sifma

asset management group

May 27, 2022

The London Metal Exchange and LME Clear
10 Finsbury Square
London EC2A 1AJ

Submitted by email to: consultation@lme.com

Re: ***Consultation on OTC Position Reporting for all Physically Deliverable Metals & Accountability Levels for Reportable OTC Positions, Notice 22/145, dated 13 May 2022 (the "Consultation")***[1]

Dear Sir or Madam:

The Asset Management Group of the Securities Industry and Financial Markets Association ("**SIFMA AMG**")[2] appreciates the opportunity to provide comments to the LME with respect to its Consultation published in Notice 22/145 wherein the LME proposes to:

- Require members to submit, on a weekly basis, details of all OTC positions in aluminum and aluminum alloy, cobalt, copper, lead, nickel, tin, and zinc, including all OTC contracts that are financially settled against an LME reference price, or physically deliverable with LME warrants or warehouse receipts;

- OTC baskets and index trades referencing the specified LME contracts would also be reportable where the LME constituents represent at least 20% of the underlying;

- No minimum threshold would apply; all positions, regardless of size, would be reportable; and

- Members would be required to report positions held by members for their own account as well as for clients (including affiliates) using a format that calls for members to report, in metric tons, the net position for each metal, the beneficial owner of the position, the OTC instrument type, as well as additional detail depending on the type of position (collectively, the **Proposals**").

SIFMA AMG has a long and heavily engaged history in supporting fair, transparent and robust exchange trading rules. And we note the Consultation is prompted by the events of March 8 when, in response to a spike in nickel prices, the LME suspended trading in all nickel contracts (not to resume until March 16) and cancelled all trades executed after midnight on that day (the "**Nickel Event**").

Our members have expressed serious concerns involving both procedural and substantive aspects of the Proposals, especially as LME's "independent review" into those events and their aftermath is ongoing

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1 LME Consultation 13 May 2022 Ref. 22/145

2 SIFMA AMG brings the asset management community together to provide views on U.S. and global policy and to create industry best practices. SIFMA AMG's members represent U.S. and global asset management firms whose combined assets under management exceed $45 trillion. The clients of SIFMA AMG member firms include, among others, tens of millions of individual investors, registered investment companies, endowments, public and private pension funds, UCITS and private funds such as hedge funds and private equity funds.

(as are regulatory reviews by each of the FCA and the Bank of England). At the core, the Proposals appear both premature, and a mis-direction from the apparent weaknesses in LME's risk management practices and controls. While it may be that client OTC positions were relevant in the Nickel Event, such positions are the regulator's purview and not LME's, and SIFMA AMG strongly recommends that LME urgently prioritize the assessment and remediation of its risk management practices as issues may be identified in LME's "independent review" and by the FCA and Bank of England.

Our comments will address a number of the components of the Proposal from this perspective with a particular focus on issues germane to the buy-side. Our main areas of focus are the following:

1. **Inadequate Time**: LME needs to allow adequate time for comment and implementation of any proposed approach,

2. **Consider Independent and Regulatory Review**: LME should hold off on such a change until after it has received the independent review, as well as regulator feedback, on the Nickel Event,

3. **First Address Risk Management Practices**: LME should instead prioritize its focus on enhancing its approach to position limits and concentration limits (which are in LME's control).

4. **OTC Position Surveillance is for the Regulator**: Surveilling the OTC market and/or positions is the regulator's role and is beyond the LME's remit.

5. **Confidentiality Must be Maintained**: Client confidentiality issues need to be thoroughly considered (e.g., disclosing client positions to a 3rd party / non-regulator, confidentiality language in trading agreements, etc.).

I. Inadequate Time

SIFMA AMG generally supports rules and market practices which seek to increase transparency, promote market integrity, reduce misconduct, and/or provide regulatory protections, however it is important that such rules are designed to achieve those goals while minimizing material adverse effects on pricing, liquidity, and hedging risks, as well as demonstrate material benefits justifying the costs.

Given the deep and far-reaching nature of the Proposals, potentially introducing significant new policies and procedures for LME members with substantive effects on clients, a two-week comment period is wholly inadequate. The Proposals would undoubtedly raise significant costs, are likely to present challenges with respect to confidentiality issues, and it is unclear if existing reporting wouldn't meet whatever reasonable and appropriate objectives which might be identified.

And especially as LME is conducting an "independent review" while at the same time the FCA and Bank of England are also evaluating the Nickel Event, the Proposals in the Consultation are premature as they can only be evaluated in the context of the findings from these reviews.

Recommendation: SIFMA AMG strongly recommends that the LME table the Proposals until they may be evaluated against the findings, and then allow a minimum of 90 days for members, clients and interested parties to comment.

II. Consider Independent and Regulatory Review

The LME's "independent review" and that of the FCA and Bank of England will most certainly identify the issues presented by the Nickel Event, existing risk management practices that require remediation, and new rules and regulations for implementation to address identified issues.

SIFMA AMG finds it completely inappropriate for the LME to have proposed such a comprehensive, far-reaching, and undoubtedly costly reporting regime ahead of the release of the findings from these reviews. Not only will the findings present a much more measured assessment of the issues but will ultimately serve as a source to justify the recommended changes to existing practices as well as new practices.

Recommendation: SIFMA AMG strongly recommends that LME wait for the findings from the reviews before beginning to formulate a remediation plan tailored in approach and scope to the issues presented by the Nickel Event.

III. First Address Risk Management Practices

At the risk of anticipating the findings from both the LME's "independent review" and the FCA and Bank of England's regulatory review, it seems clear in retrospect, that there is room for improvement in LME's own risk management practices. And the need for risk management remediation is demonstrated both by existing practices performed by LME and by practices at other exchanges which managed to avoid an experience similar to the Nickel Event.

As an example, from a review of the banding reports currently prepared by the LME, it is clear that there was a large, concentrated position in nickel futures immediately prior to the Nickel Event. We urge the LME to first evaluate its response to information already available to it before identifying new approaches to target.

In looking at LME's competitors, many operate similar businesses while avoiding similar outcomes, and have not seen the need to introduce such an OTC reporting requirement. Instead, they make full use of existing tools to maintain orderly trading. There are other mechanisms in place to avoid the accumulation of large positions in a particular product or commodity which have been mandated by the regulators, such as position limits under MiFID II, as well as position limits imposed at the exchange level. Position limits have helped ensure stable and orderly markets when set at appropriate levels and with appropriate exemptions (e.g., for hedging purposes).

Recommendation: LME should urgently assess existing tools – particularly those targeting position and concentration limits to see if they are appropriately calibrated given the outcome in the Nickel Event. In addition, LME should reassess its risk management processes should positions and/or concentrations approach challenging levels.

IV. OTC Position Surveillance is for the Regulator

As a threshold issue, SIFMA AMG firmly believes that reporting of the type in the Proposal is properly the remit of the regulator and would present significant legal, contractual, and operational hurdles which may be difficult, if not impossible, to overcome.

OTC transactions are typically governed by bilateral written contracts that prohibit any disclosure other than to the applicable regulator, or to an exchange for clearly defined purposes. Any reporting regime must therefore be tightly calibrated to the risk to be addressed. The scope of the reporting Proposal seems unnecessarily broad and deep and poorly calibrated to the risk to be addressed – in contrast to existing regulatory reporting regimes used without negative consequences.

Our members firmly believe that a non-regulator 3rd party (LME) should not have access to/receive confidential client information (identity, positions) when they are not at all affiliated with the financial transaction or relationship.

Recommendation: Evaluate existing regulatory reporting to assess the degree to which it provides transparency into the material risks identified in the LME's "independent" review as well as the regulatory review of the FCA and Bank of England. If LME believes additional reporting is needed, it should work through the applicable regulator to craft a measured proposal for notice and comment.

V. Confidentiality Must be Maintained

Our members do not perceive the Proposal is at all adequate to meet client data protection requirements and client position protection preferences to obviate the risk of a compromise of data security as well as market leakage of positions and trading strategies.

OTC information is very sensitive for both a firm and its clients as data security breaches and/or information leakages could lead to a host of fraudulent and/or anti-competitive behaviors to the detriment of client interests. The Proposal is unclear as to what data security measures would be in place. And even if reported data can be secured, in the event data is anonymized and made available (given the rich source of market information), the ownership and licensing thereof will need to be carefully considered.

Recommendation: As a part of the consideration of any reporting regime, a comprehensive plan for data security and data protection must be clearly stated and be acceptable to regulators and data owners.

VI. Conclusion

SIFMA AMG appreciates the LME's efforts to accelerate remediation plans to address the Nickel Event. However, we firmly believe the Proposals specified in the Consultation are premature as they precede completion of LME and regulatory studies. Instead, our members call on LME to assess existing risk management practices in need of remediation and believe significant upgrades to LME's practices with respect to position limits and concentration risk would be far more productive. Due to complex legal and regulatory considerations, the reporting approach envisioned by LME would best be handled through regulatory channels to facilitate reporting well-tailored to address clear risk while maintaining client data protection. And once LME has a proposal fully tailored to address the findings in the review, a notice and comment period of no less than 90 days must be provided to ensure an opportunity for a robust analysis and feedback from members, market participants, and interested parties.

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On behalf of SIFMA AMG, we appreciate the opportunity to respond to the Consultation and for your consideration of our comments and recommendations. If you have any questions or require additional information, please do not hesitate to contact us by calling Lindsey Keljo at (202) 962-7312 or William Thum at (202) 962-7381.

Sincerely,

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