Market Structure[4] - updated on 18 December 2020 by LME Notice 20/284

Implementation questions

13. As noted above, the LME is grateful for the detailed feedback that respondents provided, and acknowledges that respondents may have further clarificatory questions as they implement any changes necessary to facilitate compliance with the Prohibition. Anyone wishing to discuss any questions is invited to contact their Relationship Manager at rm@lme.com.

James Cressy
Chief Operating Officer – LME Group

cc: Board director

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[2] https://www.lme.com/Trading/Systems/LMEselect#tabIndex=2
[3] https://www.lme.com/Trading/Systems/LMEselect#tabIndex=2
[4] https://www.lme.com/en-GB/About/Market-Regulation/Guide-to-market-structure

Appendix – LME responses to consultation feedback

	Consultation feedback summary	LME response
1	A number of respondents raised concerns regarding the length of the implementation timeline and the target go-live date set out in the Consultation Notice of 21 December 2020. These concerns are driven largely by the time required to implement systems changes (either directly, and/or in relation to ISV systems) and in a number of cases, by the time needed to implement compliance arrangements (including personnel training) to prevent discretionary orders or iceberg orders being entered in contravention of the Prohibition. One respondent noted that they do not foresee any significant operational challenges in complying with the Prohibition, and did not have any views on the timeline set out in the Consultation Notice.	In light of respondents' feedback, the LME has extended the implementation deadline to market open on 25 January 2021. This deadline has been revised by reference to feedback from both Member and ISV respondents. The LME notes, however, that it is under a regulatory obligation to ensure compliance with all relevant regulatory requirements, including those contained within MiFID II. Where an issue is identified, the LME is under an obligation to remediate it as soon as reasonably practicable. Following discussions with the relevant regulatory authorities, the LME considers that this timeline extension is as much as it could offer, taking into account its regulatory responsibilities.
2	A number of respondents asked the LME to consider adopting the system deactivation approach referred to in the Consultation Notice, instead of the rule-based approach. The main driver for this feedback is a concern that a rule-based approach could introduce increased challenges in ensuring compliance.	The LME has taken careful account of the feedback received, and notes in particular that a number of respondents would prefer a system-based solution. As set out in the Notice above, the LME acknowledges that, all factors being equal, a system-based solution would be preferable. However, the LME has to consider the length of time which a system-based solution would take to implement. The LME is under a regulatory obligation to ensure compliance with all relevant regulatory requirements, including those contained within MiFID II. Where an issue is identified, the LME is under an obligation to remediate it as soon as reasonably practicable. Any system-based solution is likely to take at least a number of months, which is too long from a regulatory-compliance perspective, and therefore the LME has no option but to implement

Consultation feedback summary	LME response
	the rule-based approach initially. The question then is whether it would be preferable to implement amendments to the current version of LMEselect, v9, or to wait until v10, the design of which will address the pre-trade transparency issue. The LME's view is that implementing amendments to v9 would take several months, draw resources from v10 (which will deliver benefits across the LME's market participants), have significant cost attached and require Members to allocate resource to testing (both in relation to any matching engine changes, as well as (for GUI users) in relation to the roll-out of a new GUI). The LME therefore considers that the preferred approach is to use the rules-based approach until the implementation of LMEselect v10.
One respondent suggested that if a rule-based approach is implemented, the LME should consider an alternative approach to the prohibition in relation to native iceberg orders. Broadly, the respondent suggested that rather than completely prohibiting the use of icebergs in relation to certain products, the LME should permit their use, subject to placing an obligation on Members to ensure that the undisclosed portion of the order does not fall below EUR 10,000. This suggestion was driven by the respondent's view that prohibition icebergs in relation to Cash-Settled Futures would affect liquidity.	The LME has considered this option carefully, but has decided to implement the Prohibition in relation to icebergs as originally formulated in the Consultation Notice. The key reason for this is that placing an obligation on front office personnel to ensure that the undisclosed portion of an iceberg order is always EUR 10,000 or greater is likely to introduce manually intensive currency conversion and compliance monitoring processes than a prohibition in relation to all iceberg orders for specific products. Additionally, the LME notes that in the event that it were to adopt the approach suggested, Members would be unable to amend an existing iceberg order in order to release it onto the order book. Members would instead need to cancel the order as it nears the EUR 10,000 thresholds, and subsequently submit a new order for the remaining quantity. Further, the LME would have limited ability to monitor in real time any instances of such iceberg orders falling below EUR 10,000. For these reasons it is considered impractical to adopt the suggested approach.

	Consultation feedback summary	LME response
	A number of respondents highlighted increased challenges with ensuring compliance with a rule-based approach, and queried how the LME expects to utilise its enforcement powers in relation to the Prohibition. One respondent also noted that the system-based controls available to them to aid compliance are likely to be limited.	Please refer to consultation feedback summary 6 for further information on the LME's approach to enforcement of the Prohibition.
3	A small number of respondents asked the LME to provide a list of the affected product codes.	A full list of the affected products is set out in paragraph 9 of the Decision Notice.
4	A small number of respondents asked the LME to confirm whether non-native "synthetic" orders would fall within the Prohibition. One Member set out their view that the distinction between native and non-native synthetic order functionality could disadvantage Members who only utilise the LME GUI to submit orders, and do not currently have ISV arrangements in place.	The Prohibition is intended to apply to any system that utilises the native order functionality within LMEselect. To the extent that algorithmic orders originating from e.g. an ISV utilise LMEselect native functionality, this would also be prohibited. The LME realises that some ISV arrangements offer "synthetic" order functionality, the result of which is that the LME would see the relevant order as a limit order (which are PTT-compliant), rather than as an originating iceberg or discretionary order. Where this is the case, the Prohibition would not apply. The LME acknowledges that some Members may be affected by the introduction of the Prohibition, where other Members with existing ISV or Members' in-house arrangements that offer synthetic order functionality may be able to continue utilising that functionality to submit iceberg and discretionary orders (providing that such functionality does not interact with the LME's native iceberg and discretionary order functionality, in which case the LME would only see resulting orders as limit orders). Compliance with LME Rules is a matter for individual Members to assess in the

	Consultation feedback summary	LME response
		context of their commercial and regulatory compliance arrangements. Should Members require continued access to iceberg and discretionary order functionality, the LME would encourage Members to assess appropriate ISV synthetic order arrangements. The LME believes that (depending on individual Members' business arrangements) it is possible to implement ISV functionality within the extended Prohibition implementation window. Therefore the LME does not consider there to be any unequal treatment of Members – each individual Member has a choice about whether or not to implement synthetic functionality.
5	Two respondents asked for further explanation as to why discretionary orders are not considered to be MiFID II compliant. One respondent suggested that the LME build in a short delay to the discretionary order functionality before a discretionary order offer is lifted.	MiFID II requires the LME to make public all bid and offers advertised through its systems. However, this requirement can be waived for those orders held in an order management facility, which meet the relevant criteria in Article 4 of RTS 2.

The discretionary order type is an order type that displays one visible price but that can be matched at a more generous (discretionary) price. The improved price is never displayed in LMEselect or in the LME's regulatory market data feed, except when a transaction is executed, and therefore does not meet the criteria of an order management facility listed in article 4 of RTS 2 as that aspect of the discretionary order is never intended to be disclosed in the order book.

We have explored the suggestion that the LME could implement a short delay in relation to discretionary orders. However, given that the price at which the order is executed may never be displayed in LMEselect (and the data from LMEselect feeds through to the LME's regulatory market data feed), we do not consider that this would be PTT-compliant. |

	Consultation feedback summary	LME response
6	Several respondents requested more information regarding the LME's intended approach to enforcing the Prohibition. One Member asked whether the LME would grant a forbearance period following the implementation deadline.	Members' compliance with LME Rules is a matter for individual Members to determine, based on the relative nature and complexity of their respective businesses. Given the significant variance in Member's commercial activities and footprints, and relative sophistication, the LME cannot provide specific guidance on the compliance measures that should be implemented. Similarly, in the interests of ensuring regulatory compliance, the LME cannot waive the Prohibition (even temporarily), but will take a pragmatic approach to compliance. In particular, where the LME identifies a breach of the Prohibition, it would look to engage with the relevant Member in the first instance before taking any decision to initiate a formal investigation or enforcement action. In corresponding with Members in relation to any identified non-compliance, the LME's Market Surveillance team would ask for relevant information, including factors that led to the breach, and information regarding any reasonable steps that the Member has taken to facilitate compliance.
7	A small number of respondents suggested that removal of the discretionary order type could affect their ability to provide reliable execution for their clients, with a risk that algorithmic orders could jump ahead of a bid/offer when an order is placed (absent the discretionary order type). One respondent commented that removal of the discretionary and iceberg order types as set out in the consultation Notice could potentially make it more	The LME appreciates this feedback, and has undertaken analysis on the extent of use native discretionary orders in order to assess the population of market participants that may be impacted. Based on the data available to the LME, we have observed limited use of native discretionary order functionality across the LME's suite of contracts. Affected respondents may wish to consider establishing appropriate ISV arrangements in the event that the continued use of (non-native) discretionary and iceberg order functionality is critical to their business models. The LME appreciates this observation. However, the illustrative order types mentioned in this response involve market events triggering the publication of the order over the LME's PTT data

	Consultation feedback summary	LME response
	attractive to employ alternative synthetic/algorithmic order types (e.g. ghost / if touched) which has the effect of keeping working orders off the LME's central order book, which would result in less pre-trade transparency than more.	feed. In this respect, removal of the LME's native order functionality will level the playing field between participants in that any participant is able to put in place ISV (or in-house) arrangements that include synthetic order functionality.
8	One respondent asked whether the LME would work with all ISVs to ensure that appropriate technological changes are made to implement the prohibition, or whether this is the responsibility of Members. Another respondent noted their view that it seems unreasonable to expect ISVs to commit resources to such specific development at short notice.	The LME has contacted all approved ISVs to ensure that they were aware of the Consultation Notice proposal and associated timeline. Several of the consultation responses came from ISVs, noting that the original implementation deadline of 21 December 2020 was aggressive. The LME has therefore extended the implementation timeline to facilitate these changes being made, and with a view to avoiding the end of year change freeze that many respondents were concerned about. The LME does not, however, have a contractual customer relationship with ISVs and cannot mandate that ISVs make these changes. However, the LME will continue to work with ISVs to help support them in making these changes, but Members are encouraged to contact their ISVs to ensure that the ISVs are aware of the requirements and can deliver on them appropriately.
9	One respondent asked for more information on the LME costs and timeline for development of a system-based solution. The same respondent further noted its expectation that the LME will have seriously considered the pros and cons of implementing a system-based solution.	The LME undertook a pros and cons analysis of the rules-based and system-based approaches prior to issuing the Consultation Notice. Known implementation costs and timelines were key factors within this analysis. The LME has reviewed its analysis in the light of consultation feedback and believes that, on balance, it remains appropriate to adopt rule-based approach at this time for the reasons set out in response #2 above. The LME appreciates that Members have identified challenges with a rule-based implementation approach; but the LME commits to working with Members and ISVs to support them through the implementation

Consultation feedback summary	LME response
	phase, and has also outlined its intention to apply a pragmatic approach to enforcement in relation to the Prohibition. As also set out above, the LME notes that these challenges will be time-limited given that LMEselect v10 will remove native discretionary order functionality, and will introduce native iceberg functionality that builds in a check against the EUR 10,000 threshold (negating the need for a prohibition in relation to either of these order types).