Discussion Paper on Market Structure: Response Paper

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An HKEX Company

SETTING THE GLOBAL STANDARD

Contents

1 EXECUTIVE SUMMARY

1.1 Background to the Response Paper

On 19 January 2021 the LME[1] published its Discussion Paper on Market Structure (the "**Discussion Paper**"), which sought comments on potential structural changes designed to allow the LME Group to modernise and adapt to new market dynamics and evolving customer needs. The Discussion Paper covered four main topics: the Ring and reference prices; enhancing liquidity; realised variation margin; and additional considerations concerning market conduct. It also included a section reviewing the LME's existing strategic principles. The LME undertook a wide-ranging market engagement programme based on this Discussion Paper, running from 19 January 2021 to 19 March 2021.

As outlined in the Discussion Paper, the proposed changes aimed to achieve increased transparency – which not only aligns with the regulatory direction of travel but more broadly allows for structurally fairer and more efficient and liquid markets.

The responses to the Discussion Paper, other interactions the LME has had with market participants, and the LME's own understanding of the topics have all informed the LME on how best to develop its market structure, considering the needs of all participants and the market as a whole. This document (the "**Response Paper**") summarises the views that the LME received, and lays out how it will proceed in each area of development.

1.2 Structure of this Response Paper

To align with the structure of the Discussion Paper, the Response Paper follows the same five main sections; strategic principles of market structure, the Ring and reference prices, enhancing liquidity, realised variation margin and additional considerations concerning market conduct.

For the three main topics – *the Ring and reference prices*, *enhancing liquidity*, and *realised variation margin* – the LME has provided high-level quantitative summaries of responses. This analysis assesses the overall shape of each respondent's views towards the proposals in each section of the Discussion Paper as either negative, neutral (including no comment made) or positive. Each respondent is categorised as either a member, physical participant, financial participant or non-trading stakeholder. Data on the number of negative, neutral and positive responses is then shown by category. The data is also presented on a volume-weighted basis based on each respondent's average daily LME volume. To illustrate the total size of each categorisation group, a grey shaded box is added to make the bar size represent the total average daily volume ("**ADV**") for each group. ADV, while a crude lens to use for assessing market participant views, is used as a simple measure of participant size in order to give context to the opinions. The LME has also considered the detail of each respondent's views, while considering the importance of the various components of the LME ecosystem and the interaction of all stakeholders within it. While the LME has considered the quantitative analysis, it was the detailed understanding of the feedback received that was most important in helping the LME to consider the issues raised and determine the outcomes of the Discussion Paper process.

For the sections on *strategic principles* and *additional considerations concerning market conduct*, it was not appropriate to provide a quantitative summary in this format, because of the nature of the proposals. Within the market conduct considerations section the proposals in the Discussion Paper were at a much more formative stage and much of the feedback was seeking clarity on the detail around implementation before expressing a view for or against the proposals.

[1] Throughout this document "LME" is used to mean both LME and LME Clear where appropriate

Each major section of this Response Paper includes an "Overall themes" box that summarises the key feedback before introducing each Discussion Paper question and the detailed summary of feedback received in relation to the question. Each section then concludes with the LME's considerations and outcomes.

This Response Paper should be read alongside the Discussion Paper, which laid out the initial LME analysis on each topic.

1.3 Responses to the Discussion Paper on Market Structure

The LME received 192 responses from a diverse set of stakeholders, and is grateful to all of those respondents for taking the time to share their views. The LME has undertaken a detailed process of analysis to ensure that all responses have been fully considered and, therefore, allowing the LME to make decisions in the interest of the market as a whole.

The goal of this document is to give a summary of the opinions that were put forward, rather than to give a verbatim report of all feedback received on each topic. This is both to protect the anonymity of all those who responded, and to make this document more digestible to all interested stakeholders.

Within the range of responses received, some respondents answered all the questions directly, other respondents only answered a limited set, and some respondents gave opinions that were more general on the matters considered within the Discussion Paper, without directly answering the questions. The inter-linked nature of many of the topics and questions within the Discussion Paper also meant that many responses and themes spanned across several questions.

Within this Response Paper, the LME, as far as possible, has tried to interpret all the feedback given and align it to the questions as they were set out in the Discussion Paper in order to make this document as concise as possible. Many respondents provided large amounts of detail in their responses for which the LME is very grateful. While it was not possible to include all this detail in this Response Paper, the LME has given all information full consideration when deciding on the outcomes.

The feedback summaries are necessarily brief and intended to capture the general sentiment of feedback given, rather than exhaustively mention all relevant points made. Bullet point format has been used in some areas where appropriate.

Respondents should be aware that the feedback has been considered both in its direct application in answer to the questions in the Discussion Paper, and also considered "in the round" in order to inform the LME's general understanding of respondents' views on matters within the Discussion Paper.

This feedback document does not constitute a binding commitment for the LME to implement any of the proposals set out herein. The LME accepts no responsibility or liability to any person with respect to any action taken or omitted to be taken by such person in reliance on any statement made in this document. The LME may undertake subsequent consultations with respect to the implementation of specific proposals, in accordance with its usual consultation processes and applicable rules. Furthermore, certain proposals may be subject to further consultation and/or regulatory approval.

Nothing in this document should be construed as restricting any discretion of the LME to take such action as it considers appropriate in the operation of the LME, including through its determinations on applications for access to the LME's facilities. Nor should anything in this document be construed so as to require the LME to take any action.

1.4 Overarching themes

A number of overarching themes came through the responses to the Discussion Paper that the LME believes are important to provide context to the more detailed responses to the Discussion Paper questions. These are as follows:

- **Many traditional participants (particularly smaller physical clients) view the LME as a utility for their type of hedging business**. Often these respondents are not involved in financial markets more widely, and their LME involvement is tangential to their core business operations within the physical metals industry. They are generally not supportive of change. They believe the purpose of the LME is to accommodate their hedging requirements and they feel the existing, unique structure serves this and does not warrant change.
- **Hedge funds, and financial participants more generally, are already trading on the LME**. These financial participants (both member and client) often find the LME a difficult market on which to trade, with high barriers to entry, both in terms of literal barriers to access and a complex market structure increasing the difficulty of trading LME markets. A divergence of opinions exists between traditional and financial participants. Traditional participants tend to believe that those who want to trade on the LME should take the time to understand the market; whereas many financial participants believe the complexity of the market and having to "understand" it (compared to other standardised futures markets) itself is a high barrier to entry. They believe many of the unique LME nuances lead to undesirable consequences, such as lower practical levels of transparency, less competitive pricing, and higher costs to trade, including exchange fees, brokerage costs, and operational costs.
- **A number of traditional physical clients distrust electronic markets**. They generally prefer to have a person-to-person interaction. They are concerned that other participants in an electronic market are predatory and looking to take advantage of physical participants. They generally prefer more traditional ways of trading, such as bilateral pricing from their broker over the phone.
- **The date structure is seen as a unique positive feature of the LME for many physical participants**. The date structure allows them to hedge their physical exposures accurately, but it is seen as a challenge to trade electronically. Due to its complexity, some responses suggest that the date structure could never be traded electronically, while others think that it is a case of new technological solutions being needed.
- **There are intrinsic links between the Ring and electronic liquidity topics**, particularly when considering the timings of any changes. Any changes to the way markets trade and to business practices are likely to have an impact on liquidity. Regarding the topic of the Ring, and electronic liquidity more generally, respondents believe the LME needs to consider the overall impact to liquidity.
- **Some respondents think that standardisation will make the LME unable to compete head on with peer exchanges**. They cite these peer exchanges as having better technology and view the LME's unique market structure as a defence mechanism against this competitive threat. Others see the benefits of a more standard structure and see LME's unique structure as the reason why some clients are driven to trade on other exchanges.

The LME has taken these overarching themes into consideration in shaping the outcomes that result from the Discussion Paper.

2 STRATEGIC PRINCIPLES OF MARKET STRUCTURE

2.1 Overall themes - strategic principles of market structure

- There was broad agreement from respondents that the principles remain relevant and are an appropriate lens through which to view the future evolution of the LME market structure.
- The balance between the principles was noted, with the suggestion that trading efficiency for the investment community was being sought at the expense of serving the physical market.
- It was also suggested that there might be regulatory drivers behind some of the proposals.
- Some respondents suggested the paper was not clear on how the principles currently apply, for example what the LME currently sees as fair or unfair in the market.

2.2 Feedback summary – strategic principles of market structure

1) Do you agree that the LME's strategic principles continue to provide an appropriate lens through which to view the future evolution of its market structure?

Most respondents were in broad agreement with the LME's principles. Many respondents gave specific feedback in some areas of both the appropriateness of the principles, and how they thought the principles applied to the LME market and the matters within the Discussion Paper:

Serve the physical market

- Many physical participants and some members felt serving the physical market should have more weight within the principles and view the LME as a utility for their type of hedging business. They suggested the LME's sole purpose, or highest priority, should always be to serve the physical market and that without the physical market and its hedging activity, LME prices would lose their relevance. Furthermore, they felt the proposals in the Discussion Paper might not benefit the physical market.
- Some respondents suggested the proposals set out in the discussion paper were at odds with serving the physical market and designed to encourage non-physical participants.
- It was suggested that the principle to serve the physical market was too narrow and the LME should look to provide products that serve as effective and efficient hedging instruments more broadly (including indices, swaps, ETFs etc).
- It was also highlighted that clearing members play a vital role in market structure by providing access.

Ensure fairness

- It was suggested that non-displayed electronic orders and some algorithmic trading practices were not supportive of transparency and that market surveillance needs to be increased as electronic liquidity grows.
- Some respondents argued that certain firms have advanced technology, which they can use to take advantage and internalise more flow at the detriment of the broader market.
- The fairness of the current market structure was questioned, with the suggestion that the inter-office market and dual capacity create information asymmetry and conflicts of interest, and that the date structure increased the cost to trade for clients to the benefit of members.

Increase user choice

- Some respondents argued that the proposals in the Discussion Paper reduced user choice and removed elements of flexibility within the market structure. In particular, some respondents noted that the Ring should remain open as a choice of execution venue and inter-office fees should not be increased.
- Some other respondents argued that user choice hinders the market's ability to standardise and broaden participation.

Maximise trading efficiency

- It was suggested that without greater liquidity on the monthly contracts it would be hard to make the LME more efficient. It was noted that the LME benefits from the trading in date adjustments.

Some respondents also suggested some further principles or areas that they believe the LME should consider:

- Protect the existing market and liquidity
- Optimise market functioning
- Transparency
- Serving all market participants

2.3 LME consideration and outcomes – strategic principles of market structure

Summary

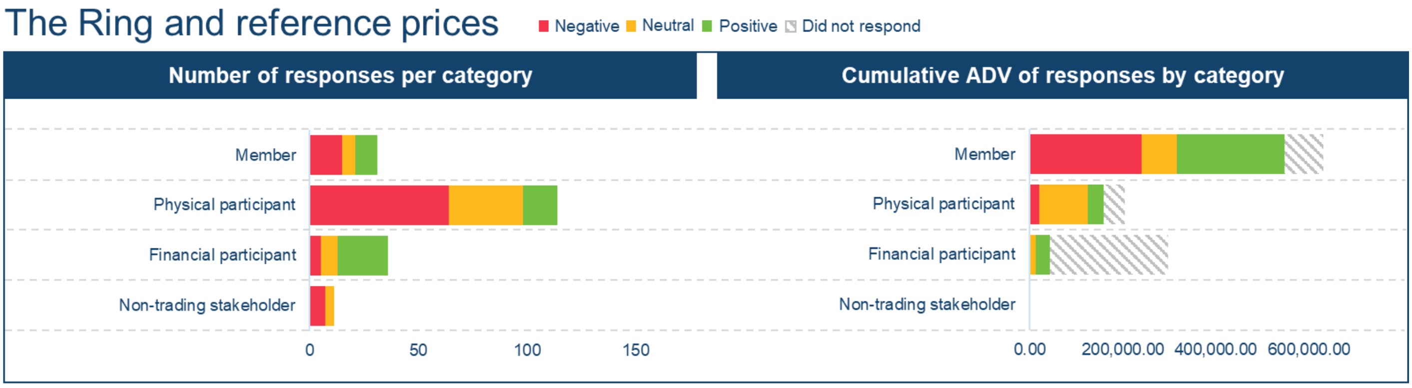
- The LME's principles – serve the physical market, ensure fairness, increase user choice and maximise trading efficiency – remain the most pertinent considerations in order to assess market structure evolution
- These principles must be balanced against each other taking into account wider considerations, to ensure any evolution is for the benefit on the market as a whole

There was overall agreement that the LME's principles remain relevant and are an appropriate lens through which to view the future evolution of the LME market structure.

A number of respondents suggested that some proposals were at odds with the principle of serving the physical market. While the LME has given due consideration to this feedback, it believes that ensuring the LME's market structure serves physical participants does not mean that it should not evolve over time. Many physical participants are themselves proponents for evolution in various aspects of LME market structure as they are keen that LME markets continue to deliver the best possible solutions for the physical market.

While the existing strategic principles are not an exhaustive list of all factors relevant to the LME's market structure, the LME continues to believe that they represent the most pertinent considerations for the development and growth of the LME as a whole.

3 THE RING AND REFERENCE PRICES



3.1 Overall themes – the Ring and reference prices

- Traditional users trust the Ring and see significant value in the member-client relationship
- Guaranteed orders are seen as important to the LME market. In particular physical clients being able to get guaranteed orders against the Official Cash Settlement
- Most participants agree that electronic pricing increases transparency and broadens participation
- Electronic pricing has worked for outrights, but the forward curve is more challenging
- Timing of any changes is important

3.2 Feedback summaries – the Ring and reference prices

2) Do you agree with the assessment of the general challenges of pricing, and factors to assess when considering a pricing process?

Where they opined on the LME assessment of the important factors of pricing, the majority of respondents agreed that access for participants, transparency and volume (as laid out in the Discussion Paper) were the key factors to consider. That said, some respondents agreed with the factors in theory, but not the practical application of these factors outlined in the Discussion Paper, as they felt other broader market impacts should also be considered.

Additionally, a number of other factors specific to pricing were highlighted as important, including predictability, replicability and reliability of the pricing methodology.

One other factor that was raised by many respondents was the ability of participants to accurately hedge against the discovered reference prices. On the LME, this is often done by members guaranteeing execution to their clients at either the Official Prices or Closing Prices. Respondents highlighted that this was particularly important to the physical market, who use the LME Official Prices in their physical metal supply contracts, and need to be able to accurately hedge this exposure.

Linked to the idea of access for participants, many respondents felt that broad stakeholder participation in pricing processes meant that prices would take account of more of the total respective supply and demand, which would lead to the most representative pricing. On a related note, it was also highlighted that pricing discovery is most effective when it uses the maximum available liquidity. Conversely, a few respondents (mostly smaller physical participants) were not supportive of broad stakeholder participation in pricing processes. They felt that the prices used by the physical industry (mostly the Official Prices) should be solely focused on physical participants. They expressed concern that financial participants might distort pricing, and could use computer programmes to take advantage of physical participants.

In response to this question, many respondents brought up several practical examples of Ring trading vs. electronic trading on the LME. They highlighted how the different venues' structures impacted pricing and trading more generally, alongside other impacts on various aspects of LME trading. The LME daily date structure was often cited as a challenge for electronic trading. Some respondents believed that the open outcry Ring was the best method to trade the date structure, and therefore is the best venue for pricing the forward curve. Other respondents felt that the Ring is an effective way to trade the date structure (as has been done historically), but also thought that technological evolution of the LME's electronic trading platform would allow this trading to be done more effectively electronically. Conversely, other participants acknowledged the general challenges of trading the date structure due to its complexity, but felt that trading it electronically in the current trading platform was preferable to Ring trading.

3) Do you agree with the review of these factors when considering the temporary Ring suspension and move to electronic pricing? Are there any other factors you think the LME should consider?

The response to this question showed a wide range of views from the various stakeholders trading in LME markets.

A large number of respondents were supportive of the improved access and increased volumes directly contributing to pricing that has resulted from the electronic pricing process during the Ring's suspension due to COVID-19. Some felt that the electronic pricing methodology has been more reliable and more representative of the total market supply and demand than when pricing was done in the Ring.

However, other respondents had a different interpretation of the data that the LME has published. Some felt that the LME should be focusing on other volume data (such as basis trades eg volume indirectly priced against Ring discovered prices, rather than directly involved in it), rather than focusing on the volumes directly contributing to price discovery.

In general, the majority of respondents (including many physical participants) agreed that the use of a volume weighted average price ("**VWAP**") methodology in the electronic market for the liquid outright contracts (3-month Closing Price, Cash and 3-month Official Prices) has been particularly effective, with many respondents preferring this methodology to Ring pricing. However, it was generally agreed that pricing the forward curve shape is more complex, and has been more of a challenge electronically. A small number of respondents expressed support for the fact the VWAP methodology generates a single Official Price (no separate bid and offer), whereas other respondents felt that only publishing a single price was a problem with the electronic pricing methodology, and wanted to see a return to publishing a separate bid and offer for the Official Prices.

Regarding the forward curve shape, some participants highlighted that the LME's date structure is particularly complex (in particular the daily dates, and the fact that every single month to the back of each curve is available to trade). This means there are often a large number of instruments trading during any period, which is a challenge for traders to be able to see and interact with during a pricing window. Many respondents felt that the electronic forward curve pricing has been a particular challenge, with some respondents clearly stating that they think the forward curve has been less effectively priced with the Ring closed. Several respondents highlighted the increase in pricing objections seen during the period of Ring suspension and electronic pricing, which they feel demonstrates the degradation of pricing. Some respondents also mentioned that the electronically discovered Closing Prices were taking longer to be calculated and published each day due to the challenges introduced by the increased amount of data.

Some participants suggested further changes to the electronic pricing process would maximise its effectiveness. They believe the LME should undertake further market engagement on evolving the pricing calculations themselves in order to most appropriately price the forward curves electronically. Where detail was given, these respondents suggested the pricing methodology should be more deterministic, with a clear calculation (rather than judgement-based pricing), and often suggested increased use of VWAPs.

There were some other suggested improvements, which included reassessing: tick sizes, the ability of participants to object, and accountability for participants active in the pricing process. A small number of respondents also suggested including data from the inter-office market in the pricing process to maximise the amount of data. Conversely, other respondents felt that it was important that pricing be done in a single venue in order to focus the liquidity for pricing purposes.

Related to the subject of forward curve pricing, some respondents felt that carry liquidity has suffered while the Ring has been closed. Some respondents clearly view this as a direct result of the Ring closure and apparent lower activity levels by Category 1 members. Some respondents also expressed concern that, if the Ring is permanently closed, then business may end up being consolidated with fewer members, which they felt would be detrimental to the market as a whole. Other respondents highlighted that the period during which the Ring has been suspended has also been one of higher general volatility. They suggested that carry volatility has been particularly high, with backwardations developing in several markets. They believe it is this volatility, rather than the suspension of the Ring, which has led to reduced carry liquidity.

Many respondents (particularly smaller physical clients and Category 1 members) gave their view that the Ring is a unique positive feature of the LME, which is particularly suited to physical client trading needs. They regard the Ring as particularly transparent and well understood by market participants. They believe that the Ring makes traders very accountable as they can see what each other is doing, and this element of self-regulation avoids pricing disruption that these respondents feel exists with electronic trading. Some of these respondents expressed concerns around reduced electronic liquidity during times of market volatility, or when there are physical supply or demand shocks. These respondents also often raised concerns around more speculative involvement in the market and algorithmic trading practices. These respondents sometimes expressed the opinion that the Ring has worked for a long time, and there is no need to change it.

A few respondents suggested that the Ring, alongside dual-capacity, actually impeded liquidity. They also pointed to the fact that most other global exchanges have moved away from these practices. It was also suggested that electronic pricing levels the playing field in terms of transparency and access.

As raised in the previous question, several respondents focused on the practice of guaranteed price orders in LME markets, and the impact that the Ring suspension has had on this trading behaviour. In general, it was highlighted that this practice has continued. While some respondents felt this meant that electronic pricing was satisfactory, other respondents (including some Category 1 members) expressed the view that guaranteed orders have only continued to be offered due to the efforts of Category 1 members. Some Category 1 members said they have continued to guarantee orders despite it costing them money, due to the temporary nature of the Ring suspension, and that a permanent move to electronic pricing would make this unsustainable.

4) Do you agree that a permanent move to using data from the electronic venue as the primary input for pricing processes should be confirmed?

Responses to this question were necessarily linked to the previous questions, with respondents having a range of views on the matter based on their views of the pricing factors. Respondents also had different preferences often driven by their varied uses of the LME.

The topic of the Ring and its history is clearly important for many participants, and this came through in a number of the responses, with the most Ring-supportive respondents being highly concerned that any changes to Ring trading may jeopardise the whole LME ecosystem. On the other side, some respondents felt that the continued existence of the Ring typified a lack of positive evolution at the LME, and felt moving away from it was a necessary first step in improvement.

Most respondents did not separate their consideration of the most appropriate pricing venue from that of any potential closure of the Ring, as such, the responses below at times consider both questions (with further detail in question 5).

At a very high level, respondents fell into one of four categories in their views on this topic:

1) **Fully supportive of the Ring** – not wanting to see any changes. Generally viewing the Ring as the best way to trade, often rejecting the pricing factors set out in the Discussion Paper or the LME's assessment of them in relation to Ring trading. This view was mostly held by smaller physical participants

2) **Qualified support of the Ring** – supportive of the Ring but recognising an inevitable evolution away from Ring trading over time. Believed that electronic trading required further support through both additional technology and/or time was needed for the market to adapt. A number of members (Category 1 and 2) and many physical clients held this view.

3) **Qualified support of move to electronic** – supportive of moving towards electronic trading and pricing, but felt that new technologies and business practices may need to be implemented in order to support the shift. Some in this category felt an initial return to the Ring ahead of a later move electronic was preferable. This was a view again held by a number of members and both physical and financial clients.

4) **Fully supportive of electronic** – of the clear view that the electronic pricing methodology implemented during the Ring suspension is preferable to Ring trading and should be permanently adopted. This view was held by a number of members, and clients. This view was held commonly, but not exclusively, by financial participants.

In general, most respondents felt it inevitable that LME markets move away from Ring trading towards electronic trading in the future, recognising that most financial markets have moved away from open outcry trading. However, many respondents hold great affection for the Ring as part of the LME's history, with some suggesting this as the sole reason for its continuance.

Aside from respondents' specific views on whether the LME should permanently move to pricing in the electronic venue, there were several timing considerations raised.

Some respondents felt that whatever the long-term approach, the LME should initially re-open and move back to the Ring for pricing activity. Irrespective of the Discussion Paper process and market engagement undertaken, some felt that any decision to move away from the Ring at this stage would have been driven by COVID-19; they believe the decision should not be taken in this manner. Other respondents highlighted that the impact of COVID-19 and Brexit have been difficult for market participant business models, and thus a return to the Ring would give them time to adapt. Some respondents felt that additional technological systems were required in order to optimally price electronically, and that the LME should implement changes before moving away from the Ring. Some respondents specifically mentioned that the LME should wait until after it has delivered its new electronic trading platform (LMEselect v10) as they felt this would deliver an enhanced electronic market. A number of respondents felt that the LME should move back to the Ring initially while evolving the electronic pricing methodology.

On the other side, some participants believed that if the long-term direction were towards electronic trading and pricing, then it would be preferable not to move back to the Ring pricing in the short term. These respondents felt that the move to electronic pricing has now happened, and moving back to the Ring in the short term would just create further disruption. These participants generally felt that it was better to give the market certainty on an electronic future of pricing at the LME, and that this would itself encourage more electronic liquidity and be a positive step for the market.

5) Should a move to electronic pricing be made permanent, do you agree that the Ring should be closed? Do you have any comments on the timing of any closure of the Ring?

As previously mentioned, most respondents did not separate their views on the Ring as a pricing venue and the Ring as a trading venue.

A small number of respondents (including some Category 1 members), questioned the viability of the Ring solely as a trading venue if pricing was done in the electronic venue. Some of these respondents were clear that they thought the Ring would be unsustainable without pricing activity. Other respondents were less categorical, highlighting that they thought Category 1 members would struggle to justify Ring participation without pricing activity, but not going as far as to say that the Ring would not be able to survive.

Other respondents (including many physical participants, and a number of Category 1 members) were clearly supportive of the Ring as a trading venue. They highlighted the unique trading structure of the Ring and indicated that Category 1 members are important in providing liquidity for certain instruments (such as carries).

A small number of Category 1 members expressed the view that any potential decision to close the Ring would need to be put to a vote of "affected B shareholders", which they believe is required by governance rules.

In terms of any timing any closure of the Ring, respondents did not separate this topic with the matter of pricing on the Ring, as such, those considerations are covered in question 4.

6) Aside from any decision over the permanent closure of the primary Ring, do you support closure of the secondary Ring, and the use of electronic pricing methodology in a disaster recovery scenario?

The vast majority of respondents (including those who were supportive of retaining Ring trading, and those who were not) agreed that the recent effectiveness of electronic pricing has shown that the secondary Ring should be closed, and an electronic pricing methodology should be used in business continuity scenarios.

A small number of respondents who were particularly supportive of the Ring in general were also supportive of retaining a secondary Ring for disaster recovery purposes. Some highlighted its use during the summer of 2016 when the primary Ring location was unavailable for an extended period.

7) Do you agree that further TAS contracts are not necessary at this time?

On the subject of trade-at-settlement ("**TAS**") contracts, many respondents (including a mix of members, and both physical and financial clients) agreed that they were not necessary. They often highlighted that the member community already provides the service TAS seeks to achieve (guaranteeing execution against reference prices). Some respondents clearly had a preference to undertake this activity bilaterally with a member, rather than electronically.

On the other hand, there were some respondents who strongly supported the introduction of further TAS contracts, which they believed would be useful to the market. Some of these respondents suggested that moving this type of activity (pricing and/or trading against unknown future reference prices) onto the electronic venue was closely aligned to the LME's principles by increasing fairness, trading efficiency, and giving users more choices of where to trade. They felt that TAS contracts incentivise a transparent and fair approach to reference prices, ensuring all market participants have access to the same information, rather than there being an information asymmetry created by some participants having knowledge of guaranteed orders in the inter-office market.

In particular, those respondents who were supportive of TAS contracts suggested they would be most useful for the Official Cash settlements (to help physical participants manage their risk), and potentially Closing Price 3-month contracts (in addition to the existing nickel TAS contract). A number of respondents also thought that TAS contracts could be useful for some 3rd Wednesday monthly contracts.

While there were respondents at both ends of the spectrum regarding TAS, there were also a number of people who took a balanced position. These respondents generally felt that while there was a potential benefit to additional TAS contracts, they were not currently necessary due to the provision of guaranteed orders by members. They felt that further TAS contracts were currently unnecessary, but that the LME should be ready to launch them if members were no longer able to guarantee orders against reference prices.

8) Do you agree with the LME's position on market conduct considerations around Ring trading? Do you have any opinions from a market conduct perspective about a permanent closure of the Ring and move to electronic pricing?

The majority of respondents either agreed that it was not necessary to consider any specific market conduct matters arising from the Ring; or specifically stated that they did not have any market conduct concerns regarding the Ring.

Several respondents felt that Ring trading was preferable to electronic trading from a market conduct perspective, highlighting that Category 1 members act as a first line of defence against suspicious activity on the Ring. Some respondents expressed the view that there were very few disciplinary issues and subsequent member Notices relating to Ring trading, which was evidence of its high standard of market conduct.

Some respondents expressed some concerns with the current electronic pricing methodology, believing it had led to more volatility in carry prices during the pricing window. They felt that the nature of the electronic price methodology (based on the Ring methodology) led to orders being entered late in the pricing window, potentially in order to influence the pricing activity.

Other respondents were concerned about a general move towards electronic trading. They believed the Ring had more surveillance than the electronic market, and that exchanges generally were not equipped to avoid predatory activity, which in their opinion reduced liquidity. Others felt the LME needed to demonstrate the ability to monitor electronic trading practices effectively.

Conversely, some respondents felt that exchanges and regulators were better equipped to detect inappropriate activity in electronic markets, as the majority of global derivatives trading is executed electronically. They regard the increase in both data and transparency from an electronic market (compared to an open outcry venue such as the Ring, or a bilateral telephone venue such as the inter-office market) as a positive feature from a market surveillance perspective.

It was suggested that expanded use of VWAPs (compared to prices being set by "last price") would improve market conduct as it would reduce the ability of single orders or trades to influence a reference price, where a "last price" methodology can encourage this type of activity.

Some respondents again raised concerns with the dual capacity model generally, but also specifically in relation to pricing activity. They felt that the combination of dual capacity and open outcry trading in particular caused material issues. The opinion was raised that "fixing scandals" seen in other commodity markets were exacerbated by dual capacity. These respondents felt that electronic pricing would significantly improve this problem.

9) Are there any other factors which you think it is important for the LME to consider in relation to the Ring and reference prices?

There were a number of other factors raised by respondents in answer to this question. Some of these have already been discussed in relation to other questions (and have already been included in this Response Paper), and others are new. The new views raised included:

- Some respondents suggested the LME should be bolder, either in terms of its scope of change or its implementation timelines. Furthermore, it was suggested the LME is viewed as lagging behind other exchanges in respect of adopting new technologies.
- A small number of respondents (including some physical participants) suggested that physical supply contracts could easily evolve to reference monthly contracts (as is common in other listed commodity markets) rather than the Cash Official Price.
- Some financial participants argued that keeping the Ring open is against the LME's strategic principles due to the restricted participation, perceived inefficiency, and high costs of open outcry trading.
- It was suggested that it was a natural progression seen in other markets for liquidity to move to the electronic venue and for member business models to focus on other value-add services such as warrant financing or more complex hedging solutions.
- It was suggested that trading on the Ring required a much greater level of knowledge than is necessary to be accredited to trade on LMEselect, which leads to a less orderly electronic market. One respondent went on to suggest that only certain members should be permitted to trade during the electronic pricing windows.
- It was suggested by some physical participants that LME should take its time and ensure that the electronic methodology is as deterministic as possible to support members guaranteeing prices, and where possible implied pricing should be used to avoid discrepancies on the curve that could be arbitraged.
- Concerns were raised that Category 1 members are particularly reliant on the Ring, and may leave the market if the Ring were closed, which would harm overall liquidity. It was questioned whether new participants would join as a result of a move to electronic pricing and, if they did, whether they might be price takers rather than liquidity providers.
- Another respondent argued that the complexity of the LME's market data fee schedule and the level of fees themselves should be considered, as they are a barrier to entry.
- One respondent suggested that an electronic request-for-quote style solution could support liquidity in broken dated carries should the Ring close.
- One respondent suggested that the Exchange could produce an official commentary on Ring activity if it were to reopen.

3.3 LME considerations and outcomes – the Ring and reference prices

Summary

- Closing Prices to move permanently electronic and methodology to be evolved in future
- Ring to reopen for trading
- Roll out the remaining 3-month Closing Price TAS contracts
- Closure of back-up Ring site
- Whether to move the Official Prices electronic, or to keep them in the Ring, is subject to further consultation

The LME has considered all the feedback received in relation to the Ring and reference prices. Particular consideration has been given to the assessment of electronic pricing and various respondents' interpretation of the data, and the potential impact on the market as a whole of the various routes forwards. The LME's view remains that the electronic pricing methodology undertaken during the temporary Ring suspension is effective, and has increased direct participation during pricing periods, as well as volumes directly contributing to pricing and practical transparency, and these factors are all significant positive improvements of the electronic pricing process. The LME believes a permanent move to an electronic process will give clarity to the market, which will allow participants' business models to further evolve and bring increased electronic liquidity to the benefit of the market as a whole.

Specifically relating to pricing objections and the challenges of pricing the forward curves from electronic data, the LME has undertaken analysis, and continues to believe that the challenges relate to an increase in available trading data during pricing windows, which leads to particular complications when combined with a "last price" methodology. In the LME's experience, most pricing conflicts arise not from tradable arbitrages being available between instruments (although this does happen for small periods at times), but from a large number of overlapping carry instruments all trading at different bid/offer spreads, and at different sides of their respective bid/offer spreads, into the end of the pricing period. The result is that it is often impossible to reflect all "last prices", and certainly not while maintaining a smooth, fully representative curve, hence the need for the significant use of expert judgement by the LME's Quotations Committee. As such, the increase in data resulting from the use of the electronic market and the resulting challenge in pricing is a "feature" rather than a "bug" of electronic pricing as it results from increased participation and data, and a "democratisation" of pricing activity.

The LME agrees that increasing the use of implied pricing could be a valuable enhancement for participants as it will increase ease of accessing available liquidity. However, as outlined, most pricing conflicts do not arise from tradable arbitrages (which implied pricing could reduce) and as such, the introduction of additional implied routes will not significantly reduce the number of pricing conflicts arising as a consequence of the LME's current Closing Price calculation methodology.

These challenges suggest that it would be possible to further develop electronic pricing methodologies in order to allow more data to be taken into account more easily, and create more deterministic pricing calculations. This would reduce the amount of expert judgement required, and give market participants more clarity on exactly how prices are calculated. However, for the avoidance of doubt, the LME's view is that the current electronic pricing methodology is preferable to Ring pricing when considering the interests of the market as a whole, for the reasons set out above, but further evolution of the electronic pricing methodology will enhance it.

The LME also appreciates the feedback of many physical participants, who express specific preference for Ring trading and pricing. While the LME does not share the fundamental concerns surrounding electronic trading and pricing, it has taken these concerns into account. The confidence of physical participants in the reliability and representativeness of LME prices (and in particular of the Official Cash Price which is most used in physical supply contracts) and their continued use of LME prices is important to the market as a whole.

Similarly, the LME recognises the importance of orders being able to be guaranteed against reference prices to LME stakeholders – in particular, the importance to physical market participants who are hedging their physical supply contracts (normally against the LME Official Cash Price).

However, these market needs must be balanced against the other pricing considerations, and against the importance of pricing in high volume, competitive trading environments with broad participation, creating the best liquidity and most accurate pricing picture. Having clear, transparent pricing calculation methodologies also allows all participants to understand how to interact with pricing processes in the manner that is most appropriate for their particular needs, including targeting the reference prices.

As such, the LME believes a permanent move of Closing Prices[2] to use electronic pricing based on the current pricing methodology is in the best interests of the market as a whole and promotes the LME's strategic principles of ensuring fairness and maximising trading efficiency. This is because the

[2] For the avoidance of doubt, given that the Unofficial Closing Prices are used by Members as an unofficial gauge of the likely Closing Price values each day (and, as the LME understands, not otherwise used extensively in the market eg as reference prices), the LME believes that it is also in the interests of the market as a whole for Unofficial Closing Prices to be moved to electronic determination, so that they are determined in the same venue as Closing Prices.

LME considers that the methodology is sound, and the electronic pricing system creates more transparency, greater participation and ultimately more reliable pricing. This is especially true of the Closing Prices which are heavily relied upon by financial participants, who are broadly in favour of the move to electronic pricing. The LME also believes it appropriate to immediately initiate market engagement on an evolved methodology. To further this intention, the LME is publishing a pricing blueprint, and establishing a Closing Price Working Group with this aim.

However, the LME believes it appropriate to keep the Ring open as a trading venue given many physical participants' desire to continue trading on the Ring.

For the avoidance of doubt, the LME has decided (taking into account the feedback received and its own analysis) that moving all pricing determinations to the electronic venue would be preferable to keeping them all in the Ring. Indeed, the LME believes that, from a transparency and market liquidity perspective, Official Prices generated with the electronic methodology would have the same benefits as Closing Prices. However, the LME also notes that meeting the preferences of physical users, who in practice are the principal users of the LME's Official Prices, is particularly important to the market as a whole in order to ensure the LME's linkage to the physical metals community and consistent with the LME's strategic principle to serve the physical market. As such, the LME believes the interests of the market as a whole could be best served by maintaining Official Price discovery in the Ring (once it reopens).

The LME will now consult (see Notice 21/112 for more details) on its proposal to keep Official Prices in the Ring, so as to allow participants the opportunity to provide their views on this arrangement. To that end, the LME is now launching a further stage of its consultation to hear market participants' views on keeping Official Prices in the Ring as opposed to moving them permanently to electronic determination along with Closing Prices. The LME notes that if it concludes, having considered the feedback received to the consultation, that the market as a whole does not support a split of the Official Prices and Closing Prices determination methodologies, the LME would move the Official Prices permanently to being determined electronically alongside the Closing Prices, on the basis that this proposal, which was originally consulted on in the Discussion Paper, is the best outcome for the market as a whole (subject only to consideration of the potential benefits of the split approach proposed at this stage of consultation).

The LME is of the view that this split approach (Official Prices in the Ring, Closing Prices electronic) could represent a clear modernisation step for the Exchange that could benefit the market as a whole. It could also take account of the needs of the more traditional physical users of the Exchange in order to best serve the physical market, and ensures a balanced market ecosystem, which is one of the core qualities of the LME. As such, this approach, in the LME's view, could also balance, to the greatest extent possible, the LME's strategic principles to serve the physical market, ensure fairness and maximise trading efficiency.

If the split approach were adopted, it would be important that the determination of Official Prices in the Ring continued to be supported by Category 1 members to ensure this split approach best served the market going forward. This would ensure that the prices are as robust and reliable as possible for the physical community. While the proposed changes may reduce overall Ring volumes (as volumes related to the Closing Price would likely migrate to the electronic market), the LME would continue to provide all the current infrastructure (including office space at the Ring) for Category 1 members, if the split approach were implemented. With this set-up, traders based at the Ring would have flexibility, being able to use any of the three LME venues; ensuring Category 1 members would not need "dual teams" in order to trade the Official Prices on the Ring, and the Closing Prices in the electronic market.

The LME considers that, with the continued support of Category 1 members, this split approach has the potential to be a sustainable and balanced solution providing increased user choice for participants. The LME also recognises that over many decades, and in the midst of great technological changes, LME participants have demonstrated their ability to adapt, innovate and find new ways to service their clients' needs. The LME believes that this will continue.

That said, the LME is mindful that Category 1 business models may change over time, and it is important to give the market clarity on the continual robustness and representativeness of Official Prices. As such, the LME believes it would be appropriate, if the Official Prices were kept in the Ring, to put in place a set of trigger conditions (related to potential shrinking Ring participation) that, if met, would cause the LME to review the approach of Official Pricing in the Ring, and potentially bring about a move to the electronic venue. The LME's current thinking is that the trigger could be set at having the support of at least six Category 1 members, who represent at least 75% of second Ring business (as measured by historical trading activity).[3]

As part of the LME's consultation on the split approach, the LME will therefore also consult on new Rules to put in place the trigger conditions referred to above.

The LME has carefully considered the arguments of a small number of B shareholders who are Category 1 members of the LME that the permanent closure of the Ring would require the written consent of, or equivalent special resolution passed by, B shareholders which are Category 1 members of the LME, because the right to trade in the Ring is said to be a right attaching to a group of B shares. This point is no longer in issue, as the LME is not proposing to close the Ring. However, for the avoidance of doubt, the LME disagrees: the right to trade on any of the LME's three execution venues is not a right that is attached to the B shares and, in particular, the right to trade in the Ring is not attached to the B shares held by Category 1 members. In future, any decision about whether to close the Ring would rest with the LME alone, which the LME would take in the interests of the market as a whole.

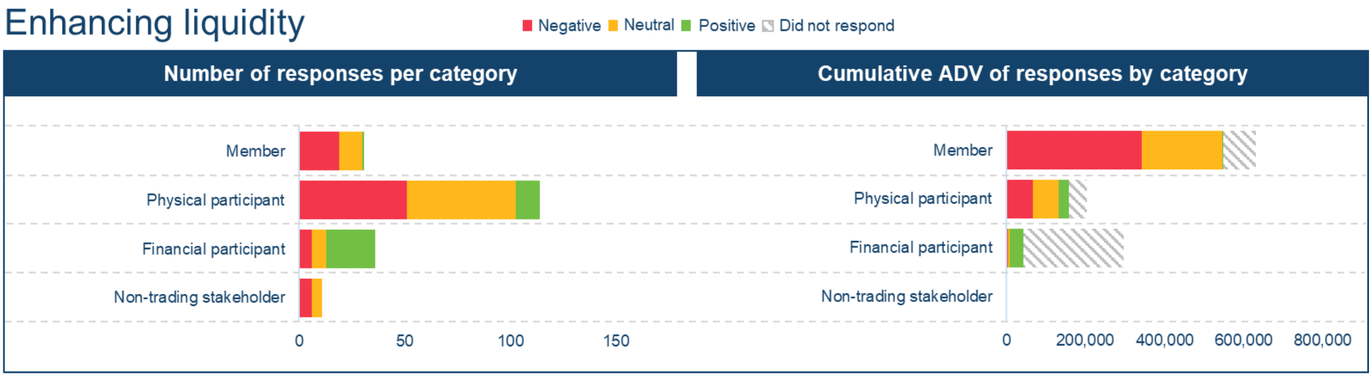
On the matter of the secondary Ring, given the aforementioned findings on the effectiveness of electronic pricing, and considering the views of respondents, LME will close the secondary Ring and move to using the electronic market as the permanent back-up of remaining Ring activity in a disaster recovery scenario. Operational details of the closure of the secondary Ring will be communicated directly to Category 1 members.

Giving due consideration to the variety of views on TAS contracts, in order to support user choice for those respondents who were particularly supportive of TAS contracts, the LME intends to launch the remaining 3-month Closing Price TAS contracts (nickel was launched in 2019) which may support participants' access to the electronic Closing Prices. The LME will monitor the ongoing usage of these contracts, and consider any feedback on the ability of the market to guarantee orders against reference prices, and remains ready to launch further TAS contracts, if appropriate.

The Exchange notes the various views on either side of the discussion on market conduct relating to the Ring and reference prices. The Exchange believes the split pricing approach will help to alleviate the various respondents' concerns. The LME is confident in its own, and its members', market surveillance tools relating to both the Ring and electronic markets.

[3] It should be noted that this 75% threshold is higher than the Ring reopening threshold because the Ring reopening threshold was determined prior to the LME having made an assessment of the performance of its electronic pricing processes, and as such it was important, at that point, to be able to return to the Ring as soon as possible. The results of the Discussion Paper support the view that electronic pricing is effective and robust, and it is therefore appropriate, in the LME's view, to apply a higher threshold in relation to the maintenance of Official Prices in the Ring, so ensuring that Official Prices remain as robust and reliable as possible.

4 ENHANCING LIQUIDITY



4.1 Overall themes – enhancing liquidity

- Most respondents are supportive of increased electronic liquidity in some instruments, but highlight that it may not be straightforward to achieve
- While not directly opposed to the proposals, many traditional participants are less supportive of electronic markets more broadly
- Participants are understandably less supportive of fee increases but they generally support the principle of promoting electronic liquidity

4.2 Overarching feedback – enhancing liquidity

Within this section, many respondents gave overarching feedback on liquidity in LME markets, and in particular their views on electronic vs. inter-office trading. This feedback did not necessarily align to the questions posed, and often had wider implications. The resulting themes are summarised below.

The majority of respondents were most concerned by the potential member-to-member fee increase and this dominated the feedback (and has thus been captured as most respondents being negative to the proposals within the quantitative assessment). However, most respondents were also supportive of enhancing electronic liquidity in some way for certain liquid instruments. There was a range of views on exactly which instruments were liquid enough and how actively electronic liquidity should be incentivised. While most respondents were supportive of some combination of measures to encourage onscreen activity, some others suggested the growth of electronic liquidity should be more organic as participants choose where and how to trade, and that the LME should not actively encourage or discourage any specific behaviour.

The importance of the inter-office market was a key issue stressed by many respondents, with some members arguing that a well-functioning member-to-member inter-office market is integral to providing liquidity to clients. A number of respondents suggested that the inter-office market would always be required for larger or more complex trades. Some respondents went further and argued that the LME date structure was incompatible with electronic trading due to the large number of carry combinations.

There was concern from physical clients that any member-to-member fee increase would not actually change business practices and would simply be passed on to clients, making the market less efficient and potentially decreasing overall liquidity and pushing volume OTC. Some physical clients expressed their concern with algorithmic trading practices on the electronic market and were therefore against any drive to increase electronic trading.

Most financial respondents were strongly in favour of enhancing electronic liquidity, due to the benefits of increased transparency and accessibility, suggesting it would lead to broader participation. The cost of doing “date adjustments” (normally adjusting a 3-month position entered into electronically to 3rd Wednesday position) was cited as a barrier to entry that currently restricts participation and limits volume. Some larger physical participants echoed these views and called into question the dual capacity model, arguing that the brokers currently (in the words of one respondent) “hoard flow”, which makes the market less liquid.

A number of respondents noted the importance of the timing of implementation for any measures to enhance liquidity. It was suggested that the market would need time for trading behaviours to adjust should changes be implemented and there was a preference for the gradual sequencing of changes.

4.3 Feedback summaries – enhancing liquidity

10) Do you agree with the LME’s assessment of the benefits of transparency in the electronic market in paragraph 5.1 [of the Discussion Paper]?

Most respondents broadly agreed that the central electronic market exhibits the maximum amount of transparency. However, many respondents also questioned whether all LME instruments are capable of becoming liquid on screen and they therefore supported transparency improvements across all venues.

Some respondents argued that the Ring and inter-office venues were already completely transparent with all member-to-member trades published on the LME’s core market data feeds. The recent pre-trade transparency solution was given as an example that had successfully enhanced transparency in the inter-office market. However one respondent did conversely suggest that there was a lack of transparency where client trades are internalised by members, and suggested the LME introduce a consolidated tape to improve transparency for carries.

A number of end clients welcomed the prospect of more transparency in the LME carry markets suggesting they often check the screen but there is rarely sufficient pricing and they have to then seek inter-office quotes to find out where the market is trading. Others conversely questioned whether the enhanced transparency achieved from moving liquidity electronic benefitted end users and expressed their view that the Ring prices reflected real supply and demand. A number of other respondents suggested further improvements to the publication of inter-office trade data and the rules around when trades are booked.

Financial participants highlighted the lack of transparency in the adjustments required from 3-month to the monthly dates which are also used to generate implied pricing for the monthly contracts. The accessibility and transparency of electronic markets was noted particularly around the Closing Price process. Some respondents noted that transparent markets are liquid because participants understand and trust them, and that this is a virtuous cycle where more transparent markets attract broader participation and opaque markets often do not survive.

11) Do you agree that the LME should look to enhance liquidity in the electronic market by increasing the member-to-member inter-office fee? Do you believe that the proposed 50% increase is enough to change behaviour?

The majority of respondents felt that that the LME should not increase member-to-member fees in the inter-office market to incentivise liquidity. Most respondents viewed it as a crude tool that may actually harm overall liquidity and decrease trading efficiency. Some respondents suggested that a small block limit would be less disruptive to business models than a fee increase.

A large number of physical clients who responded were concerned that the fee increase would ultimately be passed on to end users and was not aligned with the principles of supporting the physical market or ensuring fairness. Some thought the LME should focus on reducing electronic fees as an incentive, rather than increasing inter-office fees. Others again cited concerns around algorithmic trading practices in the electronic market. That said, some physical market participants were supportive of the proposal as long as the fees were not passed onto them, and suggested they would like to execute more business onscreen if liquidity improves.

Many respondents raised the importance of the member-to-member market in supporting liquidity provision to end clients for the LME's unique date structure. Some suggested that for large orders members need the inter-office member-to-member market in order to hedge and to support the large number of daily dates that require bespoke negotiation. It was noted by some members who provide liquidity bilaterally, that they are able to offer tighter prices on a direct basis than if they had to continuously stream prices to the central electronic venue. It was proposed that the LME should consider whether an electronic request-for-quote functionality could be implemented along with more implied pricing. A number of other members argued that disincentivising the inter-office venue was not aligned with the principle of increasing user choice and suggested the market should be free to decide which venue to execute on.

The distinction was again made between certain outright instruments and liquid carries that may suit electronic trading versus less liquid instruments which are less likely to be liquid onscreen. Some respondents suggested that any fee increase should be focused only on instruments that are standard and sufficiently liquid. There was a range of views as to which LME instruments are liquid enough, with the debate generally focused on 3-month outrights and certain carries at the front of the curve.

There were a number of supportive responses from financial participants, who noted the importance of electronic liquidity in offering greater transparency and accessibility and pointed to the fact that it is standard across exchanges for off-screen trades to have higher fees. It was also argued that the LME carry market exhibits strong network effects where large members internalise flow, and consequently do not need to book additional member-to-member legs, thereby giving them a further advantage. Some respondents suggested that the proposals did not go far enough to solve this structural issue and proposed that where client trades are booked back-to-back with a member trade, there should be a discount, offset by a slight increase to the overall client contract fee (for client trades that are internalised).

12) Do you think that the LME should look to introduce "block rules" for inter-office trades in the member-to-member market?

Overall, the feedback on this question was very balanced. A number of respondents were supportive of some block rules in line with other exchanges, and other respondents (mostly traditional members and physical participants) strongly opposed to any such rules, which were viewed as counter to the principle of user choice. A number of respondents suggested more detail was required on the exact size of the thresholds and the detail on the rules prior to opining on the issue.

A number of members were concerned with the potential impact to business models and argued that liquidity would be negatively impacted if block rules were implemented. Some members stated they did not support block rules, however these were preferable to the proposed enhanced transparency cross ("**ETC**") solution. Other members suggested that the fee increase proposal was less disruptive than introducing block rules. Some respondents then pointed to the fee differential for blocks vs. electronic trades on certain other exchanges, which they stated are lower than the 50% differential proposed in the Discussion Paper.

The date structure was noted as a differentiating feature versus other exchanges that do have block rules, and it was argued that having liquidity split across many instruments makes block rules unsuitable for the LME market. Smaller physicals and a number of larger physicals were not supportive of any restriction on inter-office trading, which they view as crucial in supporting the date structure. However, some other larger physicals were supportive of block rules provided the size is appropriately calibrated.

A number of respondents suggested off-exchange trades should be permitted in less liquid instruments or for larger sized trades, but where there is sufficient liquidity onscreen they felt trades should be executed electronically. Block rules were considered by some as crucial in ensuring smaller standardised trades go to the central limit order book. Some financial participants suggested the LME should go further and introduce block rules into the member-to-client market.

13) If the LME was to increase the member-to-member inter-office trading fee, do you agree it should introduce enhanced transparency cross rules?

Most respondents expressed concern that the ETC solution exposes members to legging risk by having to hold the trade half on LMEselect. It was argued that this would ultimately lead to increased trading costs for end clients. A number of clients suggested members were likely to just pay the increased inter-office fee, rather than take any additional risk, and then pass the additional cost on to clients. Where members did utilise the ETC solution, there was concern from clients that the uncertainty of execution would lead to wider bid-offer spreads. Some respondents argued that their appetite to bilaterally quote a counterparty means that the pricing would be different to where they would quote on a publicly accessible order book because liquidity provision is a service they offer as part of a broader relationship. Furthermore, a number of other respondents expressed concern around the operational complexity of utilising the solution.

A number of respondents re-iterated their views that fees in the inter-office market should not be increased and therefore there was no need to introduce the ETC. However, some did go on to caveat this view by adding that if the fee increase did happen then the ETC could be a useful solution.

Additionally, there were a number of supportive responses that suggested the ETC would help to incentive electronic trading in instruments that had lower liquidity. Some respondents felt that due to the complexity of the LME date structure, more than five seconds should be required to give participants a fair chance to see the order among all the LME carries available onscreen. One supportive respondent suggested the LME go further and allow the solution for member-to-client trades, and suggested it would offer a useful guarantee of best execution for clients.

14) If the LME was to increase the member-to-member inter-office trading fee, do you think the LME should look to offset this fee increase with a reduction to electronic trading fees? If so, should this be done for only member fees, only client fees, or both?

Most respondents agreed that if the LME were to increase the member-to-member inter-office fee then the LME should look to offset this with a reduction in electronic fees. However, a number of respondents also reiterated their views that the LME should not increase the inter-office fees.

There was a range of views and as to whether the fee reduction should apply to member fees, client fees, or both. Some respondents argued that because the fee increase only applied to members, any reduction should equally only be applied to member trades. Some respondents argued the decrease should apply equally across members and clients, while some clients felt the decrease should apply only to client trades in order to reduce the existing disparity in fees between members and clients.

Some financial participants also supported the reduction of client fees only due to the fact that the need to book adjustments to the monthly dates makes the LME market prohibitively expensive for prospective clients. Some sell side clients, however, suggested that reducing fees for electronic trading would not be enough to increase volumes because bid-offer spreads and the overall price levels are more important than exchange fees for end clients.

The LME fee schedule was again highlighted by a number of respondents as being too complex for most participants to comprehend and they suggested it should be vastly simplified. A number of members suggested not just a simplification but an overall fee reduction for all venues, arguing it would support long-term growth

15) Should the LME look to introduce a liquidity provider programme focused at helping existing LME members to transition some of the liquidity provision to the electronic market?

Most respondents felt the LME should look to introduce a liquidity provider programme in some form to support liquidity in the electronic market.

A number of financial participants suggested a liquidity provider programme in carries is required in order to support the implied monthly liquidity that is not currently incentivised. Some smaller physical users also argued that a liquidity provider programme for carries is crucial in order to improve the overall attractiveness of electronic trading. One respondent suggested the LME should also look to discourage OTC streaming that draws flow away from the central limit order book.

There was a range of views on which instruments the liquidity programme should focus on. Most respondents suggested that the focus should be on carries at the front of the curve, that will support liquidity in the monthly contracts via implied pricing. Some respondents suggested the LME should focus on a few instruments that are likely to see traction electronically such as TAS (on the Cash Official Price and 3-month Closing Price), carries at the front of the curve and the adjustments to 3-month.

A number of respondents suggested fee reductions were the most effective mechanism to incentivise liquidity rather than a liquidity provider programme, with some arguing that where there is sufficient genuine end user demand, liquidity providers do not need to be paid to make markets. Some respondents took this one step further and argued that rather than focusing on liquidity provision the LME should focus on generating more trading interest in the LME market (eg supporting more arbitrage business).

A small number of respondents did argue, however, that participants should be free to select the best execution venue, and that changes would happen organically if that was what participants wanted. Some respondents also questioned whether a new liquidity provider programme would succeed where, in their opinion, previous attempts have failed. Furthermore, some members who responded noted that LME members typically lack the technological capability to stream all combinations of the LME forward curve on a central limit order book and questioned the reliability of electronic liquidity when markets are volatile.

16) Do you think that the LME should look to change the definition of a short-dated carry as described in paragraph 5.5.3 [of the Discussion Paper]?

The majority of respondents on this topic were supportive of the potential change to the definition of a short-dated carry such than it could be any carry up to 15 days in length, with both legs before 3-months (as proposed within the Discussion Paper). A number of respondents argued that such a change would support the date structure by encouraging liquidity in the daily dates at the front of the curve. It was also suggested that the most important use case would be the ability to adjust from the 3-month date to the nearest monthly contract if it falls within 15 days.

One respondent suggested that rather than changing the short-dated carry fees, the LME should expand implied pricing to the daily dates across the curve to best improve liquidity on the daily dates.

Some respondents again highlighted that the overall complexity of the LME fee schedule causes operational issues and suggested the LME consider a simplification.

17) Of the three potential changes described in questions 14), 15), and 16) above [within the Discussion Paper], which do you think will be most effective to enhance liquidity?

The overall feedback on this question was very balanced, with overall responses showing a slight preference for the reduction in electronic fees and introduction of a liquidity provider programme over the short-dated carry change. Many respondents argued that a package of measures would be most effective in incentivising electronic liquidity.

Members were generally supportive of the short-dated carry change, although a number of members did suggest a combination including this would be most effective. Some members argued that trading fees are not the main factor in choosing execution venue but rather it is liquidity and therefore the liquidity provider programme could be effective in generating onscreen liquidity.

Most financial participants and some physicals regarded the electronic fee reduction and liquidity provider programme as the most effective, with some suggesting the liquidity provider programme would be crucial for the transition period. They argued that the key focus should be to enhance electronic liquidity on the monthly dates rather than the other less liquid daily dates.

A small number of respondents were of the view that none of the proposed measures would be successful and reiterated their disagreement with the potential increase in inter-office member-to-member fees, which they felt would harm liquidity.

18) Do you think the LME should make any of the described changes in the client-to-member market in addition to the member-to-member market, or any alternative sets of changes?

There was no clear consensus from the respondents on this topic with a number of credible arguments raised for and against additionally applying changes to the client-to-member market. A small number of respondents reiterated their views that none of the proposals were desirable in either the member-to-member or the client-to-member market.

The members who responded were generally of the view that the client-to-member market should remain unchanged in order to support liquidity that is dependent on existing business models developed to trade bilaterally and offer all in prices on a principal basis. However, a small number of members did argue that any changes should apply equally across the whole LME market.

Some end clients who responded felt that any reduction in electronic trading fees or changes to the short-dated carry definition should also apply to the client-to-member market. A number of financials suggested block rules and other measures should be extended to the client-to-member market for a subset of the liquid contracts. Other end clients were more cautious and suggested any changes in the member-to-member market should be fully assessed before extending to the client-to-member market.

In terms of any alternative sets of changes, some respondents suggested additional initiatives such as improving the publication of inter-office trades on the LME's core market data feeds, and expanding implied pricing functionality.

19) Do you agree that the dual capacity model can co-exist with the described enhancements to liquidity, and should not be changed?

The majority of respondents agreed that the dual capacity model can co-exist with the described enhancements to liquidity, and should remain unchanged. Dual capacity was considered essential by many respondents in order to support liquidity for the LME date structure, and presented no concern as long as conflicts are appropriately managed. However, a smaller number of respondents raised some significant concerns around dual capacity on the LME market.

Some respondents argued that if the Ring were to close, then particularly during the initial 12-24 months, dual capacity would be more important than ever to ensure continued liquidity provision while business models adapt.

Some members who responded suggested that the proposed measures to enhance liquidity would directly challenge the dual capacity model, and some went as far as to suggest that it could make the inter-office market obsolete. Other members who responded felt that the dual capacity model would be unaffected by the proposals.

The view from physical participants was mixed with some suggesting dual capacity should remain and was a crucial part of liquidity provision, while others were concerned that broker-dealers had an informational advantage over their clients and other participants in the market.

Some financial participants argued that under dual capacity it was not clear to them that members were always acting in the best interests of their clients and it created a very negative perception of the LME market, suggesting dual capacity had exacerbated conduct issues in other commodities markets. Others felt that it could co-exist as long as there are appropriate controls in place.

20) Is there anything else you think the LME should consider regarding enhancing liquidity in its markets?

A number of respondents raised additional considerations regarding enhancing liquidity. Many of these had already been discussed in relation to other questions (and have already been included in this Feedback Paper), while others are new. The new considerations raised can be grouped broadly into those relating to: fees, liquidity provision and other initiatives.

Fees:

- Many respondents argued overall fees should be reduced and are higher than other exchanges; with some suggesting carry fees in particular should be reduced to incentivise trading.
- Some respondents suggested market data fees should be reduced. Others argued the data vendors should display more LME data in a more efficient manner. One respondent argued that data for the monthly contracts should be offered for free to promote them.
- One respondent argued the LME should look to broaden the membership by reducing membership fees and implementing technological innovation.

Liquidity provision:

- One respondent argued that the LME should not just focus on the bid-offer spread onscreen but also look at what market depth liquidity providers are willing to offer, which they regard as much more sizable in the inter-office market.
- One respondent suggested that in order to be allowed to operate under a dual capacity model, members should have requirements to make two-way markets in certain lot sizes.

Other initiatives:

- One member suggested an optional T2 booking model for agency business to increase efficiency and reduce reporting requirements.
- A number of financial and physical participants argued implied pricing functionality should be expanded so the monthly dates can be traded without the additional fees associated with carry adjustments
- One participant argued the LME should look to extend the trading hours to near 24 hours to encourage more arbitrage volume with other markets in different time zones.
- One respondent suggested the Commitment of Traders Report should be enhanced.
- One respondent argued that the LME should look to make changes in the ferrous market first to demonstrate the success ahead of rolling out changes to the core base metals complex.
- One respondent suggested the LME launch options in premium and volatility terms and use options market makers to support the options market.

- One respondent suggested the LME should explore more collaboration with rival exchanges that could promote liquidity by allowing participants to more effectively trade different exchange contracts.
- One respondent argued that VaR implementation could reduce margin levels significantly and encourage liquidity in LME products.
- One respondent suggested the LME should modernise warrant trading to broaden transparency and increase the operational efficiency of transferring title of ownership

21) Do you agree with the LME's assessment that no further rules are required in order to ensure the highest standards of market conduct relating to the dual capacity model?

The vast majority of respondents agreed that no further rules are required in order to ensure the highest standards of market conduct relating to the dual capacity model. A number of respondents noted that all members are FCA-registered and consequently are bound by their rules of conduct.

A small number of respondents disagreed and suggested the dual capacity model led to a negative perception of members having an informational advantage over their clients and other market participants. They suggested it can lead to conflicts of interest and requires reform.

22) Do you agree with the LME's assessment that no changes are required in order to ensure the highest standards of market conduct relating to inside information in the inter-office market?

The vast majority of respondents agreed that no changes are required in order to ensure the highest standards of market conduct relating to inside information in the inter-office market. It was noted by many respondents that members should have strict rules in place to manage any conflicts of interest. A small number of respondents again expressed their opinion that the dual capacity and the inter-office market led to a negative perception of LME markets.

4.4 LME considerations and outcomes – enhancing liquidity

Summary

- Start to introduce measures from 2022 (subject to consultation, as appropriate)
- Focus on enhancing electronic liquidity in certain liquid instruments only
- Ensure "back-to-back" or "inter-dealer" brokerage business models remain well supported
- Increase practical transparency of inter-office market

The LME is very grateful for all feedback in this area, in particular the significant detail many respondents provided in relation to the topic of liquidity in LME markets.

Supported by the majority of feedback, the LME remains of the opinion that the transparency and pricing competition exhibited by the central electronic venue is of huge benefit to the market as a whole, and in particular to end-users. The LME notes the concerns of some participants around algorithmic trading practices, but believes that with the appropriate market structure and rule set, any negative impact stemming from this activity can be minimised, while ensuring that algorithmic participants contribute significantly to electronic liquidity.

As outlined in the Discussion Paper, the LME agrees that it is the more liquid instruments that are well-suited to being traded on the central electronic venue. On the LME this likely means the 3-month contracts (where the liquidity is already primarily electronic), alongside a number of the monthly 3rd Wednesday contracts at the front of the curve. Other instruments, such as the daily prompt dates (which are primarily used by the physical market) and longer-dated monthly contracts, which have less consistent liquidity, are likely to be most effectively traded bilaterally in the inter-office market.

Moreover, the LME absolutely understands and agrees that the inter-office market is important in providing liquidity, particularly in relation to large trades, and for complex or less liquid instruments as mentioned. However, the LME is also cognisant that this must be balanced against the downsides (also raised by many respondents) that the inter-office market itself keeps some liquidity away from the electronic central venue (and reduces transparency and pricing competition), alongside creating differential access to liquidity and market information for participants. In summary, the continued effective operation of the inter-office market remains crucial for the LME ecosystem, but should be balanced against the positive attributes of electronic centralised liquidity.

The LME also absolutely recognises the importance of the inter-dealer brokerage model in ensuring the effectiveness, efficiency and fairness of the inter-office market. As highlighted by many respondents, inter-dealer brokers who operate agency or back-to-back, business models are particularly important in sourcing liquidity in the larger, more complex or lower liquidity instruments.

While the LME acknowledges the view raised by some respondents that any incentives applied to specific venues, or rules over how the various venues operate, at some level impacts the concept of user choice, and that electronic markets should be allowed to develop organically, should this suit market participants. However, the reality of modern financial markets is that user choice, in its most basic sense is impacted by all the rules and structures in place, including regulatory requirements. The complexity of modern financial markets means that all participants' decisions are impacted by external factors, and economic inefficiencies may well mean that markets develop in sub-optimal ways, which do not provide for all user preferences. In fact, the feedback from end-user respondents shows that many users would like to make the choice to trade more of their LME business electronically, and believe the LME needs to take steps in order to build electronic liquidity to allow them to do so. As such, the LME needs to ensure that it balances the principle of user choice with the other principles (in particular fairness and trading efficiency) in order to best serve the interests of the market as a whole. It is also important to recognise that a "do nothing" approach can in practice restrict user choice by perpetuating barriers, rather than actively working to remove them.

As the LME had expected, respondents were generally not supportive of a potential increase in fees in the member-to-member inter-office market. Importantly, the LME agrees with respondent feedback, that a fee increase alone is unlikely to encourage a behaviour shift in the market, and in order to effect a change the fee increase would have to be significant enough that it could have substantial negative impacts on the remaining inter-office market. The LME believes that an approach that combines a fee increase with some form of block rule (whereby participants are only able to trade smaller sizes in the electronic market), is likely to be the most effective approach to creating the market shift in order to build electronic liquidity. The LME has also given due consideration to the feedback on changes in the client market, and does think that it is important to consider the market as a whole (including the inter-related member-to-member, member-to-client, and OTC markets) to ensure an optimal approach is taken.

The LME does think that a liquidity provider programme may be an important part of the package of changes. The LME believes that it is important to structure such a programme so that it appropriately incentivises consistent, long-term liquidity provision for the benefit of all market participants.

In summary, the LME thinks that the right approach is to identify a set of liquid instruments, and work on a package of measures (likely including fee changes, a liquidity provider programme and block rules). This approach will consider both the member-to-member market and member-to-client market, alongside the OTC market, in order to encourage a shift towards electronic liquidity in the optimal manner for the market as a whole.

The LME remains open to changes to the short-dated carry definition, though views this somewhat separately to the package of measures to encourage electronic liquidity. It is likely most of the "new" short-dated carries will not be liquid electronically, but this fee change may help liquidity in daily contracts for the benefit of physical market participants. The LME will consider this effective fee change within the context of any changes made to inter-office fees.

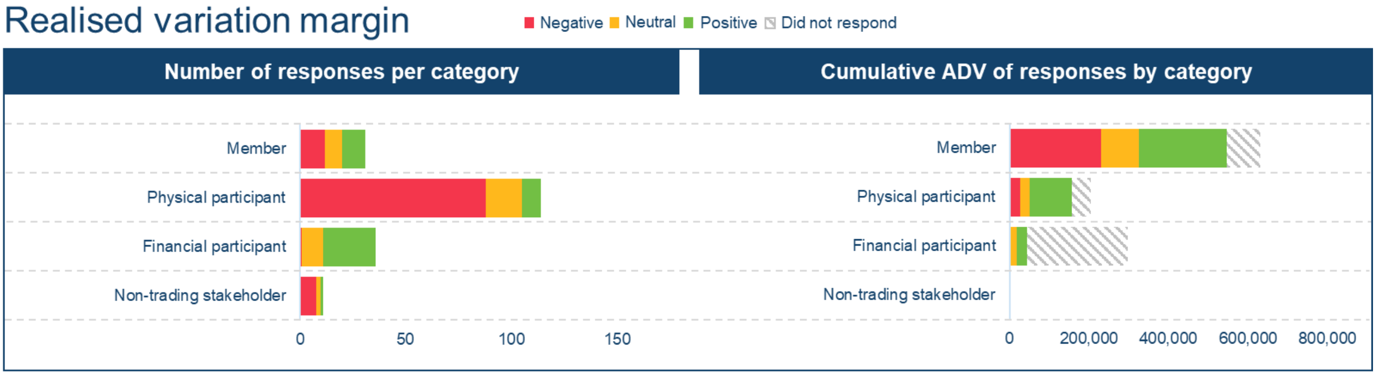
The LME remains committed to the inter-broker dealer model for large, complex and illiquid trades, and will ensure that this business model remains appropriately supported within the package of measures. This could be done by using the existing registered intermediating broker ("**RIB**") framework in order to ensure that a lower level of overall fees apply when business is conducted in a back-to-back manner.

Regarding the ETC, the LME acknowledges the concerns raised by some respondents that this type of solution would mean that pricing that was initially bilateral, would then be open to the wider market, and that this may have impacts for liquidity providers and clients. However, these impacts – such as lower certainty of execution – are part of the purpose of the ETC, which would encourage liquidity into the central electronic venue and bring greater pricing competition and transparency. It is worth noting that the proposal was not to mandate the use of the ETC, but simply to offer it as a solution available to market participants. As such, the LME will look to introduce the relevant ETC (and pre-trade communication) rules for those participants that wish to use it. In the longer term, the LME will investigate potential additional technological solutions that can be employed in order to deliver an appropriate combination of ensuring pricing competition and improving electronic liquidity, while appropriately protecting liquidity providers.

The LME recognises the importance of giving market participants time to adapt their business models to market structure changes, and similarly of not making too many changes at once in order to allow gradual change to happen. As such, given the Ring and reference price changes in 2021, the LME will work on this package of liquidity enhancing measures over the second half of 2021, with the intention of making changes from 2022 (with appropriate consultations, where appropriate).

The Exchange also recognises that the unique structure of the LME can have the unintended consequence of reducing practical levels of transparency for participants who are more used to a standardised market structure. While the LME is compliant with all regulatory transparency rules, it intends to investigate ways to increase the practical transparency for participants, with the aim of ensuring that all price-forming trades are published to the market in a timely manner, while clearly identifying non price-forming trades as appropriate, in order to help inform all market participants.

5 REALISED VARIATION MARGIN



5.1 Overall themes – realised variation margin

- Broad support for the standardisation of RVM by financial community (member and client) and larger physical traders
- Smaller physical players view RVM as risking their credit line provision by members. The provision of credit is very important to smaller physical clients and they view it as a USP of LME markets
- Daily settlement is operationally challenging for smaller physical participants
- Many financial participants acknowledge the importance of credit lines to physical participants and do not want those participants to be excluded from the market

5.2 Feedback summaries – realised variation margin

23) Do you agree with the LME's assessment of the benefits and downsides of RVM?

The majority of respondents broadly agreed with the LME's assessment of the key factors, however some felt the downsides of RVM (notably the potential negative impact on credit provision) were understated and required further analysis. Conversely, some other respondents did not think the benefits of RVM were adequately elaborated on. Respondents on both sides of the debate welcomed further engagement with the LME ahead of any change to explore the potential advantages and ensure any unintended consequences were avoided where possible.

The key concern raised by a number of respondents (mostly traditional members and smaller physical participants) was that a move to RVM would reduce the ability of members to provide credit to end clients, particularly to smaller clients that may struggle to access credit lines otherwise. While this was outlined in the Discussion Paper, some respondents felt the overall impacts (and indirect consequences) on the market were underestimated and, in their view, significantly outweigh any advantages of standardising the margin methodology.

Some respondents opined that the provision of credit by brokers was a key differentiator for the LME against its peer exchanges. They noted that LME's position as the centre of global metals trading was built upon credit provision combined with the prompt date structure, its warehouse network and the flexibility of multiple execution venues. They believe that a move to RVM would remove one of the LME's key competitive advantages, and felt that this risk was not adequately considered in the Discussion Paper.

Some respondents also expressed a concern that the proposed move to RVM signalled that the physical market was no longer a priority for the LME. They felt the LME ecosystem was being re-engineered to attract unknown and unquantified financial participation at the expense of the existing physical participants. One respondent felt the proposed change would only benefit one type of user and should be supported by clear evidence that it would not cause significant detriment to other types of users. Furthermore, some participants argued that all trade clients rely on credit, not just the small and medium firms. However, the responses from many larger trade clients were clear that they would prefer to see a move to RVM.

Overall, traditional participants' concern regarding the proposed move to RVM was dependant on whether it would impact their credit lines; if there were no impact on credit, they would not be as concerned with the proposed change in margin models. On other aspects of margining, there was some support for RVM from physical participants. For example, some physical end users said that they would like to be able to withdraw profit upfront, although this was caveated that they viewed their credit facilities as of greater importance. A number of respondents noted that existing business models work well for the current structure and have done so for a long time, and any change would upset these models.

A number of respondents highlighted that they believe the relevance of LME pricing, and the LME's status as the global metals market leader was reliant on the participation of physical users, who themselves relied upon contingent variation margin ("**CVM**"). As such, there was concern that a shift to RVM may lead to physical participants leaving the market, which could undermine the credibility of the official prices due to a lack of genuine physical participation.

Additionally, some physical participants were also concerned that a move to RVM could also result in a concentration of brokers, which would increase credit risk and reduce competition.

Many physical participants explained that they need their futures hedge to match the payment terms of their physical contracts, and therefore settle at maturity. Some respondents also expressed concern around the operational complexity, administrative difficulty, and liquidity requirements of paying margins on a daily basis if credit lines are no longer available. These concerns spoke of the need to manage daily movements of cash, which would result in a much larger administrative burden and potentially require IT development.

In addition, some respondents also noted that currency restrictions, such as in China, make RVM difficult to manage and makes the credit lines they receive integral to their participation in the LME market.

It was highlighted that there is a risk that if the LME was to implement RVM, a large portion of business may move OTC in order to continue credit line provision. It was noted that not all members can offer OTC contracts, and therefore this may lead to a further concentration of business among fewer members and consequently increased systematic risk in the ecosystem.

Many respondents (mainly financial and large physical participants) agreed with the LME assessment of the benefits of RVM and were strongly in favour of a move to RVM. These respondents argued that the change would broaden participation in the LME market and offer significant operational efficiency gains by utilising a proven global market standard methodology. They also argued it would lower trading costs, improve capital efficiency and eliminate costly manual processes. A number of respondents recognised the global prevalence of the RVM model and argued that that its widespread adoption by other exchanges demonstrates its strengths.

Some financial participants who are active on the LME market explained that CVM limits their ability to trade by tying up capital, reducing their volume and participation on the LME market. One respondent explained that even though their physical business references LME prices, they actually hedge using a rival exchange contract and take the basis risk because of the issues with the LME being a CVM market. One financial participant argued that due to the existence of CVM, LME market structure effectively discourages investors from participating.

Some respondents also detailed concerns around the increased credit risk in the system caused by CVM. They highlighted that the credit lines offered within the LME's current market structure come at a cost to some other users, predominantly smaller clients whose profits are effectively used to subsidise other clients' losses. They expressed concern that this was not fully understood by all users. Responses questioned whether members should be able to use the profit from one client to subsidise the losses of another client. It was also felt that CVM makes porting positions more challenging in the event of a default. It was argued that RVM was a much fairer and more transparent margin methodology.

24) Do you believe that the LME should transition to an RVM model?

Overall, the views were divided on this topic with many respondents on both sides of the debate expressing strong opinions in line with their views expressed in answer to the previous question.

Many of the same points were raised in answer to this question, which are not fully repeated here.

In general, smaller physical clients and the members whose business models rely on CVM were strongly opposed to a move to RVM. While financial participants and larger physical players were generally supportive of a move to RVM as they felt it would broaden participation and make the market more efficient.

Some members who responded were strongly in favour of a move to RVM. They argued that the current unique margin methodology is an operational and regulatory challenge for them to manage. A number of members also outlined the challenge of having positive margin balances "trapped" at the clearing house, which has a cost to their business. They suggested that there were material efficiencies from standardising and removing a barrier to entry that will broaden participation from their client bases and ultimately benefit the entire ecosystem.

A number of respondents, who were supportive or neutral, did however note that the impact on small or medium sized physical participants needed to be considered in regards to any change. They valued the role of such users within the LME ecosystem and did not want to see them unable to access the market due to a lack of credit provision. Ultimately, they supported changes that grow liquidity and broaden participation without jeopardising the existing liquidity in the market.

Other members were strongly opposed to a transition to RVM. Their key arguments were focused on the impact on credit provision to smaller physical participants as discussed in the previous question. It was suggested that such a move would be against the principle of serving the physical market and would be remove one of the unique selling points of the LME market. It was argued that this could see physical clients unable to access the LME market, and consequently the LME prices to lose relevance.

Financial participants and large physical players were generally very supportive of a move towards RVM noting that they have experience of the efficiencies it brings on other markets and cited its position as the industry standard methodology on all other exchanges.

One respondent raised NASDAQ's Nordpool power futures as an example of a commodity market that migrated from CVM to RVM, stating that while there were concerns from end clients, ultimately it had a positive impact on the market, attracting more financial players and generating more liquidity for all end clients.

Some supportive respondents noted the potential challenge to existing business models designed to provide credit based on the CVM model; however, they argued that the market would find alternative solutions to provide credit, as is the case in other commodities markets.

Many physical participants (in particular smaller physicals) expressed strong views against the move to RVM. The majority of these respondents felt that the risk to their credit lines from a move to RVM was the most concerning issue in the Discussion Paper. A number of such respondents explained that their member had explicitly informed them that their credit lines would be impacted if the LME transitioned to RVM.

Physical participants again raised concerns around the potential concentration risk that may occur because not all members will be able to continue to offer credit and service clients. This could have a negative impact on competition and liquidity.

In addition, a number of physical participants were concerned that the move to RVM would ultimately be followed by removal of the daily date structure, which they regard as crucial.

25) Do you agree that the LME's high level proposed timeline is appropriate for a transition to RVM?

In general, if the LME was to transition to an RVM model, the high-level proposed timeline was considered appropriate to accommodate the sizable and complex changes required.

Financial participants offered a range of views on timelines for the proposed transition, some asking for RVM to be implemented as soon as possible, while others noting it is a significant undertaking and asking for it to be introduced in an orderly and considered manner, giving users time to adapt.

Most members who responded suggested that three to five years would be the minimum amount of time required and would expect the LME to consult further with its members to shape the detail of the transition before confirming the exact timeline. However, a few members suggested that if the change was to be made, they would rather it was done sooner rather than later and also highlighted that any transition period itself should be minimised in order to reduce the complexity of having multiple margin models simultaneously in systems.

Some respondents had strong views that the proposed timeline was in fact too conservative, as they felt the benefits for RVM were clear and argued that the change should be implemented much sooner in order to realise the benefits associated with the industry standard margin methodology.

26) Is there anything else you think the LME should consider regarding a transition to RVM or its margin methodology more broadly?

Overall, if the LME was to transition to RVM, respondents stressed the need for significant engagement on the technical details of any transition in order for them to assess how it would impact existing systems and processes.

A number of stakeholders indicated that they would appreciate the LME reviewing the current initial margin requirements and providing an overview of the impact a move to RVM would have on the LME initial margin rates perhaps using a previous year to show what their margin requirements would have been. One respondent also questioned whether the LME would require additional margin to compensate for no longer holding positive CVM balances.

Similarly, some respondents suggested that it would be useful to see more detail of the impact this proposed change may have on the cash and non-cash collateral processes and how the close-out process would work. One respondent suggested the LME takes advantage of the established market processes and reporting protocols to enable close-outs on an automated basis.

A number of respondents suggested the LME could take aspects of RVM and CVM and offer a hybrid approach to its clients. They argued that this would allow each segment of the market to enjoy the benefits of either margin methodology according to their preference.

A common theme in the feedback was the support for the adoption of a value-at-risk ("**VaR**") initial margin methodology, as it was expected to result in margin efficiencies. Respondents asked the LME for an update on this project and suggested implementation of VaR should be prioritised.

27) Are there any other developments to the LME's clearing service that you would like the LME to investigate?

Further comments and additional considerations regarding the LME's clearing service are detailed below.

- A number of respondents argued that the LME should consider introducing additional forms of non-cash collateral, with some also suggesting that the LME look to allow a larger portion of non-cash collateral for initial margin coverage. In addition, some argued for other measures to optimise the efficient use of collateral, such as only charging fees on utilised collateral and operating net payments rather than gross.
- Some respondents suggested the LME should offer CNH as a settlement currency and establish a CNH settlement and margin system. This would allow more flexibility for clients and help them to manage exchange rate risk.
- A few responses suggested that the LME look to collaborate with other exchanges to support cross margining of products.
- One respondent suggested that there could be a better process to encrypt trades into a standardised format to then be processed by both the clearer and clearing house.
- One respondent requested that the LME review the volume figures to ensure they are not distorted by the T4 booking structure.
- One member stated that they view the net omnibus segregated account ("**NOSA**") structure as important and appreciate the LME's support of this structure as it supports liquidity and credit provision.
- One respondent argued that the LME should look into whether it could accept off-warrant metal as collateral with an appropriate haircut.

5.3 LME considerations and outcomes – realised variation margin

Summary

- No immediate changes to margin methodology
- Deliver VaR before other changes to margin methodology
- Explore flexible approach allowing benefits of CVM for some clients, while delivering RVM for the market

The LME is grateful for the significant feedback received in this area of the discussion paper. The LME has considered all the feedback received, which has helped shape the LME's thinking and has assisted it to refine the outcomes in this area.

The LME is committed to serving the physical market, and is cognisant of the important role that credit provision plays in ensuring physical participants are able to access the LME market. While the LME agrees with those respondents that noted that netting of initial margin within NOSAs will continue to support credit provision, the LME has also taken into account the feedback from a number of smaller physical clients who are concerned that a move to RVM could impact their credit lines. Therefore, the LME will endeavour to ensure that its margin model and structure supports its members in continuing to provide credit to end clients.

That said, the LME also agrees with the feedback from financials and large physicals that outlined the significant benefits of RVM in terms of standardisation, efficiency and reduced systemic risk in the ecosystem. The LME remains of the view that ultimately, it would benefit the market as a whole to transition to RVM at some point in the future, but appropriate consideration must be made to ensure that the physical market continues to be well-served.

As such, the LME believes that the current CVM methodology should not be changed, until the physical market can be adequately catered for under an RVM model.

Given the clear advantages of the two models for different stakeholders, and in line with the principle of user choice, the LME will investigate the development of an approach that recreates, or enables the recreation of, the cash flows of a CVM model for RVM contracts, which could support the provision of credit for smaller physical participants. The investigation will consider facilitating the provision of a separate client account where members can keep all clients that want to continue with CVM like cash flows. To support such a solution the LME could utilise reports and rule changes (where deemed necessary) such that members are able replicate the client cash flows of a CVM margin model. The LME will also explore other technical solutions that could support the continued provision of credit to clients. For any such solution, it is important that positions in a member's house account offset regardless of whether the client positions sits in a regular RVM client account or the separate client account used to replicate CVM cash flows. Once the investigation is complete and an approach is confirmed, the LME will look to pilot this solution in its ferrous contracts, which are already margined using RVM, ahead of any potential transition to RVM for other contracts.

The LME has also considered the broad support received for introducing a VaR initial margin methodology that will provide margin efficiencies for physical and financial end users. The LME is therefore prioritising the delivery of VaR ahead of any transition to RVM in order to realise the benefits to all end users.

The LME is therefore confirming that there will be no immediate change to the margin methodology, and does not currently intend to implement a move to RVM until: (1) the feasibility of a flexible approach to margining has been demonstrated in its ferrous contracts, (2) VaR has been delivered.

The LME also notes the feedback from many respondents in respect of the significant amount of time required to implement a transition to RVM due to the complexity of the change. In the Discussion Paper the LME proposed a timeline of three to five years. The LME still considers such a timeline to be appropriate, dependent on the stated requirement to meet criteria (1) and (2) above, and the need to give participants sufficient time to prepare. As such the LME does not believe a transition to RVM is feasible until at least 2026, should the move be undertaken at all.

6 MARKET CONDUCT CONSIDERATIONS

6.1 Overall themes – market conduct considerations

- Broad support for more transparency in stock reporting
- Physical transaction reporting seen as overreach
- Existing lending rules regarded as adequate by many
- Limited interest in LME exploring other measures to protect against squeezes
- OTC reporting seen as operationally challenging and potential overreach

6.2 Feedback summaries – market conduct considerations

28) Do you believe that it would be beneficial for the LME to introduce a disclosure mechanism for warranting/cancellation activity?

Most respondents were supportive of the general principle of increasing transparency relating to warranting /cancellation activity in respect of LME warrants. However, many did not opine on the specifics of having a disclosure mechanism as mentioned within the Discussion Paper. Among those that did respond more directly to the topic of a disclosure mechanism there was some support, particularly from participants who felt this could help them to manage their activities, by allowing them to make disclosures and thus no longer be in possession of inside information. Other respondents felt that participants should already have their own methods for managing conflicts of interest, and so such a system was unnecessary.

Some respondents highlighted that there was no perfect answer to increased transparency. The nature of a physical commodity market is that some participants will have information that other participants do not. However, other respondents did raise concerns around how the warranting and cancellation process was currently used by participants, and the resulting impact on price movements.

Many respondents were concerned that increasing the burden on physical market participants trading in the LME ecosystem, both by increasing the operational costs, and reducing their flexibility, would disincentive physical traders to use the LME, which would have a negative impact on the LME ecosystem as a whole.

Many respondents (including both those who were supportive and unsupportive of the idea) questioned the practical difficulties of implementing such a system, in particular if it was based on participant intention. Many highlighted that the exact details of such a system would be very important (and many asked to engage with the LME on the details) in particular to ensure that the information was as accurate as possible and to reduce potential for incorrect signals to be sent to the market. Some respondents also suggested there should be threshold levels for disclosure requirements.

Within the context of this question, several respondents provided feedback on the LME warehousing system more generally. Some respondents believed that warehouses need to become more efficient and thus reduce the cost of LME warehousing. Other respondents felt that, while the LME has done much to reduce queues, there were still some issues at times.

All stakeholders were keen to see any additional processes constructed in a way that minimised the impact on existing practices, rather than adding additional operational complexity. Most respondents wanted to be involved in the conversation with the LME to provide input into the detail of and measures to be introduced in this regard.

29) Do you think the LME should look to increase the transparency around holdings of warrantable, but not warranted, inventory?

The majority of respondents were supportive of increased transparency for stocks and physical movements of metal and suggested that the LME's existing off-warrant stock report ("**OWSR**") was an encouraging first step. They highlighted that transparent, accurate and timely data was crucial for a well-functioning market.

Financial participants were in general supportive of this proposal and argued that the frequency of publication of the existing OWSR should become daily. Physical participants and members provided a range of views on both sides, but generally agreed with the underlying notion to increase transparency as long as it did not limit their legitimate market activities.

A number of respondents raised challenges around the ability to implement such a solution in practice, with some suggesting that inaccurate data is worse than no data and, therefore, that on balance the current OWSR scope is sufficient.

Many respondents indicated that they thought it would be challenging to implement a robust system that did not inadvertently restrict physical traders from moving their stock into warehouses, and again raised concerns around how the implementation of an intention-based system could be effective. One physical participant highlighted that the intention of the metal holder can change very rapidly, and that the decision of what to do with the metal should be at the sole discretion of the metal owner. One respondent argued that there could be added confusion in practice as users may interpret what must be disclosed differently. Some respondents were nervous about an intent-based regime, as they felt that assessing when an intent formed is difficult to do and were concerned that if their intent changed unexpectedly then they may face a risk.

The physical community had a range of views on this question. Most were supportive of some additional transparency but ultimately saw the information as proprietary and, therefore, considered it inappropriate to publish. Additionally, they felt that in some cases, if stock was not warranted, and there was no intention for it to be warranted in future, then it should not be subject to LME's reporting requirements. Some respondents elaborated that they felt that this might even push volume away from the LME, as some physical participants view their off-warrant stock holdings as commercially sensitive.

A number of members and physical participants argued that the LME inventory data should show all potentially available metal – not just unwarranted metals – but all metals that meet LME delivery specifications and that are in LME locations. Members stressed the importance of the report being updated and released daily, side by side with the current LME inventory report. Their responses highlighted that this would provide a more relevant and complete data set, and support the market in understanding available stock levels. They believed that this could relieve some of the surprise stock moves that may cause alarm, as they would have seen the stock as soon as it entered the warehouse and then monitored it as it was warranted over a number of days, rather than as a lump move. Another respondent also questioned the definition of "warrantable" and raised examples, such as material that meets delivery specifications but is lacking documentation, which could go unreported.

One physical end user saw this as a good start, but suggested it still lags behind some of the LME's peer exchanges in adding real transparency to the market. They argued that there should be consequences for those that report late or incorrectly. A major physical trader reiterated this sentiment, requesting that reporting become mandatory, as they found the voluntary nature of the current reporting unreliable.

A concern was raised by a member that believed this proposal could negatively impact the ability of the LME to serve the physical market. They outlined that this may add additional costs and over-exaggerate the role of the LME by adding oversight to physical supply contracts.

If the LME were to pursue such a solution, there was strong demand for further engagement from all participants such that the detailed design may minimise the impact on existing business models.

30) Do you believe the LME should investigate disclosure obligation for large physical transactions?

The feedback received on this question showed strong views on both sides of the argument. Many respondents felt strongly that it was beyond the remit of the LME to extend oversight into purely physical transactions, and that requiring this kind of disclosure could significantly discourage physical market participants from trading on the LME.

However, other respondents suggested that where transactions reference the LME they should be reported, as they can impact the LME market. There was general agreement that where physical transactions do not reference the LME market, such transactions fall outside the LME's jurisdiction.

Generally, proponents of this measure believed disclosing large transactions referencing the LME price in a reasonable time-frame would be beneficial to the overall market because large physical transactions could contribute to squeezes on the LME market. Some financial players felt that large physical transactions are often monopolised by big players and can move the market.

A number of members believed any requirements for reporting physical transactions could be considered intrusive by physical participants and was uncommon on any other exchange. It was suggested that this would not align with the strategic principle of serving the physical market.

31) Should the suggested disclosure mechanisms be intention-based, or are the practical impediments too significant? Are there any viable alternatives to an intention-based regime?

Most respondents were unconvinced that intention-based mechanisms could work effectively, and felt that the practical impediments would indeed be too material. Respondents also noted that they believe that "intention" would be too hard for the LME to police and therefore could undermine the credibility of the data.

A common concern from respondents was that it is very difficult to prove when an intention is formed, and intentions evolve regularly over time on the LME market. It could also lead to potential scenarios where intentions are registered, but the participant will never actually warrant the material.

A number of respondents suggested that an intention-based ruleset may introduce unintended consequences and questioned whether it could discourage liquidity by requiring further disclosures. One member argued that LME members should disclose information to the LME but it should not be published to the market as they were concerned that disclosing such information could create an asymmetry that forces metal away from LME warehouses. Physical participants shared such views and stated they were more comfortable with the current disclosure mechanisms.

A number of members noted that adding to pre-existing reporting requirements would be helpful and offer more meaningful transparency than an entirely new construct. Along those lines, some respondents suggested greater monitoring and daily reporting of eligible LME stock that is warrantable and held at LME locations by LME registered warehouse operators (i.e. both on-warrant and off-warrant stock). More comprehensive reporting on all warrantable stock held by LME warehouse operators at LME locations would offer meaningful transparency improvements, rather than an intention based system, which could be difficult to implement.

One physical participant did argue that practically the mechanism must be intention-based. They elaborated that an objective framework should be used for the disclosure mechanism, but the LME's compliance team should assess any consequent trading on an intention basis. They stressed that if this policy was thorough, its existence alone would discourage negative behaviour.

Some alternatives or additional elements were suggested, such as:

- One respondent suggested that warehouses instead report total capacity and total free capacity by metal
- A notice period prior to warranting would be a more practical solution, as intention was too hard to define
- The intention disclosure could be required only above a certain size threshold, so smaller moves would be exempt
- The mechanism could be supported by a financial commitment when stocks are cancelled

Members would welcome further conversation and information on the proposal should the LME intend to pursue this disclosure regime.

32) Is there anything else you think the LME should consider regarding transparency of in the physical metals markets?

Overall, responses indicated that the current LME policies were working well and have been enhanced by the off-warrant stock reporting which has generated further transparency. Most respondents believed that the LME had found the appropriate balance in terms of not being too prescriptive while providing transparency to the market and ensuring appropriate surveillance.

Some additional suggestions were raised including:

- Providing data on location premiums and discounts and supporting warrant swaps between warehouses
- Ability to limit the receipt of certain brands of LME warranted material (for example where sanctions guidance may restrict a member from holding a certain brand)
- A request to review warehouse rent charges, as it was felt that these are an important component when metal owners make storage decisions, and it was implied that LME rent was too high
- Some smaller physical end users suggested that dominant position-holders over a certain threshold should be disclosed due to the risk of influencing markets, as smaller market users will not hold dominant positions
- Similarly, a physical user suggested that after a large price movement, which has resulted from a significant delivery or withdrawal, the LME should conduct a post-move investigation
- One respondent suggested that the LME should consider prohibiting the re-warranting of metal at the same location once it has been removed from the first warehouse
- A request was made for the LME to publish a report similar to the LME Commitments of Traders Report, which would group inventory by the category of entities holding them (eg merchants, banks, consumers etc)

33) Do you believe the LME should look to introduce rules limiting the ability of one party to acquire a significant holding of new or remaining warrants?

The majority of respondents felt that the current LME lending guidance and the MiFID position limit regime provide adequate protection against market squeezes. Many respondents were concerned that any further restrictions or additional reporting may impact participants' ability to execute legitimate business. Some respondents felt that this could negatively impact the link between the LME and the physical market, and potentially jeopardise the relevance of LME pricing.

A number of respondents believed that anything limiting the free movement of physical metal could jeopardise the LME's position as a market of last resort.

Although physical participant respondents were in general concerned with any additional rules, a number of smaller participants did indicate support for this proposal due to their concerns over larger physical participants' potential influence on physical markets. However, while some agreed with the proposal in principle, they believed it would be difficult to implement effectively.

One member expressed support for the proposal, stating that they recognised the LME needs to serve the physical market, but there should be limits in place to restrict any potential influence on LME prices when one participant has a significant holding of warrants.

34) Do you think the LME should investigate position limit rules, or similar rules around position accountability or reporting?

Overall, responses regarding position limits were relatively balanced. While the majority of respondents gave a simple “yes” or “no” answer, a number went into more details on their views, and why position limits may or may not be beneficial to the market.

The majority of member respondents were not supportive of the idea, with many highlighting the existing MiFID position limits, which they felt were sufficient. Some member respondents suggested the LME’s focus should be on the oversight and investigation of large positions, rather than on set limits. A few members were somewhat supportive of position limits, though highlighted the potential impact on commercial entities and market liquidity. As such, they felt any rules would need to be carefully written with appropriate exemptions.

Non-member responses were very balanced. Many respondents highlighted that position limits are common on other exchanges and thus would be an appropriate area for the LME to investigate. Others felt that the existing combination of MiFID rules and LME lending guidance already solved the problem that position limits would be trying to address. Again, there was some concern that position limits could restrict some legitimate business.

There was some support for an “accountability” regime, where market participants would not be prohibited from holding larger positions, but holdings above certain thresholds would trigger monitoring and investigation by the LME.

35) Do you think the LME should seek to introduce additional rules around the reporting of OTC positions?

While the majority of respondents expressed concern about the complexity and operational cost of introducing OTC reporting rules, other respondents were in favour of more reporting of some relevant OTC positions, because they are inherently linked to LME trading.

A number of respondents stated that they are already required to meet a number of significant regulatory requirements and were providing this information to the regulators already. Respondents were concerned with having to produce any additional reporting and noted there could be significant operational costs with having to do so. They also questioned why the LME would require this information and for what purpose, as it relates to trading that does not occur on the LME market. They also suggested that this was not standard practice on other exchanges.

Some respondents argued that reporting of the OTC market was outside the reach of the LME. Some physical participants saw this as the LME overstepping its remit. They felt that if OTC market activity has an impact on exchange activity (through price or positioning), it should be these impacts on the LME price or liquidity that are monitored or investigated, if required, by the LME.

Members noted that if the LME was to pursue adding OTC reporting rules, they believe this is an area where further analysis would be required in order to ensure that the right balance is struck, that policies do not conflict with existing obligations and that they are operationally deliverable in practice.

Some respondents highlighted that additional reporting would put a higher burden on smaller specialised brokers who have to spend a larger amount proportionally to facilitate additional reporting obligations, which may be duplicative.

Financial participants were generally in favour of additional OTC reporting, however some did highlight that reporting can be burdensome and suggested the responsibility should lie with LME members. They suggested aggregated reporting was a better solution that other exchanges use and has been shown to add transparency.

However, some other respondents strongly favoured additional OTC reporting, as they believed it was an important factor in ensuring consistency between the LME and closely associated OTC markets. In the long term this may encourage some business on to the exchange (by reducing the "advantage" of OTC), and thus increase the liquidity on the LME.

36) Is there anything else you think the LME should consider regarding market conduct around the potential for market squeezes?

Overall, the feedback indicated that there is support for the LME exploring further ways to prevent market squeezes, but most respondents did not have immediate suggestions or further concerns that they wish to be addressed. Most respondents appreciated the work done to date by the LME and felt that the current approach was working well, but would support any further work to limit the potential for market squeezes.

Some respondents suggested an increase in the frequency or detail of reporting would be useful, specifically the futures banding report and the off-warrant stock report. One physical participant suggested that more robust and timely reporting of market positioning would help identify and combat potential issues of market conduct without having to implement rules that could fall outside of the LME's jurisdiction.

37) Is there anything else you think the LME should consider regarding any other aspect of market conduct?

Overall, responses from all market users indicated that they did not have any further material suggestions as they felt the progress being made was positive and they were happy with the pathway LME was pursuing.

One respondent welcomed more engagement and closer working between the LME members and the LME Market Surveillance team. They suggested that this would support firms focusing on key areas of risk to better understand their implications. Secondary to this, a member welcomed any additional training, resources and guidance that centres around market conduct, with a focus on new traders and a refresh for existing traders.

6.3 LME considerations and outcomes – market conduct considerations

Summary

- Developments to off-warrant stock reporting to further improve transparency
- Investigate limited OTC trade reporting
- No direct physical transaction reporting requirements
- Continue with current approach to preventing market squeezes via LME lending rules

The LME is very grateful for all the feedback received on the considerations concerning market conduct. It is worth noting that in this section the ideas were at a formative stage, and all the detail provided by respondents in their answers will help shape the next steps of the LME's thinking in these areas. As mentioned by some respondents, there are many areas where the LME would undertake further engagement with participants (whether formal or informal) before implementing any changes.

The Exchange agrees with the overall positive feedback on the existing LME rules, processes and procedures in this space with many respondents indicating their support for the current structures, including the lending guidance and progress made with off-warrant stock reporting. The LME also understands respondents' concerns that significant increases in disclosure requirements may have unintended consequences, including the potential to push physical business away from the LME. As such, the LME does not intend to pursue any significant changes in this area, but instead to incrementally build on the existing structures.

The LME agrees with respondents that intention-based rules, while theoretically interesting, are likely to be practically complex to implement and difficult to ensure compliance with, which may ultimately reduce their effectiveness.

In line with the general support for more transparency around physical holdings, but concern around disincentivising physical activity on the LME market, the LME intends to explore further enhancements to the OWSR. These enhancements will be designed to make the report more useful and reliable for participants, balancing the need to maintain the LME's strong link to physical markets, while also recognising a fair trade-off between metal owners benefiting from the ability to deliver warrants into LME warehouses with an increased level of transparency around certain metal holdings for all market participants.

The LME will focus on ensuring the OWSR is a comprehensive and accurate record of off-warrant material that may be warranted in future. The intention will be to establish objective criteria in order to ensure accurate reporting, while also having rules to discourage unwanted behaviour – such as to limit the ability of material to be warranted unless it has previously been registered to the OWSR.

Driven by a desire not to overly burden LME warehouses with additional operational complexity, and/or increase costs within the LME warehouse ecosystem, the LME will also investigate moving the reporting requirements to metal owners, supported by LME members.

The LME also intends to increase the frequency and timeliness of reporting, with the goal of achieving a daily OWSR to be published alongside the LME's existing warehouse inventory reports. Given the complexity of delivering these changes, and the importance of having reliable reports, the LME believes it is likely that enhancements will be made incrementally over a number of years, starting in 2022.

The LME does not currently intend to actively investigate a system to allow users to disclose warranting or cancelation activity, as it believes OWSR enhancements will be more effective in giving market participants a transparent overall picture.

In terms of the proposals in the Discussion Paper regarding potentially requiring reporting for large physical transactions, the LME has considered the feedback and understands the concerns of physical participants that this type of disclosure may discourage physical users from trading on the LME. As a result, and in order to respect the boundaries of the physical market, the LME does not intend to extend its scope into pure physical transactions by way of introducing reporting obligations. Clearly, this limits the LME's ability to proactively monitor for physical market anomalies impacting trading activity; however, the LME believes that its focus for the time being should be on using its enhanced investigatory powers to undertake any required retrospective action where necessary.

In terms of the proposals related to market squeezes, such as restricting warrant holdings or adding additional position limits, the LME agrees with the feedback that the lending rules are effective at preventing market squeezes. The Exchange understands respondents' concerns that increased rules in this area may prevent legitimate business from taking place, alongside having other unintended consequences. As such, the LME does not at this time intend to further investigate rules on warrant holdings or futures position limits.

Regarding the possibility of introducing additional rules around the reporting of OTC positions, the LME is cognisant of respondents' concerns about the operational complexity of this type of reporting, and the view of some respondents that OTC trading is outside the Exchange's remit. However, the LME also recognises the importance of ensuring close monitoring of OTC trading in instruments very closely linked to the LME in order to ensure it has appropriate oversight of activity most likely to have an impact on OTC markets. It is also important to ensure that OTC trading is not used to inappropriately avoid the LME's rules and reporting requirement.

As such, the LME will investigate introducing the reporting of those OTC trades that are most similar to LME contracts, as these are the contracts most likely to impact LME markets and will be the easiest to report. The LME will, of course, need to ensure that any new reporting requirements are written in such a way as to prevent minor changes to OTC contracts for the specific purpose of taking them outside of the LME's scope. As part of this investigation, the LME will consider the possibility of using the LME's existing systems in order to allow participants to register these OTC trades, thereby ensuring that the increased operational burden is as low as possible. The LME will also consider the crossover into its Financial OTC Booking Fee, to reduce the overall operational burden wherever possible.

6.4 Feedback summary – other topics

38) Do you have any further comments on any of the topics covered within this Discussion Paper? Or any other topics you think the LME should consider?

A number of respondents provided further comments and additional considerations on topics within the Discussion Paper. Many of these had already been discussed in relation to other questions (and have already been included in this Feedback Paper), while others are new. The new considerations raised can be broadly grouped into those relating to: the LME ecosystem, market data, give-ups and new products. Below is a summary of such feedback.

The ecosystem

- A number of respondents argued that the LME's focus should be on defending its position and serving the physical market rather than making changes to attract new participants. They argued that the LME should focus its efforts on ensuring its prices remain the global reference prices for base metals that are used in physical contracts.
- Some other respondents expressed a more open view of the ecosystem and argued that the LME should work closely with all core end-users and key liquidity providers, where possible working in partnership to bind the LME ecosystem together.
- Some respondents expressed concern that the LME was apprehensive of change due to the views of the member community and more weight should be given to the views of end users.

Market data

- A number of respondents made comments around market data and suggested potential changes. Firstly, the overall cost of market data was cited as a barrier, with some respondents suggesting reporting requirements for market data users are also overly complex and deter participation in the LME market.
- Some end users argued the LME should make some data, such as carry pricing, monthly outright pricing and monthly average prices, available free of charge.
- In addition, some respondents applauded the increase in data on the LME website, but went on to suggest that more free historical market data should be added, such as volume, warehouse stock data and open interest. They argued this would support market analysis and promote the LME market.

Give-ups

- One respondent suggested that the LME should look to make changes to the give-up process in order to align with other exchanges, which they felt would improve efficiency and encourage greater participation.

New products

- In terms of new product launches, some respondents highlighted that the LME should look to bring new contracts to market much quicker. They cited delays in the launch of certain products as having impacted their success. Some respondents also argued the LME should spend more time with its users to understand the technological considerations for new products to support faster delivery and uptake of new products.
- A number of respondents reiterated their commitment to work with the LME to explore new opportunities for organic and sustainable growth initiatives.
- One respondent suggested the LME look to launch an alternative set of contracts directly targeted at investors, which could be RVM-based and directly compete with more standardised futures contracts.

6.5 LME considerations – other topics

The LME is very grateful for all the additional feedback given by respondents, and thought it useful to respond to some of the ideas.

Regarding the LME ecosystem, in line with the outcomes of the 2017 Discussion Paper on Market Structure, the LME believes the broad range of participants on the LME is one of the core positive attributes of the market. While the physical community remains absolutely core to the LME (hence the LME's strategic principle to serve the physical market), this does not mean that LME markets should solely be structured to meet the needs of physical participants (nor would this be possible, given the diverse preferences of different physical participants). Moreover, the LME does not believe that appropriately serving the needs of the physical market precludes any market evolution. In fact, many physical participants themselves are keen to see LME markets evolve in many areas. Some of the more traditional LME participants choose to characterise market evolution as "physical participants vs. financial participants", but this does not align with the LME's understanding of the needs and preferences of its diverse user base – which are more nuanced than this characterisation would suggest.

The LME welcomes the feedback around market data. This is an area that the LME is seeking to develop over the next few years, through rationalising its market data offering onto the LME's new LMEsource multicast platform, and increasing the practical transparency offered in some areas, such as inter-office market data. Finally, the LME is also looking at what additional data services it may be able to create in order to increase its offering to participants.

The LME is aware that the give-up process necessitated by the "T4" booking structure can be operationally challenging for participants who are used to more standardised futures markets. While the LME will certainly keep in mind any potential ways to standardise the give-up process, this may not be easily achievable within the LME's unique market structure.

The LME welcomes discussions with any participants wishing to work on identifying new market growth opportunities and notes that many participants continue to drive growth in the LME's ferrous and other cash-settled contracts. These contracts have been specifically structured in order to be easier for participants to adopt, and all have a common structure to reduce the operational burden for members and other participants wanting to trade them.

Regarding the potential for new, more standardised contracts specifically aimed at the financial community; it is worth noting that this was a question specifically posed in the 2017 Discussion Paper on Market Structure. At the time, this was largely seen as likely to be a negative step for the market and unlikely to be successful, as most participants have liquidity as a primary concern, so would be unlikely to trade in a new market with lower liquidity, even if they ultimately preferred some of its attributes.

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