

To: All members and other interested parties

Ref: 17/378

Classification: Consultation

Date: 22 November 2017

Subject: **CONSULTATION ON LME RULE CHANGES FOR FINANCIAL OTC BOOKING FEE POLICY AND USE OF LME DATA AND FACILITIES**

## Summary

1. The London Metal Exchange (the “**LME**” or the “**Exchange**”) is seeking the views of its Members and other interested parties in respect of the introduction of certain changes to the Rules and Regulations of the LME (the “**Rulebook**” or the “**LME Rulebook**”), which relate to: (i) the introduction of a new booking fee policy for OTC contracts (a proposed draft of which is set out at Appendix I) entered into by financial counterparties (the “**Financial OTC Booking Fee Policy**”); and (ii) the introduction of a number of other changes to clarify the extent to which LME data and facilities may be used for non-LME business and to protect the integrity of the LME’s data and trading venues more broadly (together, the “**Consultation**”).

## Defined Terms

2. Terms not otherwise defined in this notice (this “**Notice**”) shall have the meaning ascribed to them in the proposed revision of the Rulebook set out in Appendix II of this Notice.

## Background

3. In the Strategic Pathway document, published as an attachment to LME Notice 17/302, dated 7 September 2017 (the “**Strategic Pathway**”), the LME set out its intention to introduce the Financial OTC Booking Fee Policy. The LME sought feedback in respect of the Strategic Pathway from interested parties. Thereafter the LME discussed its proposals around the Financial OTC Booking Fee Policy with a number of Members and other market participants, including with the LME’s User Committee. These discussions



with market participants have helped the LME to shape the Financial OTC Booking Fee Policy and the other proposals set out in this Notice.

4. In particular, the LME has made a number of changes as a result of this market engagement. Originally, the LME had intended for the Financial OTC Booking Fee to be payable from 1 January 2018, but after discussion with market participants, the LME is proposing that the Financial OTC Booking Fee would be payable from 3 April 2018, thereby giving Members and their Affiliates extra time to understand their obligations under the Financial OTC Booking Fee Policy and make appropriate arrangements for reporting. Furthermore, the LME has introduced a set of fee waivers, discounts and offsets in response to market feedback.
5. Furthermore, in introducing the Financial OTC Booking Fee Policy, it became apparent to the LME that OTC contracts are being created as the result of trading on a broad variety of platforms, and that it would therefore be prudent and necessary to determine rules as to the acceptable use of platforms, for the creation of OTC contracts using LME prices or other intellectual property. This is also consistent with the stated aims of the Strategic Pathway.
6. The LME's position on the acceptable use of platforms, for the creation of OTC contracts using LME Data, as articulated by the proposed Rule changes in this Consultation, has been shaped by the views of market participants. In general, there is broad acceptance as to the existence and use of "single dealer" platforms, where an LME Member will create an automated platform to make prices to, and create Client Contracts for, its clients. However, there is concern as to the potential proliferation of multi-dealer platforms, which may have the effect of fragmenting market liquidity.

### **The Consultation process**

7. The Consultation is open to all interested parties, including, without limitation, Members, Clients of Members and Affiliates of Members.
8. Formal responses to the Consultation should be submitted in writing. The Consultation will remain open for responses until close of business on 12 January 2018. Responses made after the closing date of the Consultation will



not be taken into consideration. The LME will take into account all responses received by the closing date.

9. Any market participant wishing to ask questions or to seek clarification on any issue covered by the Consultation, is asked to contact Jamie Turner on +44 (0) 207 113 8714 or at [jamie.turner@lme.com](mailto:jamie.turner@lme.com). Any market participant wishing to submit a response to the Consultation is asked to send it to Kishan Chandarana at [kishan.chandarana@lme.com](mailto:kishan.chandarana@lme.com).
10. Although the LME will consider responses submitted in any format, it would be helpful if respondents could reply to the numbered Consultation questions (“**Consultation Questions**”) set out in this Notice.
11. The LME may need to share responses received with regulatory authorities, members of its group including LME Clear, its legal or other professional advisers, or as required by law. Anonymised responses (verbatim or paraphrased) may be included in the decision notice stating the outcome of this Consultation. Apart from this, all responses received will be treated in confidence.

### **The Financial OTC Booking Fee Policy Proposal**

12. This section sets out details of the proposal to implement a Financial OTC Booking Fee Policy (the “**FOTC Booking Fee Proposal**”).

#### Purpose of FOTC Booking Fee Proposal

13. The LME is seeking to acknowledge the current disparity in the fees paid by Members servicing their Clients by means of a Client Contract and those servicing their Clients by means of an over the counter (“**OTC**”) contract. The LME views its “all-in” Client fees (i.e. the cost of a Member trade together with the associated Client Contract) as fair and is therefore introducing a financial over-the-counter booking fee (“**Booking Fee**”) in order to rebalance the inequality between the firms servicing their Clients by means of a Client Contract and those servicing their Clients by means of an OTC contract. It is further intended that the Booking Fee would compensate the LME for use by financial institutions of LME prices and other intellectual property belonging to the LME.



14. The applicability of the new Booking Fee, and the operational requirements to support its implementation, are set out in the new Financial OTC Booking Fee Policy.

#### The FOTC Booking Fee Proposal

15. The FOTC Booking Fee Proposal comprises:
  - (a) the introduction of the Financial OTC Booking Fee Policy; and
  - (b) the introduction of a new Membership Regulation 19 (*Financial OTC Booking Fee Policy*), which would oblige Members to:
    - i. comply with the Financial OTC Booking Fee Policy, report to the LME OTC trades falling within the scope of the Financial OTC Booking Fee Policy and pay to the LME any Booking Fees calculated by the LME in respect of such reported trades;
    - ii. require Affiliates who are within the intended scope of the Financial OTC Booking Fee Policy to comply with the Financial OTC Booking Fee Policy;
    - iii. where required, permit the LME and/or its representatives access to records and information of the Member and its Affiliates, and respond to reasonable queries from the LME, to enable to the LME to verify compliance with the Financial OTC Booking Fee Policy.

#### How the Financial OTC Booking Fee Policy would Apply

16. In order to ensure that there is consistency in application of the LME's approach under the various ways by which entities are able to access and use LME's data and prices for the purposes of entering into OTC contracts, the LME intends to incorporate requirements to comply with the OTC Booking Fee in:



- (a) The Rulebook, which applies to Members and requires Members to procure the compliance of their Affiliates with this Financial OTC Booking Fee Policy; and
- (b) data usage licenses and data distribution agreements, which apply to licensees under such agreements.

#### When would the Financial OTC Booking Fee Policy Come into Effect?

- 17. The LME is intending to issue a consultation decision notice in early February 2018. The LME is proposing that the Rule Changes set out in this Notice would come into effect shortly thereafter. The Financial OTC Booking Fee Policy would come into effect by notice as specified in the Financial OTC Booking Fee Policy; it is currently intended that the registration obligation would apply from 12 March 2018, and OTC trading would be reportable (and the Booking Fee payable) from 3 April 2018.
- 18. It is currently intended that, in parallel with issuing the LME's decision notice in early February 2018, the LME will serve notice on all licensees that have licensed LME Data under the LME's data usage licence. The notice would vary the terms of the LME's data usage licence to require licensees and their affiliates to comply the Financial OTC Booking Fee Policy. The terms of the LME's data usage licence can be varied on 90 days' notice in writing.

#### The Effect of the Financial OTC Booking Fee Policy

- 19. The effect of the Financial OTC Booking Fee Policy is that entities falling within the scope of the Financial OTC Booking Fee Policy ("**Booking Fee Participants**") would be required to:
  - (a) report to the LME the aggregate tonnage referenced in certain OTC contracts that they enter into ("**Relevant OTC Contracts**") to the LME; and
  - (b) pay to the LME a booking fee in respect of such Relevant OTC Contracts, subject to certain waivers, offsets and discounts.



The Scope of Application of the Financial OTC Booking Fee Policy

20. The Financial OTC Booking Fee Policy would require the reporting of, and potential payment of a fee in respect of:
- (a) Entities falling within the definition of Booking Fee Participant (as set out in the Financial OTC Booking Fee Policy); in respect of
  - (b) OTC transactions falling within the definition of Relevant OTC Contract (as set out in the Financial OTC Booking Fee Policy).
21. The following table summarises: (i) the type of entities which would fall within the definition of Booking Fee Participants; (ii) whether exemptions may be available to remove certain entities from the definition of Booking Fee Participants; and (iii) the contractual document that creates the binding obligations to comply with the Financial OTC Booking Fee Policy. For the full definitions of the terms used in the table below, please see Part 1 of the Financial OTC Booking Fee Policy.

Type of Entity	Potential Exemptions	Governing Contract(s)
Category 1, 2, 3 or 4 Members	<ul style="list-style-type: none"> <li>• No Financial Institution within Group (including Member)</li> </ul>	Rulebook
Affiliate of Category 1, 2, 3 or 4 Member	<ul style="list-style-type: none"> <li>• No Financial Institution within Group (including Affiliate)</li> <li>• Client Asset Manager</li> <li>• Physical Participant</li> </ul>	Rulebook (obligations on Member)
Licensee that is a Financial Intermediary (who may also be a	N/A	Data Agreement or other relevant contract



Category 5 Member)		
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22. The Financial OTC Booking Fee is intended to apply to entities intermediating OTC financial contracts in LME metals in a similar manner to LME Client Contracts, but without registering those OTC contracts at the LME, and thus not paying trading and clearing fees, and not contributing to market infrastructure costs. It is not intended to apply to entities trading LME metals for physical business or for investment needs. As such, the LME believes it is appropriate to exempt groups that do not contain any Financial Institutions. Additionally, certain corporate groups may include financial entities intermediating contracts, entities trading for the purpose of investment, and corporate entities trading for the purpose of hedging physical needs. The LME believes it is appropriate to exempt Affiliates whose primary business is either in the management of client assets, or in the manufacture or use of physical metals: such entities are not financial intermediaries, and therefore it would not be appropriate for the Financial OTC Booking Fee to apply to them.
23. The potential exemptions identified in the table above are set out in the Financial OTC Booking Fee Policy. Any entity to which an exemption specified in the table above applies would not be a Booking Fee Participant (as defined in the Financial OTC Booking Fee Policy) and would therefore not be required to pay the Booking Fee or to report Relevant OTC Contracts.
24. In addition to the exemptions identified in the table above, there is also an Intra-Group Waiver (as defined in the Financial OTC Booking Fee Policy), the effect of which is to dis-apply the requirement to report such transactions to the LME and dis-apply the Financial OTC Booking Fee from transactions between affiliated entities. It does not dis-apply the reporting obligation or the application of the Booking Fee, for Relevant OTC Contracts with entities outside the relevant Booking Fee Participant's Group.
25. The following table summarises the types of contracts to which the Financial OTC Booking Fee Policy applies – that is, contracts that are Relevant OTC Contracts (please see the Financial OTC Booking Fee Policy itself for the precise detail):



<b>Contracts or products that are not input into LMEsmart or cleared by LME Clear, such as (but not limited to) contracts that are:</b>	<b>Which have any of the following characteristics:</b>	<b>And which are not:</b>
<ul style="list-style-type: none"> <li>• Subject to an ISDA</li> <li>• Documented by long-form confirmation</li> <li>• Documented in any other form; or</li> <li>• Un-documented</li> </ul>	<ul style="list-style-type: none"> <li>• May settle on the basis of, or with direct or indirect reference to, LME prices or data</li> <li>• Include the LME branding or IP or references to the LME</li> <li>• Are margined on the basis of LME Data</li> <li>• May be settled using the LME infrastructure</li> <li>• Uses the the LME's list of specifications brands, locations and/or warehouse operators (where such list utilises all or part of the database compiled by the Exchange).</li> </ul>	<ul style="list-style-type: none"> <li>• Contracts with platinum or palladium as the underlying metal</li> <li>• Contracts with ferrous metals as the underlying metal</li> <li>• Contracts which have as the underlying metal a precious metal which is the same as an LMEprecious Contract</li> <li>• Contracts already subject to the Derived Data Licence</li> <li>• Contracts between Affiliates which are in the same Reporting Group</li> <li>• Contracts that refer to the London Metal Exchange Index (LMEX) as the basis for determining their value</li> <li>• Contracts entered</li> </ul>





		into before the date specified by notice following the entry into force of the Financial OTC Booking Fee Policy
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Structure of the Financial OTC Booking Fee Policy

26. The Financial OTC Booking Fee Policy is structured as follows:

<b>Part:</b>	<b>Content:</b>
1	Defines to whom the Financial OTC Booking Fee Policy applies, and the available exemptions – that is, who qualifies as a Booking Fee Participant
2	Sets out the arrangements through which Booking Fee Participants shall notify the LME of their participation in the arrangements of the Financial OTC Booking Fee Policy
3	Defines the trades that are subject to the OTC Booking Fee Policy – that is, what is a Relevant OTC Contract
4	Explains how the Booking Fee is calculated and the arrangements for payment
5	Specifies how Relevant OTC Contracts should be reported to the LME, and the arrangements for auditing compliance with the Financial OTC Booking Fee Policy
6	Specifies how the Financial OTC Booking Fee Policy may be changed
7	Outlines some example scenarios
8	Glossary



## Protecting the integrity of the LME's venues and data

27. As noted in the LME's Strategic Pathway, certain market participants have voiced concerns around unrestricted use of LME intellectual property and facilities by third-party, "multi-dealer" platforms insofar as it could fragment liquidity and threaten the LME's commercial interests. This section explains the proposals to implement restrictions on the use of LME intellectual property or facilities for the purpose of transactions that are executed on trading platforms other than the LME, and to protect the integrity of the LME's data and trading venues more broadly.
28. In the Strategic Pathway document, published as an attachment to LME Notice 17/302 dated 7 September 2017 (the "**Strategic Pathway**"), the LME set out its conclusions on codifying behavioural standards in respect of execution on the LME's market. As set out in particular in paragraph 8.3 of the Strategic Pathway, the LME does not believe it appropriate to facilitate a situation whereby some market participants achieve a commercial advantage by shielding a large proportion of trading activity from the LME market. Such behaviour not only reduces the effectiveness of price formation, but additionally requires those who do not engage in such activity to disproportionately subsidise the market infrastructure (via the payment of LME fees) in comparison to those who do not execute on the LME market. Accordingly, the LME proposes to codify certain behavioural standards in its Rulebook, as further detailed below.
29. The LME is therefore introducing the "**Facilities Proposal**" (to clarify the use of alternative platforms to create contracts using LME intellectual property or booking systems), the "**Gross Trades Proposal**" (to require the booking of trades on a gross basis into LMEsmart), the "**LMEselect Order Transparency Proposal**" (to require that all orders intended to be submitted to LMEselect are actually submitted) and the "**API Terms Proposal**" (to ensure that data made available by means of the API is subject to appropriate protections, including the Financial OTC Booking Fee Policy where applicable).



## The Facilities Proposal

30. The Facilities Proposal arises from the introduction of the Financial OTC Booking Fee Policy, and specifically the fact that many OTC contracts are entered into by means of electronic trading platforms. The LME believes it is appropriate, in the context of the Financial OTC Booking Fee Policy, to more broadly codify rules for the acceptable use of third-party platforms when creating contracts (be they OTC or centrally-cleared) which use LME intellectual property, or are booked by means of LME infrastructure.
31. Feedback suggests that the market broadly supports the existence of single dealer-to-client platforms. However, the LME has received feedback from certain market participants that it should, as far as possible, regulate the use of its intellectual property and market infrastructure by third-party, multi-dealer platforms.
32. The LME is mindful of the fact that its Members may wish to utilise third-party platforms, which lawfully make use of LME intellectual property or systems, for example a venue to which the LME licenses prices, or a venue utilising LME intellectual property or infrastructure by means of an open-access arrangement. Accordingly, the Facilities Proposal sets out details of the LME's proposal to issue a notice under the Rules where, as determined by the LME in its sole discretion and acting reasonably, any Non-LME Multi Dealer Trading System (as defined below in paragraph 34 of this Notice) is lawfully making use of the Intellectual Property Rights of the Exchange, including, without limitation, where such Non-LME Multi Dealer Trading System has: (i) entered into a licence agreement for the use of Intellectual Property Rights belonging to the Exchange; or (ii) been granted open access rights pursuant to prevailing applicable legislation.
33. The Facilities Proposal comprises:
  - (a) the introduction to the Rulebook of a new Membership Regulation 20 (*Restrictions on use of LME property or systems for Non-Exchange Contracts*); and
  - (b) the introduction to the Rulebook of a number of new provisions into Membership Regulation 18 (*Intellectual Property*); and



- (c) the introduction to the Rulebook of a new LMEsword Regulation 5.6 (*Use of LMEsword for Settlement of Non-Platform Contracts*); together with
- (d) associated definitions in Part 1 (*Interpretation*).

34. The key features of the Facilities Proposal are as follows:

- (a) a new definition of a “**Non-LME Multi Dealer Trading System**”, essentially comprising a trading platform or other system for bringing together multiple buying and selling dealing interests that is not operated by the LME (and is not a Single Dealer to Client Platform);
- (b) a new definition of “**Non-LME Platform Contract**”, covering contracts or products traded on, executed on, or arranged or agreed via a Non-LME Multi Dealer Trading System;
- (c) requirements for Members not to use LME Data, Product Specifications or other Intellectual Property Rights for the purpose of trading, clearing or settling Non-LME Platform Contracts or otherwise for purposes competing with the operations of the LME;
- (d) confirmation that LME Warrants may not be used to settle Non-LME Platform Contracts, and that the Ex-Cleared functionality of LMEsword may not be used to facilitate the settlement of Non-LME Platform Contracts;
- (e) a prohibition on Members or Clients using the LME's inter-office market to route Non-LME Platform Contracts through the systems of the Exchange;
- (f) a prohibition on Members or Clients bringing-onto the LME Non-LME Platform Contracts;



- (g) an ability for the LME, by notice, to dis-apply any of the restrictions in (c), (d), (e) or (f) above in respect of specific Non-LME Multi Dealer Trading Systems;
- (h) clarification that the LME reserves its rights to any rights (including Intellectual Property Rights), licences and permissions in and to the LME Data, the Trade Marks and the Product Specifications, together with some more specific provisions explaining certain restrictions on the use of such property for certain purposes;
- (i) the Exchange shall issue a notice publicising the situation where, as determined by the LME in its sole discretion, acting reasonably, any Non-LME Multi Dealer Trading System is lawfully making use of the Intellectual Property Rights of the Exchange, including, without limitation, where such Non-LME Multi Dealer Trading System has: (a) entered into a licence agreement for the use of Intellectual Property Rights belonging to the Exchange; or (b) been granted open access rights pursuant to prevailing applicable legislation; and
- (j) the introduction of a provision into the LMEsword Regulations stating that LMEsword shall not be used to settle Non-LME Platform Contracts in breach of the requirements specified in Membership Regulation 20 and clarifying that this requirement shall apply to any Account Holders, not just Members.

### The Gross Trades Proposal

- 35. The Exchange proposes to implement a requirement for Agreed Trades to be entered into the Matching System on a gross basis. This proposal is intended to ensure that the market can view a transparent post-trade record of market activity and that financial advantage is not extracted by the systematic “netting-up” of trading, in order to reduce the fee burden.
- 36. The Gross Trades Proposal comprises the introduction to the Rulebook of a new Trading Regulation 3.12 (*Agreed Trades as Gross Transactions*), which would require Members to ensure that, in respect of trades arranged in the inter-office market, the details of each Agreed Trade entered into the Matching System constitute the details of a single transaction, without the



application of any prior netting, compression or aggregation of multiple transactions, while allowing for prompt date adjustments.

### The LMEselect Order Transparency Proposal

37. The Strategic Pathway stated that the LME would be making changes to its booking flow to facilitate the flow of “green trades” through the Matching System to its clearing system. These changes come into effect on 13 November 2017, and green trades will be charged for in the usual way from 1 January 2018<sup>1</sup>. The LME is proposing rules to prevent Members from “crossing up” trades in their own system before they are entered in the Matching System, which would ensure that the entire market benefits from the display of quoting activity on the LMEselect platform.
38. The LMEselect Order Transparency Proposal comprises the introduction to the Rulebook of a new Trading Regulation 12.18 (*Transparent Reporting of Orders to LME Select*), which would require that Members ensure that, in respect of both Client and Member’s house orders executed by Members via LME Select, Members must not cross-up any such trades in their own systems before they are Executed as Agreed Trades in LME Select.

### API Terms Proposal

39. It is proposed to incorporate into the Rules terms governing access to LME Information through an API, that are currently set out in a side-letter between the LME and each Member.
40. The intention behind the API Terms Proposal is to reduce the number of agreements in which there are contractual obligations between the LME and its Members. The current side letter is a bilateral agreement between the LME and each Member. Given that the Rules constitute a master agreement between the LME and each Member, the LME considers that it is appropriate to incorporate the terms governing the use of the API into the Rules.
41. The API Terms Proposal comprises the introduction to the Rulebook of the terms that are currently set out in the separate side letter between the LME

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<sup>1</sup> See LME Notice 17/363 dated 27 October 2017



and each Member, and applies the Financial OTC Booking Fee Policy where applicable.

### Consultation Questions

42. The LME requests that respondents to the Consultation answer the following questions:

**Question 1** – Do you have any comments on the Financial OTC Booking Fee Proposal (excluding the Financial OTC Booking Fee Policy)? If possible, please use the table below to provide comments.

Regulation reference (if applicable)	Comment / proposed change	Rationale
Regulation [ ]	[Please complete]	[Please complete]

**Question 2** – Do you have any comments on the Financial OTC Booking Fee Policy? If possible, please use the table below to provide comments.

Financial OTC Booking Fee Policy paragraph reference	Comment / proposed change	Rationale
OTCBF Paragraph [ ]	[Please complete]	[Please complete]

**Question 3** – Do you have any comments on the Facilities Proposal? If possible, please use the table below to provide comments.

Regulation reference	Comment / proposed change	Rationale
Regulation [ ]	[Please complete]	[Please complete]



**Question 4** – Do you have any comments on the Gross Trades Proposal? If possible, please use the table below to provide comments.

Regulation reference	Comment / proposed change	Rationale
Regulation [ ]	[Please complete]	[Please complete]

**Question 5** – Do you have any comments on the LMEselect Order Transparency Proposal? If possible, please use the table below to provide comments.

Regulation reference	Comment / proposed change	Rationale
Regulation [ ]	[Please complete]	[Please complete]

**Question 6** – Do you have any comments on the API Terms Proposal? If possible, please use the table below to provide comments.

Regulation reference	Comment / proposed change	Rationale
Regulation [ ]	[Please complete]	[Please complete]

**Question 7** – Do you have any other comments in relation to this Consultation?

### Timing and steps following the Consultation

43. The changes to the Rulebook may be subject to regulatory non-objection before they can become effective. Following due consideration, the LME may implement:





- (a) in respect of each of the Financial OTC Booking Fee Proposal, the Facilities Proposal, the Gross Trades Proposal, LMEselect Order Transparency Proposal and/or the API Terms Proposal (each a “**Proposal**”), that Proposal, a modified version of that Proposal, an alternative to that Proposal, or no measure in respect of that Proposal;
- (b) any other measure(s); or
- (c) no measures.

44. Following this Consultation, the LME will issue a decision notice confirming any changes to the Rulebook and/or the Financial OTC Booking Fee Policy.

### **Benefits & Unintended Consequences**

45. The LME acknowledges that there may be costs for Members in complying with the Proposals. However, the LME believes that the Proposals are justified to ensure fairness and to address the disparity in fees paid by Members servicing their Clients by means of an OTC contract rather than a Client Contract. The LME has not identified any unintended consequences as a result of the Proposal. The LME is interested in the views of respondents to the Consultation in this regard.

**Jamie Turner**

**LME Market Development**

cc: Board Directors  
User Committee  
All metal committees  
Physical Market Committee  
Trading Committee  
Ring Dealers Committee  
Traded Options Committee  
Warehousing Committee



## Appendix I

### Proposed Financial OTC Booking Fee Policy

*Distributed with this Notice.*

Link: [Financial OTC Booking Fee Policy](#)



**Appendix II**  
**Proposed Rulebook Changes**

*Distributed with this Notice.*

Link: [LME Rules Rider](#)