
30 June 2017

Ms. Georgina Hallett
London Metal Exchange
10 Finsbury Square
London
EC2A 1AJ

RE: FIA EPTA response to LME Discussion Paper on Market Structure

Dear Ms. Hallett,

I am writing to you on behalf of the FIA European Principal Traders Association (**FIA EPTA**) regarding the London Metal Exchange (**LME**) Discussion Paper on Market structure. We welcome this opportunity to comment upon and provide input to the debate around LME's market structure and future strategic direction. We believe there is significant scope for further improvements to the LME's market structure and governance, so as to ensure the exchange can adapt to wider market developments as well as to changes to the regulatory framework. To that end, we appreciate your consideration of our comments below. Kindly note that a number of our members will individually submit comments to the LME that discuss these and other issues in more detail.

About FIA EPTA

FIA EPTA is comprised of 28 principal trading firms (**PTFs**) which deal on own account in a wide range of financial instruments traded on trading venues across Europe. PTFs play a key role in the modern financial ecosystem, bridging gaps in supply and demand between market participants and facilitating price discovery, especially at times when markets are volatile. FIA EPTA members engage in manual, automated and hybrid methods of trading. Collectively, FIA EPTA members are an important source of liquidity for trading venues and end-investors, allowing those who use the capital markets (whether to invest or to manage their business risks), to buy or sell financial instruments efficiently and at low cost. FIA EPTA's mission is to support transparent, robust and safe markets with a level playing field for all market participants. We strongly believe access to markets should be open to all and non-discriminatory in order to minimise barriers to entry and increase competition and efficiency.

General comments

FIA EPTA members welcome the review of the LME market structure, and in particular the LME's stated objective of maximising participation and democratising the exchange. In addition to an analysis of its market structure and policies, we believe a reassessment of the LME's governance structure should also be undertaken to ensure that the LME facilitates an ecosystem which is efficient, democratic and competitive for all participants.

The LME ecosystem

The LME recognises in Chapter 2.1 that its ecosystem is diverse and that categorisation of stakeholders is inherently difficult. However, FIA EPTA members are of the view that this categorisation could be made at a more granular level to better reflect the contributions of specific stakeholders, including PTFs. In particular, we feel that LME has failed to recognise the importance of PTFs as providers of two-sided liquidity in the LME's ecosystem. To the extent that other market participants have concerns around the activities of PTFs, we believe the LME should seek to dispel these by educating the community.

Of concern to us is the LME's negative depiction of "high frequency traders" (**HFTs**) in Chapter 2.1.4. We would like to dispute the implicit assertion that PTFs which use low-latency technology do so to merely extract value from a relative speed advantage. Rather, PTFs use such technology as a risk

management tool, while deploying various trading strategies that provide liquidity to other market participants. Also, we do not agree with the assertion that only passive trading contributes liquidity to the orderbook. Both “making” and “taking” in effect can be means to provide liquidity to the market.

On the basis of the LME’s misconception of how PTFs may use low-latency technology it proposes the introduction of so-called “speed-bumps”. We are of the view that such measures are unnecessary and ineffective given the LME market structure and product universe. We would also argue they are contrary to the best execution principles provided for in Article 27 of the recast Directive 2014/65/EU on markets in financial instruments (**MIFID II**), where appropriate speed of execution is a key consideration. Such measures have been proposed in the specific context of U.S. equity markets, but are the exception, not the rule. Further, the structure of the U.S. equity markets is on many levels fundamentally different from the LME. It should be noted that speed-bumps prevent liquidity providers from updating their quotes in real time to accurately reflect new information that impacts markets, thus leading them to widen bid/ask spreads, reducing quantity available in the market, and increasing execution costs for end-users. We believe that the introduction of speed-bumps would be detrimental to the LME’s market at a time when the LME should, rather, be exploring and encouraging changes to the exchange which will increase deeper liquidity and lead to greater efficiency.

Membership structures

We believe that current membership procedures do not fully reflect the principle of “*maximis[ing] participation and “democratis[ing]” the LME*”. FIA EPTA members have found LME membership procedures and criteria to be overly burdensome, opaque and generally inequitable. The LME’s low membership levels when compared to other peer trading venues serve, in our view, as an illustration and indicator of the barriers to entry that exist for the LME. In particular, we consider that there exist artificial structural and financial hurdles to gaining access to the benefits afforded to full members. We strongly encourage the LME to fundamentally review, modernise and simplify its membership structure to align with common capital market practices at other trading venues.

Further, we would agree with the LME’s assessment of the peculiarities of the membership options available to PTFs and believe that it would be reasonable to offer a lower fee to Category 4 proprietary trading members to stimulate the up-take. As the LME points out, at present the only way for PTFs to access lower fee rates is to become a Category 3 (“individual clearing members” or **ICM**) member which has a discriminatory effect on smaller firms.

Product innovation

We believe that in order to reinvigorate its market and to ensure that it can continue to provide benefits to all participants (including physical users), the LME should simplify and modernise its market model and product offering. In particular, we consider it key for the LME to acknowledge the importance of the futures market for the health and growth of the exchange. Central to the “futurisation” of the market would be a move away from a 90-day to a 30-day date structure, to be supplemented by monthly futures. This would allow physical users to continue to have access to a granular hedging mechanism, while allowing significant levels of liquidity to congregate in the futures contracts. Such a solution would allow for a viable interface between the date structure and the futures market, enhancing the quality of the LME market for all users.

Standardisation

We would welcome further standardisation, simplification and modernisation of administrative procedures and technological systems at the LME. This would reduce the operational burdens currently faced by participants as well as encourage new participants to join.

Cost structure and incentives

FIA EPTA members are concerned that the LME’s existing fee structure and clearing model are unnecessarily costly and inequitable for market participants. We consider that the booking and netting inefficiencies embedded in the LME’s current models act as cost deterrents from participation on the LME. We would advocate, therefore, the adoption of the Realised Variation Margin (**RVM**) approach as well as of a VaR based margin model. Moreover, at present only membership categories 1 to 3 allow for proprietary trading at competitive pricing. However these categories are costly and burdensome, thus also serving as a disincentive to participation. We strongly believe that changes to the LME’s current approach should be implemented in order for the LME to fulfil its ambitions as expressed in the guiding principles accompanying the Discussion Paper.

Further, we consider that the T4 model raises costs for participants while at the same time inappropriately incentivising OTC trading, as actual fees for OTC trades are significantly lower than for trades on the lit order book. In general, we strongly favour a transparent and equitable fee structure, including trading fees that do not differentiate on the basis of trading capacity (client vs. proprietary).

Additionally, we are concerned by the escalating cost of market data and would advocate for the provision of discounts on data fees for liquidity providers. Such discounts enable market makers to provide liquidity more efficiently and would serve as strong incentives for them to further improve the LME's market quality. Additionally, we believe reductions in data fees for market making firms would be appropriate given their contribution to the price discovery process, reducing search costs for other market participants based on their significant investments in terms of IP and risk management capabilities.

Finally, we are of the view that the notable efficiencies and improvements that liquidity providers and market makers bring to the LME should be appropriately recognised and compensated. Hence, a clear incentive structure should be built into the LME's market making schemes.

Committee membership

We consider that at present the membership of the LME member committees lacks diversity, illustrated by the under-representation from PTFs. Currently, FIA EPTA member firms only have representation on two of the LME's twenty-five committees, namely the user committee and trading committee, with no representation on the committees responsible for corporate governance¹. FIA EPTA members believe that the LME should diversify its committee membership as a tangible measure of its commitment to operating a diverse and democratic market place.

Further dialogue

FIA EPTA members and I would welcome the opportunity to discuss the above points and other relevant issues further with the LME in a meeting. In the meantime, we remain at your disposal to provide further information and input to your analysis of the LME market structure.

Yours sincerely,

Piebe Teeboom
Secretary General
FIA European Principal Traders Association

¹ See the composition of LME committees published on the LME website [[Link](#)]