Standard for the Conduct of Participants in LBMA Precious Metal Auctions

I. Introduction

1. The FICC Markets Standards Board

The FICC Markets Standards Board (FMSB) was established in 2015 in response to the Fair and Effective Markets Review (FEMR) in the UK with a mandate to issue clear and practical guidance designed to improve conduct and raise standards in the wholesale fixed income, currencies and commodities (FICC) markets. FMSB is building a body of Standards and Statements of Good Practice (SoGPs) over time, prioritising those areas where FMSB member firms (Member Firms) consider there is a lack of clarity in the standards of behaviour expected of market participants, or a lack of understanding of the issues relevant to a product or transaction type, or evidence of poor conduct.

2. Applicability of FMSB Standards

Each FMSB Member Firm is expected to confirm annually that it is committed to conduct its FICC market activities (its 'Activities') in a manner consistent with the Core Principles contained in FMSB Standards, and to have internal policies, procedures and controls reasonably designed to give effect to those Core Principles where they are applicable to its Activities, in a manner that is commensurate with the nature of its Activities in the relevant entity or jurisdiction. That confirmation is expected to apply to all FMSB Standards issued in final form in the calendar year prior to the year in which the confirmation is made.

The details of FMSB Member Firms are available at fmsb.com.

Standards are published on FMSB's website and non-member firms and their affiliates are encouraged to consider them. In this way, Standards are also made available to users of wholesale FICC markets (e.g. corporates, investors and other end-users) so that they may be made aware of their existence and FMSB's expectation of market conduct.

FMSB will, as part of its normal course of business, periodically review the applicability of its published Standards to ensure they are relevant and up to date for market conditions.

3. Relationship with law and regulation

FMSB Standards and SoGPs do not impose legal or regulatory obligations on Member Firms, nor do they take the place of regulation. In the event of any inconsistency, applicable law, rules and regulation will prevail. In developing Standards and SoGPs, certain regulators may have commented on their drafting, alongside Member Firms and other bodies, such that the Standards and SoGPs, once finalised and published, are intended to represent an authoritative statement of global good practices and processes. However, they are not normally endorsed by regulators. Where they are endorsed by a regulator, this will be made clear on the face of the Standard or SoGP in question.

4. Relationship with other industry codes ('Codes')

Other Codes already exist in relation to certain FICC markets, such as the LBMA Precious Metals Code, while others are in the process of being produced. There will be some overlap between FMSB's work and such other bodies and FMSB will seek to ensure it adopts a consistent approach in cases of overlap wherever possible, and will seek to avoid issuing a Standard or SoGP where the subject matter is already covered adequately by existing regulation or a Code issued by another body. It may draw attention to Member Firms of an existing code and request that Member Firms consider its applicability and act in a manner consistent with it, where appropriate.

II. Standard for the conduct of participants in LBMA Precious Metal Auctions

1. Explanation

LBMA Auctions establish prices in certain precious metals that are used as benchmark reference prices. Participants in LBMA Auctions submit bids and offers on behalf of clients wishing to buy or sell the relevant metal ('Client Orders') and are also able to submit bids and offers for themselves ('House Orders'). FMSB understands that certain Participants may not be submitting House Orders due to concerns around the management of regulatory and conduct risks associated with: (i) sourcing liquidity through an auction process which sets the LBMA Precious Metal Price; or (ii) managing both Client Orders and House Orders in the LBMA Auctions. This Standard is designed to provide some clarity as to the way in which those risks can be managed, so as to increase the volume of bids and offers submitted to LBMA Auctions and improve the quality of price discovery resulting from them, thereby improving the effectiveness of the market.

Defined terms used in this Standard shall the meanings given to them in Section 3 ('Glossary') or the 'Introduction' above.

<u>**What are LBMA Auctions?**</u>

LBMA Auctions are trading processes that facilitate the matching of buyers and sellers of a precious metal at a point in time. The LBMA Auctions run in a series of rounds. At the start of each round, the Administrator publishes a price for that round. Participants then enter orders (how much metal they want to buy or sell at that price). At the end of each round order entry is frozen and the Administrator checks to see if the difference between buying and selling (the imbalance) is within the imbalance threshold (a number of ounces determined by the Administrator for each metal).

If the imbalance is outside of the threshold at the end of a round, then the auction is not balanced, the price is adjusted, and a new round starts.

If the imbalance is within the threshold, then the auction is finished, and the concluding price is set and that price becomes the LBMA Precious Metal Price for the metal in question. Any imbalance is shared equally between all direct participants (even if they did not place orders or did not log in) and the net volume for each participant trades at the final price[1].

<u>**What role do LBMA Auctions play in the precious metals market?**</u>

The concluding price of the LBMA Auction is the LBMA Precious Metal Price at a particular time or day. The LBMA Precious Metal Price is used both contractually (to determine the price in some physical contracts and as a reference in derivatives products) and as a guide to the current market price for the precious metal in question by a broad range of market participants including miners, refiners and end-users.

In situations where there are lower levels of price elastic liquidity in the LBMA Auction the concluding price of such Auction (i.e., the LBMA Precious Metal Price) and the price observable in the market by Participants at which the relevant metal is trading outside of the LBMA Auction Process (referred to in this Standard as the 'Prevailing Market Price') may diverge. Increased participation in the LBMA Auction and higher levels of price elastic

[1] Participant trades in the platinum and palladium LBMA Auctions are executed at 0.5 US Dollars above the final price – for more information, see Paragraph 7.6 of LBMA Platinum and LBMA Palladium Prices Regulations, October 2021, Version 1.4 ('LPP Prices Regulations').

liquidity, including through the submission of House Orders, could help reduce this divergence and thereby further enhance the price formation process across the different liquidity pools.

What is the purpose of this Standard?

This Standard establishes principles intended to facilitate, in a manner which adequately manages and mitigates conflicts of interest, Participants in managing both Client Orders and House Orders in LBMA Auctions. In doing so, the Standard seeks to increase the liquidity available in LBMA Auctions and thereby reduce any potential divergence between the concluding LBMA Precious Metal Price for the precious metal in question and the corresponding Prevailing Market Price.

2. Scope and applicability

This Standard applies to Participants, including both direct participants and those participants who leave orders with direct participants, in the LBMA Auctions listed below with its current Administrator:

- Gold and silver auctions operated by ICE Benchmark Administration (IBA)[2]
- Platinum and palladium auctions operated by the London Metal Exchange (LME)[3]

In addition to applicable law or regulation, Member Firms must ensure they continue to meet the requirements of the LBMA Precious Metals Code and the governing documents for the LBMA Auctions that are produced by the IBA and the LME (the '**Governing Documents**'). This Standard is intended to supplement such Governing Documents and does not supersede or in any way alter existing requirements.

3. Glossary

Term	Definition
Administrator	The firm(s) responsible for operating the LBMA Auction from time to time. IBA are, at the date of publication of this Standard, responsible for operating the LBMA Auctions in gold and silver and LME are, at the date of publication of this Standard, responsible for operating the LBMA Auctions in platinum and palladium.
Client Order(s)	Orders placed into an LBMA Auction by a Participant for its client, either directly, or via another Participant.
Governing Documents	The rules and regulations relating to a specific LBMA Auction to which Participants have to adhere, which are published by the relevant Administrator and as amended from time to time.
House Order(s)	Orders placed by a Participant into an LBMA Auction either directly as a direct Participant or indirectly via another direct Participant with the intention of managing the Participant's risk inventory. Depending on the role of the Participant in the market, the risk inventory may arise from prior or anticipated facilitation of client orders, or proprietary risk positions.

[2] Code of Conduct for the IBA precious metals auctions and the LBMA gold and silver price benchmarks, February 2020, Issue 4 ('IBA Code of Conduct').
[3] LBMA Platinum and LBMA Palladium Prices Regulations, October 2021, Version 1.4 ('LPP Prices Regulations').

Term	Definition
IBA	ICE Benchmark Administration Ltd.
LBMA Auction(s)	A trading process that facilitates the matching of buyers and sellers of a precious metal at a point in time.
LBMA Precious Metal Price(s)	The concluding price of the corresponding LBMA Auction that represents the benchmark price for the relevant metal at a particular time or day.
LME	The London Metal Exchange.
Participant(s)	An entity that participates in an LBMA Auction either by directly placing House or Client Orders into the LBMA Auction or that does so indirectly via another entity.
Prevailing Market Price	The price observed by Participants to be the price at which a metal is trading in the precious metals market outside of the LBMA Auction process.

III. Core Principles and commentary

This Standard sets out five Core Principles relevant to participation in LBMA Auctions together with supporting commentary. When applying the Core Principles, Participants should consider the requirements placed on them by the Governing Documents and applicable regulation. In particular, Participants should consider their systems, controls, policies and procedures that cover their use of client confidential information within the bounds of legitimate market-making.

1. LBMA Auction participation

Core Principle 1: Auction Participants may enter both House Orders and Client Orders, subject to their having appropriate controls in place relating to the management of conflicts of interest and complying with such controls.

One situation in which a Participant may place House Orders into an LBMA Auction would be in order to buy metal below or sell metal above the Prevailing Market Price. By intermediating trades and providing liquidity, the Participant acts to absorb supply and demand imbalances, and the provision of liquidity into an LBMA Auction may enhance the effectiveness of the precious metals market. For an illustration of this Core Principle, see Annex 1, example 1.

2. The importance and attributes of increased liquidity provision

Core Principle 2: In light of the benefits derived from increased liquidity in the auction process, Participants are encouraged to structure their businesses such that they are able to add discretionary liquidity in the form of House Orders to the LBMA Auctions, subject to appropriate controls, the Governing Documents and management of conflicts of interest.

Increased market liquidity has a number of potential benefits including ‘narrower spreads, lower transactions costs, reduced volatility, greater price discovery and lower costs of capital’.[4] The provision of liquidity by Participants in the form of House Orders to LBMA Auctions can therefore be beneficial to the effective functioning of the precious metals market. This should help reduce the potential divergence between the LBMA Precious Metal Price and the Prevailing Market Price.

While recognising the benefit that House Orders may provide to an LBMA Auction, the provision of such liquidity is dependent on the interest and capability of the Participant. Accordingly, the price and size of House Orders may change during the operation of an LBMA Auction.

For an illustration of this Core Principle, see Annex 1, example 2.

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[4] See p176 of Prohibitions and restrictions on proprietary trading and certain interests in, and relationships with, hedege funds and private equity funds, Final Rule, adopted by the Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation and Securities and Exchange Commission.

3. Conflicts management

Core Principle 3: Participants managing Client Orders should have policies, procedures, systems and controls in place to ensure that, where House Orders are entered into the LBMA Auctions, the House Orders are not placed with the intention of utilising the Client Order information to benefit the Participant.

Participants, as part of their risk inventory management, may enter House Orders into an LBMA Auction at a price that enables such Participant to meet future anticipated client demand. The expected effect of this is to reduce the potential divergence between the LBMA Precious Metal Price and the Prevailing Market Price in line with Core Principle 2. In turn, this could impact the concluding price of the LBMA Auction and, as a result, the price at which Client Orders are filled. For illustrations of this Core Principle, see Annex 1, examples 3 and 4.

Core Principle 4: Participants managing derivatives transactions that reference the LBMA Precious Metals Price may submit House Orders to manage their own risk. In such circumstances Participants should take appropriate steps to identify and to prevent or manage conflicts of interest which may arise from this activity.

Given the use of the LBMA Precious Metals Price as a reference price for derivatives products, Participants may need to manage actual or perceived conflicts of interest between the use of such products referencing the LBMA Precious Metals Price and their participation in LBMA Auctions. Participants may also refer to the principles relating to the management of potential conflicts of interest set out in FMSB's Binary Options Standard for the Commodities Market[5] (although such principles are only directly applicable to binary options).

Core Principle 5: Participants managing Client Orders should have policies, procedures, systems and controls to ensure the use of Client Order Information in their precious metals activity outside of LBMA Auctions is not reasonably expected to disadvantage the client.

Member Firms should, in accordance with the Governing Documents and applicable law, determine the policies, procedures, systems and controls that are best tailored to the structure of their business.[6] [7]

[5] See FMSB's 'Binary Options Standard for the Commodities markets', available here.
[6] Paragraph 6.5 of the IBA Code of Conduct states that 'participants shall ensure that they have implemented proportionate internal controls and procedures to mitigate actual, potential or perceived conflicts of interests'.
[7] Paragraph 14.1 of the LPP Prices Regulations states that 'each Participant must maintain, operate and periodically review organisational and administrative arrangements to enable it to identify and manage effectively any conflicts of interest that may arise in connection with its participation in the LPP Prices Discovery Process'.

Firms may adopt different organisational models governing their precious metals trading activity, including:

- two segregated trading desks, where one desk manages House Orders and precious metals trading activity outside of the LBMA Auctions, and a second desk manages Client Orders with physical separation and an information barrier between the two desks; or
- a single trading desk managing precious metals trading activity outside of the LBMA Auctions as well as House Orders and Client Orders. Where this model is adopted, firms must ensure that there is an adequate combination of controls, training and trade, order and communications surveillance measures to manage and mitigate any potential conflicts of interest and ensure that these principles and applicable market abuse and other regulatory obligations are adhered to.

Participants that manage Client Orders in a principal capacity, alongside managing precious metals risk inventory outside of the LBMA Auctions, may use their inventory management capability when handling Client Orders. For an illustration of this core principle, see Annex 1, example 5.

Annex 1 Examples of risk management activity

Set out below are illustrative and non-exhaustive examples of the application of certain core principles from this Standard. The examples are stylised and do not seek to specify the policies, procedures, systems or controls that a Participant may put in place pursuant to regulatory requirements or conflicts management. The examples should not be understood, or interpreted, as precise rules or prescriptive and comprehensive guidance.

Examples 1, 2 and 3 apply to all Participants managing House and Client Orders regardless of whether the trading desk managing House Orders has access to Client Order information.

	Example	Assessment against Core Principles	Rationale
1	A Participant who, as part of their precious metals activity outside of the LBMA Auctions provides liquidity to one or more client distribution channels (e.g., a futures exchange), observes that the relevant LBMA Auction Price is below the equivalent price on a futures exchange. As a result, the Participant places a House Order to buy into the LBMA Auction and offers to sell the metal acquired through the LBMA Auction onto the futures exchange or through another client distribution channel.	Consistent with Core Principle 1 ✔	By intermediating trades and providing liquidity, the Participant increases the effectiveness of the precious metals market by absorbing supply and demand imbalances.
2	A Participant places a House Order to buy into the LBMA Auction. During the course of the LBMA Auction, the Participant enters into a series of principal transactions with clients outside of the LBMA Auction to buy the same metal from those clients. As a result of this client activity and in accordance with the Participant's control framework and approach to managing conflicts of interest, the Participant changes their House Order to a sell order based on an updated intent to reduce their risk inventory.	Consistent with Core Principle 2 ✔	The inventory requirement of the Participant to meet future client demand changed, and as a result, the Participant changed their House Order.

	Example	Assessment against Core Principles	Rationale
3	A Participant (either on the same trading desk that manages House Orders, or on a different segregated desk) receives a Client Order to buy in a LBMA Auction. During the LBMA Auction, the Participant observes that the published price, at the end of a round, is below the Prevailing Market Price. In order to buy metal below the Prevailing Market Price in the subsequent action round, the Participant, in accordance with the Participant's policies, procedures, systems and controls, places a House Order to buy into the LBMA Auction.	Consistent with Core Principle 3 ✔	The intent of the House Order is to buy metal below the Prevailing Market Price and not to take advantage of the Client Order information to benefit the Participant. This activity should also help reduce the divergence between the LBMA Precious Metal Price and the Prevailing Market Price.

Examples 4 and 5 apply only to Participants where the trading desk managing House Orders has access to Client Order information.

	Example	Assessment against Core Principles	Rationale
4	A Participant receives a large Client Order to buy in an LBMA Auction. Based on an expectation that this order will create an imbalance in early rounds of the auction, the Participant places a House Order to buy in the early rounds of the same LBMA Auction. Once the LBMA Auction price has diverged from the Prevailing Market Price, the Participant removes the House Order to buy in a later auction round and replaces it with a House Order to sell with the intent of selling above the Prevailing Market Price.	Inconsistent with Core Principle 3 ✘	The Participant has placed House Orders into the Auction utilising the Client Order information in a way that is intended to benefit the Participant.

	Example	Assessment against Core Principles	Rationale
5	A Participant receives a Client Order to buy at the LBMA Precious Metal Price which is substantially larger than the observed liquidity in the LBMA Auction.[8] The Participant, acting in a principal capacity, manages Client Orders alongside their precious metals trading activity outside of the LBMA Auctions. The Participant believes that a better price could be achieved for the Client Order through only entering a portion of the order into the LBMA Auction and discusses this with the client in accordance with the principle on communication in the FMSB Large Trades standard. The Participant therefore hedges part of the risk (that is, places buy orders for the same metal as principal) through other execution venues, as the Participant believes that the market impact of the aggregate order will be reduced by spreading the execution over time and execution venues, resulting in a better outcome for the client.[9] The Participant takes the remaining part of the order onto their own inventory and fills the entire Client Order.	Consistent with Core Principle 5 ✔	The Participant has used the Client Order information in a way that is intended to benefit the client by using their precious metals risk inventory with the intent of reducing the market impact of the Client Order.

[8] FMSB's 'Standard for the execution of Large trades in FICC markets' (available here) provides further guidance and principles on the execution of trades which meet the definition of 'Large Trade' as applied in that Standard.
[9] Participants may also refer to the principles and guidance set out FMSB's 'Reference Price Transactions standard for the Fixed Income markets' (available here) which addresses similar conduct considerations where hedging activity may impact the price at which a Client Order is filled.