

To: All Members and other interested parties

Ref: 22/181 (LME Notice Reference)
22-043 (LME Clear Circular Reference)

Classification: Trading

Date: 20 July 2022

Subject: **INDEPENDENT NICKEL MARKET TRADING REVIEW – MARKET ENGAGEMENT**

Summary

1. Following the notification to the market of the LME and LME Clear's (together the "**LME Group**") decision to commission Oliver Wyman to undertake an Independent Review into events in the Nickel market leading up to the Nickel market suspension (LME Notice 22/168 and LME Clear Circular 22-040 dated 23 June 2022), this Notice provides further detail on the market engagement exercise.

Background

2. This exercise will comprise two distinct elements:
 - (A) a voluntary market-wide engagement exercise, whereby all interested parties are encouraged to contribute views on any topics which they think relevant; and
 - (B) a mandatory data information request to LME Category 1 to 4 Members (inclusive), to allow Oliver Wyman access to relevant data to assess the development of market conditions prior to the Nickel market suspension.
3. As part of the fact-finding phase of the Independent Review, Oliver Wyman is seeking to:
 - (a) form a thorough understanding of what led to the market conditions in the Nickel market in Q1 2022 leading up to the market suspension on 8 March 2022;
 - (b) consider the factors that contributed to these conditions in the Nickel market; and
 - (c) identify actions that could be taken by the LME and LME Clear to reduce the likelihood of similar market conditions arising, and mitigate and minimise the impact of them in the event they were to arise.

(A) Voluntary market-wide engagement

4. To inform the fact-finding phase of the Independent Review, Oliver Wyman is seeking input from all interested parties including, but not limited to, Members, clients and other market participants.
5. Oliver Wyman is seeking input on the following potential contributing factors to understand if any, or others, contributed in particular to the market conditions seen in the Nickel market during Q1 2022, and respondents' opinions on how to mitigate and minimise the impact of these conditions in the future. The full set of questions and definition of each factor can be found in the Annex.

Physical market and contract specifications

- Supply and demand in the underlying Nickel market, concentrations, and susceptibility to shocks
- Alignment between the LME Nickel contract and the wider physical nickel market
- Delivery rules and requirements, lending rules and backwardation limits

Trading limits, controls and rules

- Position reporting, position limits and accountability levels
- Trading rules and real-time trading controls
- Suspicious or anomalous trading activity

Risk management, clearing & collateral model of LME, LME Clear, Members

- Margining methodology and margin call practices
- Concentration risks and margin lending practices
- Capitalisation and liquidity levels across the market and exposure limit setting
- Loss sharing structures and associated incentive

Market structure and roles of institutions

- Distribution of liquidity across venues
- Opening hours and available liquidity
- Prompt date structure and distribution of liquidity
- Depth of liquidity and client order routing
- Price benchmark timing & methodology

6. Oliver Wyman would also welcome input on additional factors and potential mitigants not referenced in the Annex where, in the opinion of interested parties, these should be considered as part of the Independent Review.
7. However, as set out in Notice 22/168, the Independent Review will not cover the LME and LME Clear's decisions, decision-making processes and governance arrangements, including on 8 March, given that these will be considered as part of the regulatory reviews announced by the Financial Conduct Authority and the Bank of England.
8. Interested parties are invited to submit written input on any of the topics within scope of the Independent Review, and should do so via email to LMEnickelreview@oliverwyman.com, by **18.00 London time on 2 September 2022**. The LME Group notes that in order to inform its proactive development and assessment of further market structure reform, information shared by respondents with Oliver Wyman through this process shall also be shared with LME and LME Clear staff.
9. Further, interested parties who wish to have a meeting with Oliver Wyman to give feedback on these topics verbally can contact Oliver Wyman via email at the address set out in paragraph 8 above, specifying the topics to be discussed. Respondents can request that part or all of their meeting with Oliver Wyman be held on a confidential basis (noting that the key points arising from any confidential discussions will be shared with the LME Group on an aggregated basis).
10. Feedback or information shared – whether verbally or in writing – with Oliver Wyman will not be referenced on an attributed basis in Oliver Wyman's public report unless the relevant respondent has consented to this. However, Oliver Wyman may quote, summarise or otherwise reference respondents' feedback in the public report on a non-attributed basis.
11. Oliver Wyman may reach out to respondents to clarify points or information provided.

(B) Data gathering from Members

12. In addition, and as anticipated in Notice 22/099, Oliver Wyman has identified a set of data which it will need from Category 1-4 Members to inform the Independent Review.

13. Accordingly, the LME will exercise its power under Regulation 12.1.4 of Part 2 of the LME Rulebook to facilitate the gathering of this data from Category 1-4 Members, as applicable.
14. The specific data request items will be provided bilaterally to Members by the LME's Market Surveillance team.

Matthew Chamberlain
Chief Executive Officer, LME

James Cressy
Interim Chief Executive Officer, LME Clear

cc: Board directors
Special Committee
User Committee
All Metals Committees
Ring Dealers Committee
Traded Options Committee
Warehouse Committee

Annex – Independent Review questions and topics

The Oliver Wyman Independent Review team is seeking responses to the following questions:

1. In your view, what led to the market conditions in the Nickel market in Q1 2022, up to the suspension of the market on March 8, and why?
2. Which of the factors listed below, or others, contributed to the market conditions in Nickel over that period, or might contribute to a similar event in the future, and why?
3. What should the LME, and the broader metals market, do to reduce the risk of similar market conditions occurring, or to help make such conditions more manageable?

Note – The Independent Review shall not cover the LME and LME Clear’s decisions, decision-making processes and governance arrangements including on March 8.

Physical market and contract specifications

Potential contributing factor	Topics of interest to the Independent Review
Supply and demand in the underlying Nickel market, concentrations, and susceptibility to shocks	Overall supply and demand trends in the nickel market Concentration of producers and consumers of Nickel, across regions, countries, and companies Susceptibility of the physical nickel market to shocks, impacts of geopolitical events, in terms of price, availability of supply Impact of macroeconomic factors and supply/demand patterns during Q1 2022 Critical differences between Nickel and other non-ferrous metals
Alignment between the LME Nickel contract and the wider physical nickel market	Products included in the specification of the LME Nickel contract (i.e. refined Nickel) and products excluded (e.g. nickel matte, iron-nickel, NPI) Fungibility of different grades of physical Nickel, ability to arbitrage between markets Usage of LME prices for Nickel products not included in delivery specifications Availability of physically deliverable LME Nickel and wider physical Nickel stock levels in late 2021 - 2022
Delivery rules and requirements, lending rules and backwardation limits	Warehouse loading/delivery rules, transparency of ownership of warrants Physical metal lending rules (i.e. dominant position obligations which impose that lending is required on all holdings of 50% or above of total LME live warrants) Backwardation limits (i.e. restrictions on tom-next carries on any venue at a price in excess of 1% of relevant metals' previous day's cash official price)

Trading limits, controls and rules

Potential contributing factor	Topics of interest to the Independent Review
Position reporting, position limits and accountability levels	<p>Large position reporting and limits / accountability levels across i) LME venues; ii) uncleared OTC derivative transactions referencing LME Nickel prices, and; iii) other transactions referencing LME Nickel prices</p> <p>Degree of market transparency provided by position reporting, and its relative importance</p> <p>Level of control afforded by LME's position limits / accountability limits, their calibration, investigation, and enforcement</p>
Trading rules and real-time trading controls	<p>Rules and controls intended to prevent disorderly and / or manipulative trading behavior for LME contracts, including Nickel, on LME venues, e.g.:</p> <ul style="list-style-type: none"> • Order size restrictions • Volatility controls such as price bands and speed bumps • Message throttles
Suspicious or anomalous trading activity	<p>Identification of manipulative / abusive trading practices, e.g. front-running, wash trading, others</p> <p>Identification and remediation of erroneous orders, to the extent they create anomalous market behaviour</p> <p>Effectiveness of controls and governance in minimizing the above</p>

Risk management, clearing & collateral models of LME, LME Clear and Members

Potential contributing factor	Topics of interest to the Independent Review
Margining methodology and margin call practices	<p>LME Clear margining methodology and impact of design choices on the market, incl. margin model methodology (SPAN vs VaR) and margining approach (e.g. Contingent VM vs. Realised VM)</p> <p>Key elements related to the LME Clear process of margin calls (e.g. price signal to margin call transmission, timeliness and fulfilment criteria, intra-day practices)</p> <p>Member and end-client level margin methodologies. Key elements related to the Member to end-client level process of margin calls (e.g. timeliness and fulfilment criteria, intra-day practices)</p>
Concentration risks and margin lending practices	<p>Ability of market participants (e.g. LME Clear, Member, end-clients) to identify and manage specific risks related to clearing and margining, including but not limited to:</p> <ul style="list-style-type: none"> • Concentration risk arising from large position sizes in relation to market liquidity • Margin lending and leverage associated with Member and end-client positions
Capitalisation and liquidity levels across the market and exposure limit setting	<p>Capitalization and liquidity levels of Members and end-clients, including:</p> <ul style="list-style-type: none"> • LME Clear Membership and Member requirements, e.g. \$10 MM min capital requirement for members

	<ul style="list-style-type: none"> • Controls, such as exposure limits (e.g. caps and/or add-ons to margin requirements in relation to available liquidity of counterparty) related to margining practices of LME Clear vis-à-vis Members and Members vis-à-vis end-clients • LME Clear collateral requirements (e.g. eligible collateral types, haircut methodology) and any implications for ability of Members to meet margin calls • Ongoing reporting performed by the Member to LME Clear regarding activity on OTC/non-cleared market and potential relevant implications of such activity
Loss sharing structures and associated incentives (including client segregation levels)	<p>Loss sharing structures and associated incentives within the LME Clear framework and at the Member and end-client level, considering:</p> <ul style="list-style-type: none"> • Size of default fund and stress testing mechanisms • Calibration of loss sharing structures in the default waterfall (“skin-in-the-game”) • Use by Members and end-clients of client segregation models (e.g. ISA, Net OSA, Gross OSA)

Market structure and the roles of institutions

Potential contributing factor	Topics of interest to the Independent Review
Distribution of liquidity across venues	<p>Distribution across venues (The Ring, LMEselect, and the inter-office telephone market, and the uncleared OTC market), of orders, trades, and available liquidity in Nickel</p> <p>Extent to which this distribution effectively matches offsetting buying and selling interests or inhibits their matching</p>
Opening hours and available liquidity	<p>Opening hours and available liquidity in Nickel on LME venues throughout the trading day and its impact on the distribution of orders and trades</p> <p>Extent to which this distribution creates sufficiently deep liquidity and reliable price formation or leads to periods of insufficient liquidity or unreliable price formation</p>
Prompt date structure and distribution of liquidity	<p>Manner in which orders, trades, and available liquidity in LME Nickel on LME venues are distributed across the LME Nickel prompt dates</p> <p>Extent to which this distribution effectively matches offsetting buying and selling interests or inhibits their matching</p>
Depth of liquidity and client order routing	<p>Ability, or otherwise, to agree and execute transactions of sufficient size with reasonable and predictable market impact / slippage on LME venues</p>
Price benchmark timing & methodology	<p>Representativeness and robustness of prices across LME venues for the purposes of:</p> <ul style="list-style-type: none"> • Official price publication, e.g. open / close • Calculating intraday margin calls <p>Resilience of prices across LME venues to manipulation and erroneous order entry</p>

Note the Independent Review will consider the above potential contributing factors, others that arise during the course of the review and additional factors suggested by market participants.