

31 July 2017

N06/17

Consultation on the amendments to the Rules of the London Stock Exchange in preparation for the Markets in Financial Instruments Directive (MiFID II) and general rulebook review

Introduction

1. This Notice provides details of the proposed amendments to the Rules of the London Stock Exchange (“the Exchange” and “the rules”) to accommodate the Markets in Financial Instruments Directive (“MiFID II”), as well as proposed changes as the result of a general review. Member firms are encouraged to review this Notice together with its attachments, and to provide any feedback at the earliest opportunity, but no later than close of business on Friday 15 September 2017.

Approach to review

2. In undertaking its review, the Exchange has continued its policy of maintaining a generic rule book which is subject to fewer changes as a result of the Exchange developing, or adding, to its trading services. Going forward, the structure of the rule book itself will remain the same in that it cross references to the Millennium Exchange & TRADEcho Business Parameters document and the Guide to the Trading System (MIT201) for further reference information where appropriate. The revised Guide to the Trading System and the Millennium Exchange & TRADEcho Business Parameters document will also be available here in due course: <http://www.londonstockexchange.com/products-and-services/technical-library/millennium-exchange-technical-specifications/millennium-exchange-technical-specifications.htm>
3. It is not the Exchange’s intention to replicate MiFID II within the rule book. However, it is proposed to include specific cross references where it is both useful and necessary. As mentioned above, the Exchange has taken this opportunity to review the validity of the rules more generally and, as a result, is also proposing some additional amendments in order to provide further clarity.

Notice attachments

4. There are two attachments to this Notice: Attachment 1 contains the revised rules in marked-up form, and Attachment 2 is a cross referencing tracker document between the current rule book and the proposed revised rule book.

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Summary of notable changes to the rules

Core rules – Member firms

5. The Exchange intends to remove the ring-fenced categories of membership for Fixed Interest and Gilt-Edged Market Makers. These categories will no longer be required as these member firms will be able to determine in accordance with MiFID II what business they wish to bring on Exchange. Any member firms in these ring-fenced categories will be categorised as full member firms with effect from the implementation of these rule amendments.
6. In addition, the current non-trading membership profile (a member firm with no trading access to the Exchange's markets) will be formalised as a new category of Exchange membership. As a result, member firms with this category of membership will no longer have trading codes allocated to them. This change will also be reflected within the trade reporting rules in order to clarify the Counterparty Identifier to be used. All member firms that currently have no access to the Exchange's markets will be categorised as non-trading member firms with effect from the implementation of these rule amendments.
7. Further changes to the membership rules include the introduction of a definition of a "non-MiFID firm", together with new rules requiring these firms to provide the Exchange with the required transaction information for the submission of transaction reports. In addition, the guidance to the authorisation rule has been updated and clarified.

Gilt Inter Dealer Brokers and Wholesale Dealer Brokers

8. MiFID II does not support the current rule book framework for the provision of Gilt Inter Dealer Broker or Wholesale Dealer Broker services within the Gilts market. Member firms with this membership profile can in future offer their services under the Organised Trading Facility ("OTF") or Multilateral Trading Facility ("MTF") construct off Exchange. The Exchange has already met those member firms affected in order to facilitate a smooth transition to the new regime. As a result, the definitions and rules relating to these member firm services will be deleted.

System testing

9. New rules and guidance have been added regarding conformance testing and the testing of algorithms deployed by member firms.

Order book trading rules - Order entry

10. In relation to order entry, a new rule is being introduced requiring member firms to supply additional information within their orders as required by MiFID II. Rule guidance has also been added in respect of the use of the Member Portal for firms to supply specific information in relation to their orders.

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Direct electronic access

11. A new definition of direct electronic access is being introduced to cover both direct market access and sponsored access services. A requirement is also being introduced for member firms to notify the Exchange prior to the implementation or cessation of direct market access services for their customers, as well as the utilisation of kill switch functionality. These requirements already exist for sponsored access services. Further detailed guidance has been added to the rules in relation to both direct market access and sponsored access.

Liquidity providers in order driven securities

12. The Exchange introduced the concept of a liquidity provider in order to provide member firms with the ability to support certain corporate bonds traded on the Order book for Retail Bonds and then latterly on the Order book for Fixed Income Securities with bid-only prices. As many of the rule requirements for liquidity providers replicate those for market makers, it is proposed to remove the definition and rules referencing liquidity providers and to include the concept of a bid-only market maker (in specified securities only) within the market making rules.

Off Order book trading rules - on Exchange trades

13. The Exchange proposes to amend the “on Exchange” rule (3000) and its guidance to increase flexibility for member firms trading in securities admitted to trading on the Exchange’s markets. In addition, new guidance is proposed to clarify the types of transaction that may be brought on Exchange.

Trade reporting

14. In terms of the rules regarding off order book trade reporting:
 - the guidance with respect to the reporting of riskless principal transactions has been updated and guidance relating to the reporting of matched principal transactions has been added;
 - the deadline for the submission of trade reports has been amended in line with MiFID II and now includes two separate deadlines dependent on instrument type;
 - the guidance regarding deferred publication has been updated;
 - the guidance regarding the content of a trade report has been updated in respect of: counterparty identification in relation to non-trading member firms; the removal of trade type indicators; the inclusion of traded currency; the updating of trading capacities; the inclusion of settlement

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due dates for non-standard settlements; and the removal of guidance relating to converted currency trades and the Reporting condition;

- the rules regarding the process for correcting trade reports have been updated with additional guidance added;
- the rules regarding the use of dealing agents have been updated; and
- a new rule regarding Exchange enforced cancellations of off order book trades is being introduced, with additional guidance provided.

Gilt-edged and fixed interest markets

15. In line with the policy of the rule book being generic, the definitions of a gilt-edged market maker and a fixed interest market maker will be deleted, with the generic market maker definition being utilised as appropriate.
16. The Exchange also proposes to delete many, largely legacy, rules relating to the trading of gilt-edged and fixed interest securities so that, where possible, the trading of these securities is aligned with the order-driven or quote-driven trading rules.

Market maker rules – registration

17. The market maker registration rule has been updated in respect of gilt-edged market makers. New guidance has been added regarding market maker registrations where a security itself is moved between order and quote-driven trading services.

Market making agreements and schemes – algorithmic trading

18. New rules and guidance are proposed requiring those member firms which engage in algorithmic trading and pursue a market making strategy to notify the Exchange of the fact via the Member Portal and to enter into a market making agreement with the Exchange. In addition, the new rules set out member firm obligations under a market making agreement as well as the notification requirements regarding firms ceasing to pursue market making strategies and exiting market making agreements.
19. New rules and guidance are proposed regarding the Exchange's provision of market making schemes, together with a requirement to have a market maker agreement in place.

Settlement, clearing and benefit rules

20. There are a limited number of changes to rules and guidance in this section of the rule book in order to include matched principal transactions as appropriate.

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Default rules

21. References to RepoClear are being deleted as use of this clearing service relates to Gilt Inter Dealer Broker services. In addition, those default rules which reference Gilt Inter Dealer Brokers and Wholesale Dealer Brokers and their market contracts, are being amended or deleted as appropriate.

General administrative updates

22. The use of defined terms within the rules has been reviewed and updated within the rule book as necessary. The flag to denote directional rules (“D”) has been removed.

Useful information

Member Portal

23. Later this year, the Exchange intends to implement the Member Portal which is an online communication tool that will enable member firms to view and manage changes to their membership profile, including their company information, access to trading services and technical configuration. The Member Portal will also include functionality for member firms to manage certain MiFID II obligations, such as the ability to provide the relevant information for short codes entered on order messages and the ability to register as a market maker for algorithmic trading. The Membership Team will shortly provide all member firms with details of how to register to use the Member Portal.

Queries

24. Member firms who have queries relating to either their membership category, or their membership profile, should contact the Membership Team at: membership@lseg.com or +44 (0)20 7797 1900 (STX: 31900).
25. With respect to any technical queries member firms should either contact their Technical Account Manager or the Technical Account Management Team at londontam@lseg.com or +44 (0)20 7797 3939 (STX: 33939).
26. For any queries relating to the Exchange’s MiFID II trading services please contact the Business Development Team at clients@lseg.com or +44 (0)20 7382 7650 (STX: 37650).
27. For queries relating to the draft rules please contact: Dagmar Banton +44 (0)20 7797 1210 (STX: 31210) dbanton@lseg.com or Paul Haddock +44 (0)20 7797 4332 (STX: 34332) phaddock@lseg.com.

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Consultation

28. Reviewers are asked to provide any comment and feedback on this consultation by no later than close of business on Friday 15 September 2017. Responses to the consultation should be sent by email to: stockexchangesnotices@lseg.com.

Denzil Jenkins
Head of UK Compliance & Group Regulatory Policy

This Stock Exchange Notice will be available on the website at
<http://www.londonstockexchange.com/en-gb/products/membershiptrading/rulesreg/stockexnoticesnew/>

Calls to London Stock Exchange plc may be recorded to enable London Stock Exchange to carry out its regulatory responsibilities