Policies and Controls for the Prevention of Disorderly Trading

Please respond to:
Trading Operations

1   Introduction

This document sets out the London Metal Exchange's (the "**LME's**") policies and arrangements for the prevention of disorderly trading, and the management of volatility and pre-trade and post-trade controls on LMEselect. It addresses the obligations imposed upon UK Regulated Investment Exchanges ("**UK RIE**") under the UK MiFID Framework[1] and Financial Conduct Authority ("**FCA**") Handbook ("**FCA Handbook**"), with particular reference to Articles 18, 19, and 20 in the UK version of Commission Delegated Regulation (EU) No 2017/584 ("**UK MiFID RTS 7**") which apply to trading on LMEselect.

The following policies are set out in this document:

- Order Throttle Policy

- Kill Switch Policy

- Cancellation of Orders Policy

2   Defined Terms

Capitalised terms not otherwise defined in this document shall have the meaning ascribed to them in the Rules and Regulations of the LME (the "**LME Rulebook**").

3   Power to Request Information

Part 2 of the LME Rulebook sets out the powers of the LME to request information from Members. These powers include notably the power to request information from Members regarding their organisational requirements and trading controls, or about the organisational requirements and trading controls of any Client of a Member. Members must comply with any request of the LME or must procure that its Client complies with any request of the LME.

4   LME Controls

The LME must take steps to ensure that fair and orderly trading is maintained with regard to the submission of orders, and to protect both the LME and Members' own systems and infrastructure from inappropriate activity.

As required by UK MiFID RTS 7, the LME has in place the following arrangements which assist in preventing disorderly trading:

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[1] Directive 2014/65/EU, and all delegated legislation thereunder, was onshored by way of the European Union (Withdrawal) Act 2018 (the "**UK MiFID Framework**")

a)   limits per member of the number of orders sent per second (Order Throttle Policy);

b)   mechanisms to manage volatility (Price Limits and Price Bands);

c)   pre-trade controls;

d)   post-trade controls; and

e)   other arrangements, including the LME's own monitoring capabilities.

Finally, Members are expected to have their own controls which this document describes below.

4.1   Order Throttle Policy

The LME implements throttle limits which limit the maximum number of order entry/updates per second that can be submitted via each LMEselect FIX and binary session. Order entry/updates submitted in excess of the throttle limit in any given second will result in those orders/updates being rejected by the system. Order cancellations are not considered for the purpose of these limits.

The LME also implements a throttle limit at Member level which limits the total aggregated number of order entry/updates that can be submitted per second across all FIX and binary trading sessions for that Member. The throttle limit that applies at Member level will be published in the LMEselect Configuration available on the LME website.

The throttle limits are determined at the sole discretion of the LME and are subject to review and change from time to time. Any changes to the throttle limits will be updated in the LMEselect Configuration.

The LME is not responsible for missed trading opportunities resulting from the application of the Order Throttle Policy.

The LME will ensure that Members are treated equally in the application of the Order Throttle Policy.

4.2   Volatility controls: Price limits and Price Bands

The LME uses a number of mechanisms to help manage price volatility and avoid erroneous order entry in LMEselect: (1) Dynamic Price Bands; (2) Static Price Bands; and (3) Daily Price Limits ("**DPL**").

The LME's dynamic and static price bands act as price collars to automatically reject orders that do not meet pre-set price parameters on an order-by-order basis. They are designed to allow for readjustment during the trading session and in all its phases. Manual adjustments can be made on contract and prompt levels to manage situations where the parameters must be manually overridden to ensure orderly trading and can include the suspension of bands in exceptional circumstances with the approval of senior management.

Under the DPL Multiple Day Framework (available on the LME's website), the LME will automatically halt the market for a particular metal if certain circumstances are met.

As required by Article 18 of UK MiFID RTS 7, the LME makes public details of the operation of these mechanisms and their application to specific Contracts on the LME website at www.lme.com/en/Trading/Volatility-controls-price-limits-and-price-bands.

The LME will ensure that:

a) mechanisms to halt or constrain order entry/updates and trading are tested before implementation and periodically thereafter when the capacity and performance of the trading systems are reviewed;

b) IT systems and human resources are allocated to deal with the design, maintenance and monitoring of the mechanisms implemented to halt or constrain trading; and

c) mechanisms to manage market volatility are continuously monitored.

The LME maintains records of the rules and parameters of the mechanisms to manage volatility and any changes thereof, as well as records of the operation, management and upgrading of those mechanisms.

Finally, the LME publishes a Fast Market Policy, which can be found on the LME website. This policy primarily relates to the power of the LME under the UK version of Commission Delegated Regulation (EU) 2017/578 ("**UK MiFID RTS 8**") to suspend Members' obligations to provide liquidity (if they have undertaken such obligation under an LME scheme) in case of a situation of extreme market volatility. For the avoidance of doubt, nothing in the LME Fast Market Policy will prevent the full and effective application by the LME of the volatility controls described above.

4.3 Pre-Trade Risk Management ("PTRM")

As required by Article 20(1) and (2) of UK MiFID RTS 7, as part of its pre-trade controls the LME has PTRM controls in LMEselect to set and manage pre-defined limits which are set by the LME at the Member level ("**Exchange set limits**") and apply at order submission to all activity entered by the Member into LMEselect. Exchange set limits are determined at the sole discretion of the LME and are subject to review and change from time to time. Notification of changes to Exchange set limits shall be provided to impacted Members as soon as is reasonably practical before the new Exchange set limits take effect.

In exceptional circumstances, Exchange set limits may be individually adjusted on request and in agreement with the Member. Any request to increase Exchange set limits should be done by email to tradingoperationsgroup@lme.com and must come from an authorised person at the Member.

In addition to Exchange set limits, Members have access to the PTRM controls via the LMEptrm system. Members are responsible for establishing risk groups and end clients (e.g. individual traders and DEA clients) and are required to set limits ("**Member set limits**") at the Member level, and risk group level, and at Member level for non-clearing members that clear through them. The LMEptrm User Guide sets out details for managing Member set limits, which will default to zero and must be set by Members before they or their Clients can commence trading on LMEselect.

Members have the ability to override their own Member set limits in accordance with their internal procedures where appropriate.

Exchange set limits and Member set limits include a maximum value, both in lots and notional value per order. Limits are established at a product level and further split by contract type: outright, carry and Tom Next.

All orders are assessed against both Exchange set limits and Member set limits. The most stringent limit will apply, and any order submitted in excess of a limit will be rejected.

All PTRM limits (i.e. Exchange set limits and Member set limits) are designed to allow for readjustment during the trading session and in all its phases.

4.4   Trade halts and pauses

The LME may, at its absolute discretion, acting reasonably, halt or pause trading on LMEselect for such periods it considers necessary in the interests of maintaining a fair and orderly market. The LME will keep such measures under constant review, and trading will be resumed as soon as reasonably practicable following any such halt or pause.

Without prejudice to the generality of that power of the LME, Trading Operations can initiate a market trade halt or pause if LMEselect is experiencing operational issues, where there is significant market volatility or where there are other issues – such as for instance:

- Network or technical issues;

- Reference data issue;

- As a result of the DPL Multiple Day Framework;

- Any other event where a trade halt or pause has been deemed necessary by the LME to ensure orderly trading so as to afford proper protection to investors.

When a trade halt has been initiated, orders cannot be entered or amended, and all open orders are cancelled.

When a trade pause has been initiated, open orders remain in the orderbook and can be cancelled but not amended. No new orders can be entered and there will be no matching of resting orders.

When the market is halted as a result of the DPL Multiple Day Framework: Members should refer to the DPL Multiple Day Framework policy for guidance on what they may do during the halting/suspension event and on how the LME will publicly communicate on the market halt and on market re-opening.

When the market is halted or paused for a reason outside of the DPL Multiple Day Framework: where the likely duration of the market halt or pause is known at the outset, the LME will communicate the steps that will be taken to resume trading, including the proposed timeline. However, where there is uncertainty as to when

orderly trading may resume, the LME will provide updates to the market throughout the halt or pause and in relation to its decision to re-open the market.

4.5   Kill Switch Policy

Kill Switches enable the LME to halt trading by participants, either at the Member level, risk group level or end client/user level or, halt or pause trading across the market, either as a whole or in a particular contract or prompt date(s) for a contract.

A Kill Switch will usually be invoked only where a situation has developed, appears to be developing, or is likely to develop which may give rise to a disorderly market or some other kind of market disruption. Below are non-exhaustive examples:

Kill Switch for Member, risk group or end client

Access for a Member, risk group or end client may be restricted or disabled in the event of circumstances such as, but not limited to:

- A breach of the LME Rulebook which is likely to have an adverse impact on market activity;

- A Member, risk group or end client causing a disorderly market or bringing the market into disrepute;

- As a result of section 6 of this Policy (Suspension of Access) or

- A runaway algorithmic Trading Account causing market disruption.

Kill Switch for "trade halt / pause"

A trade halt or pause at any level i.e. cessation of trading across the market as a whole or in a particular contract or a prompt date of a contract, could be initiated in the event of circumstances such as, but not limited to:

- A technical issue in which market participants are, or are likely to be, unable to access the market;

- A major trading event or economic factor significantly impacting a market;

- To mitigate systemic risks posed by a Trading Account or LME Select Participant.

For the cancellation of unexecuted orders submitted by a Member or by a sponsored access client following a halt or pause in trading, the Cancellation of Orders Policy would apply.

4.6   Cancellation of Orders Policy

The LME may be required to cancel orders placed in, or in order to prevent, disorderly trading conditions and breaches of capacity limits, as a result of a technical issue, or on the basis of any other applicable regulatory or rule requirement.

Orders may also be cancelled under the following non-exhaustive circumstances:

a) Upon the request of the Member, where the Member (or Client if relevant) is unable to delete its own orders;

b) where the order book contains erroneous duplicated orders; or

c) following a market halt initiated either by the LME or by the FCA or any other relevant regulatory authority; or

d) following use of the kill switch either for a participant or at a market level as per the Kill Switch Policy.

In relation to (a) above, to request the cancellation of any unexecuted orders placed by a Member or a Client, an authorised person from the Member must contact the LME's Trading Operations team. The request must be supported by an email to: tradingoperations@lme.com.

The LME may also cancel or revoke orders and trades/transactions in accordance with the LME's Error Trades and Erroneous Order Submissions Policy.

4.7   Post-trade controls

Article 20(3) of UK MiFID RTS 7 sets out that UK RIE may establish the post-trade controls that they deem appropriate on the basis of a risk assessment of their members' activity.

The LME employs the following post-trade controls:

Trade Cancellation

As set out in the Error Trades and Erroneous Order Submissions Policy, the LME reserves the right to price adjust or cancel erroneous trades to preserve the integrity of the market. The policy outlines the circumstances relating to and the handling of error trades and erroneous orders on LMEselect. This includes both the LME and Member process for dealing with error trades, including the no cancellation range, trade adjustments and trade cancellations.

There may be cases where the Clearing House does not accept a Transactions for clearing on the basis of its Rules, as a result of which LME will be required to void the Contract pursuant to Article 5 of the UK version of Commission Delegated Regulation (EU) 2017/572 ("**UK MiFID RTS 26**").

The LME may also cancel or revoke transactions in case of malfunction of the LME's mechanisms to manage volatility or of the operational functions of LMEselect, for example loss of connectivity, market data feed issues or other technical issues which impact reference prices and order book management.

4.8   Other arrangements

To support the controls employed, the LME's Market Surveillance team monitor order and trade activity across all LME trading protocols via the Nasdaq Trade Surveillance (SMARTS).

The Clearing House performs a continuous assessment and monitoring of market and credit risk of the Member and controls regarding the maximum long and short and overall strategy positions.

Members and their Clients are reminded of the requirements of investment firms engaged in algorithmic trading as set out in the UK MiFID Framework, with particular reference to Article 17 of the UK version of Commission Delegated Regulation (EU) 2017/579 ("**UK MiFID RTS 6**"). To assist Members, the LME provide the following:

a) The LME Drop Copy Gateway provides Members and Clients with access to near real-time reports for monitored entities on transactions executed on LMEselect for the current trading day. This service gives Members access to monitor trading activity conducted on LMEselect and to reconcile their own trading logs with data made available by the LME. The service can be tailored to meet the specific requirements of the Member and its Clients.

b) LMEsmart provides Members with a view of matched transactions prior to them reaching LMEmercury and this information can be exported; and

c) LMEmercury provides visibility for Members to calculate outstanding exposure and monitor real time positions of its traders and clients.

5   Monitoring

The LME will perform ongoing monitoring of LMEselect including, without limitation, performance and capacity, orders sent by Members on an individual and aggregated basis, message flow, and the concentration flow of orders, to detect potential threats to the orderly functioning of the market.

6   Suspension of Access

The LME may suspend access to any of its trading venues, either at the Member, risk group, end client level, or for the whole market, at the initiative of the LME or at the request of the relevant Member or the Clearing House, or where required by the rules of the Clearing House, or by the FCA or any other relevant regulatory authority.

7   Members' Controls

Members are required to comply with all relevant regulatory requirements including, but not limited to those derived from the UK MiFID Framework. In particular, Members must notably have policies in place for the following:

a) pre-trade controls on price, volume, value and usage of LMEselect, and post-trade controls on the Member's trading activities, including any DEA Clients, across both LMEselect and the Matching System.

b) These policies should set out the process by which the configuration for each control is determined; the process for revising such configuration, and any over-ride or emergency process;

c) the technical and functional conformance testing that must be undertaken prior to deployment of all third-party systems and/or applications that interface with LMEselect and/or the Matching System. For the avoidance of doubt, the reference to third-party systems/applications shall include those developed in-house by the Member themselves as well as those provided by vendors; and

d) in addition to any over-ride or emergency policy referred to in a) above, Members must have a policy relating to the use of kill functionality with regard to business executed on LMEselect.

e) Members have kill switch functionality made available via the LMEptrm system which can be executed when they need to cancel immediately, as an emergency measure, any or all of their unexecuted orders submitted in LMEselect. For these purposes, unexecuted orders include those originating from risk groups or individual end clients. Members must be able to identify which trading algorithm and which trader, trading desk, or, where applicable, which client is responsible for each order that has been sent to LMEselect. In the event that the LMEptrm system is not accessible, the LME can enact kill functionality on a Members' behalf. The process by which a Member can request use of the kill functionality, including who can request it, should be included within the policy.

Members must ensure that all of the policies referred to in this section 7 are also reflected in relevant "Business Continuity/Disaster Recovery Plans" (BCP/DR) maintained and followed by Members, such that the invocation of either does not result in any reduction in the level of control exercised over the business conducted through the LME's systems.

Members must ensure that all staff in key positions at Members are suitably qualified.

Members are reminded of their obligations with regards to conformance testing, the testing and certification of algorithms and the conditions pursuant to which they may offer direct electronic access to their clients. For further information, see the Algorithmic Trading and Direct Electronic Access Policy.