

***Interview with a physical user of the LME***

- SPEAKER1 00:03 Recording. OK, so the recording has started. So first off, could you just give me a little bit of background about what your entity does and what your role is in the entity?
- SPEAKER2 00:24 Right. For me personally, I've been a metal trader, especially for base metals and ferrous metals. And I've been working in a trading company and been in this market for many years, for about 30 or 25 years or something like that. And our company has two different functions and functions where I am now. We are a classical trading company for physical material that we sell worldwide, and we provide our customers for processing in industry.
- SPEAKER1 01:09 OK, and how do you when you come to sort of maybe hedge risk or something like this? How would you typically place orders?
- SPEAKER2 01:20 For the price of water. At the end of the day, normally I do not purchase or price the base metals in the same way as I sell to the customer, because it can be that one supplier is offering a certain leverage and the customer does want to have a fixed price. And this is certainly the timing when I place a hedge to cover the risk at the end of the year on the LME via metal brokers.
- SPEAKER1 01:51 And so, is it all sort of voice sort of or instant message or email type execution?
- SPEAKER2 01:59 Yes, it is actually the normal way as well with the customer as well as with the brokers is taking the telephone and placing an order personally.
- SPEAKER1 02:15 And I mean, why would it be that a physical trader like yourself, I mean, why would you have any interest in using platforms like, like CQG, you know these types of vendor platforms? And if not, why not? Why do you still prefer to place orders in the classical sense?
- SPEAKER2 02:36 that we were? It depends a little bit on the business. Normally, having a word with the broker always provides a little bit of information. What's going on, on the market? Why is it there and that's because I cannot keep on reading all the news that is provided every day and every second. Otherwise, I would not be able to trade anymore. So just to get a bit of the feeling, the impression and on a personal basis, on a word basis is very important for me, because you also get the impression of being reading between the lines or what is going on. And for this reason, personal contact is very important for me to feel the market. What's going on, because for me, the market is still a people business and the other side would just be, let's say, official close executions, very standard, where I would not need to have

additional information about the market because I need to execute a trade for the official closed today for from day one, I said where a trading platform would be sufficient.

- SPEAKER1 03:50 OK, so have you been following the proposed changes to the LME's market structure?
- SPEAKER2 04:01 Very close to being honest. I know there are changes. I mean, also due to the current situation, we saw what went on the LME ring itself, something which I think is understandable, even if it's a pity, because I think this is the last regional market where people are shouting their orders throughout the room. For me, it is a strange development, especially since electronic platforms can be an advantage in order to maybe to save time. But it's also a risk because it can create a self-dynamic regarding placing orders, receiving orders. And this could lead to a dynamic in the physical markets which would not reflect reality or the economy, actually.
- SPEAKER1 05:03 And there's been a lot of sorts of stories in the press about, you know, taking views from, you know, I think that the Deutsche Metal Verband is a good example. I think they've been quite vocal about some of these proposals. And I think there's been a lot of concern about the changes to the way in which the margining would work, because the way at the moment it works effectively allows for discounting to take place, whereby the broker can offer credit lines and allows other brokers to offer credit lines. And but what the LME is sort of pushing for is a move to more sort of futures model where you can get nice profits straight away, pretty much like the CME. You don't have to wait until the actual day, sort of the final date, to realize your profits. And they're saying that that is more attractive to a new type of liquidity provider, a new type of market participant and firms which use more consistent data structures you know, where they can come in and execute quickly and quit and liquidate quickly. I mean, how would that change, in your opinion maybe the dynamic of the market for a firm like yourselves?
- SPEAKER2 06:27 Yeah, for me. I mean, for quite a long time. I mean, let's go back to 2005, where the financial institutions had to find new ways to make money by investing money. And these types of companies certainly bet on the volatility of the markets in order to make money. If the result would be that maybe, let's say, physical material or material which is to reduce the debt limit, whatever will be available anymore for the physical markets, for companies who actually produce something out of these commodities because of an over dynamic, let's call it that way, in the financial markets. I mean, this is a catastrophe at the end of the day. So, I say I think the development of

that situation will certainly tend to even more volatility on the markets. If you're on the right side of the table, then you make more money. Thank you very much. Making money by money is not my personal favourite thing to actually do to make a profit, because at the end of the day, in the physical industry, you buy something you treat the material to make something out of it. And this provides an additional value to the final product whatsoever or to the market services, the environment and the economy at the end of the day. And for me, this is certainly the healthier way of having more volatility in the market and also more tools just to put all this and get profits, get credit lines, but on the other hand, then realize the profit immediately. I think this is very dangerous with regard to the transparency of who actually is the market partner on the other side of the computer filling in these orders. And we had in the past, also in the country where I live this year, quite a few big financial institutions who detected that one of their traders was making mistakes, trying to correct it, did not work out. And the company went almost bankrupt due to this. And I think this is very dangerous.

- SPEAKER1 09:16 And that trader, was he using? Was he using automated trading techniques or electronic trading techniques?
- SPEAKER2 09:25 I don't know these trades. Right. I'm not sure. But I'm sure if I read the news, then I'm absolutely sure they did. Yes.
- SPEAKER1 09:34 Do you think some sort of more traditional market participants from the physical side, do you think they're likely to leave, abandon the LME and maybe go, OK, if these types of changes take place?
- SPEAKER2 09:51 if I may make a personal statement about this, I mean, for me, I hedge my mental positions to get rid of the risk because we are not speculating, not with one kilogram, because if you are on the wrong side, then you can drive a company bankrupt and you have to sack all the people and say, sorry, it was my mistake . I cannot afford to do this for. I lost track to what I wanted to say...
- SPEAKER1 10:32 So, OK, do you think physical firms might look.
- SPEAKER2 10:37 Oh, I got to track back. I wanted to use it. I was used to trade with the broker who went actually bankrupt, and I was very happy that I could transfer my hedging positions to another broker because it was not OTC. At the end of the day, I'm not an expert in the regulations today regarding the LME and of course, also institutions such as the LME have to go with the digitalization and with the improvement and have to modernize the state of the art. On the other hand, this will also lead to much more compliance work to see who is behind, et cetera, et cetera, which is also where it's getting more and more complicated.

I mean, if I think back to when I started trading and had an agreement with the first broker over 20 years ago, it was, I think, two or three pages to be signed and a bit of information about the ownership of the company. And that was it. Today, he takes five or six months to approve everything. You have to provide your shoe numbers and everything to approve that you are actually existing, and you are aware of what you are doing. And I think the responsibility for the LME or the controlling institutions, but also for the companies themselves, is to keep things traceable for the markets because if you get a credit line but you get immediately to profit and you drive to markets to a certain level where the industry cannot afford buying material anymore, then it certainly would cost more money than whatever profit could be realized .

SPEAKER1 12:45 There's this concept that's grown up in the UK probably since the last financial crisis of what they call conduct risk, and what this is, is where the regulators effectively are trying to encourage firms to account for additional types of risk. So previously, you know, you might have had market risk, credit risk, counterparty default risk, those types of things. But this is a way of where the regulator said, OK, well, for the firms that are active in the market, we want them to almost account financially for a risk of harm that could happen as a result of poor behaviour. So, it could be the poor behaviour of you or your traders, poor behaviour of people in your accounting team. It could be poor behaviour in this latter case of a machine. It could be that you've created a machine and it started to trade and is doing silly things. And obviously any LME there have been some in the past. I mean, there's the very famous case of harmonica back in the 90s and the big abusive price squeeze. As somebody as a user of the market. Do you think that the entry of more sorts of machine-led electronic trading helps to reduce that type of risk and therefore makes the market may be fairer for people like you? Or do you think it potentially makes that risk worse because the traditional intermediaries are sort of maybe losing a degree of control and, you know, they no longer in complete control of the order or does that they take anymore?

SPEAKER2 14:25 I think it makes the risk worse, because if let's say, let's call it a machine or an automated process, pulling the trigger and that creates a chain reaction, just bang, bang, bang, buying or selling, selling or whatever, because this goes it very, very quickly, as I learned, or can go very quickly . You need to at the end of the day, you need to have someone who puts the red button in order to stop it. Otherwise, the market price, the so-called market price won't be a market price anymore when completely out of control. And this is why for me as a

conservative way, I think this will withdrawal or increase the risk, then reduce it.

SPEAKER1 15:19 And have you seen as your sort of company or yourself, if you ever see any instances of this or being on the sort of receiving end where maybe you've gone to work in order with your broker and then a price level, which was there when you went to work, that order has become quite erratic and change by the time you've gotten your fill.

SPEAKER2 15:44 So, I think so far, I was lucky. No, no, it's more it's more of a surprise in certain circumstances where the price rises or the price loss, which has nothing to do with the actual market price due to circumstances of news that you hear. I mean, on a certain level, I think this is normal. People hear the news. They try to analyze and think what influence this could have on the market price or on the price of the future or an exchange rate or whatsoever. But if I imagine that that these sanctions would be triggered automatically and not only by one electronic system, but by hundreds or something like that I think the physical companies, or the traders say they could not handle these waves up or down anymore. And at the end of the day, if the price goes to a certain level where maybe you are not the forward anymore to physically with your money paid, what you need to buy in order to sell it to a producer or to process the material yourself, then you can stop. And this will be certainly ironically and certainly not good to know about me personally, I have not I was not given the volume. I mean trading is not that huge on an hourly basis, although everywhere we move by themselves, hundreds of thousands of lots to say moment. So, for us it is still, as said, conservative. We can still overview with the markets and on the other hand, also with the customer. We talk with them over the phone. If the current situation gets better, then we can also meet and talk and see a little bit about what are their requirements, because at the end of the day, what does a market partner want? He does not want to be cheated. So, you have a market price. You can say, OK, the label level at ten thousand dollars. Is this justified or not? If you just look at the production costs, they certainly are not. If you look at what's going on the market right now with all the environmental influences, logistics and the pandemic, etc., then you can say maybe you're doing this, you know, something like that depends always on which side of the table your sitting at. But at the end of the day, I think people want to be treated in a fair and more or less transparent or correct way. Everybody knows that everybody needs to make a bit of money due to a service the company or the individual trader would provide, but not due to just volatility and speculation, because I think maybe it's that way or the other way. For me, it is clear that the final financial institutions

and nothing against them in principle, let's say, without the money being invested in these kind of raw material platforms, I think LME will not be existing anymore because they don't have any money to work with. But on the physical side, for me, this is my focus and I think this should stay as important in the markets.

- SPEAKER1 19:56 The FCA just on that part about looking after customers' interests. I mean, the Financial Conduct Authority, which is the lead regulatory authority in the UK, regulates the LME in the UK. And one of their main statutory objectives is to make sure that the interests of customers are protected. I mean, that's one of their main objectives. Do you as a user of the market, do you have confidence in regulators like the FCA and even the trading venue to actually look after your interests as a user of the market?
- SPEAKER2 20:38 It's a good question, I have not been in contact with him for quite a long time or these other regulators and also me personally, I'm not a lawyer and not studying these hundreds and hundreds of pages, because actually the complexity, as I mentioned also before already only to get an account with a brokerage to start trading. This is already very, very complex today. And in general, I might say I have a natural trust in people or institutions. And I do not think that institutions or people are always trying to find a way for their own profit or to cheat or something like that. And I think they are also clever, clever people behind to exactly try to in the case of FCA to try to take the interest of the of the market participants or the customer to provide a certain protection not only for the well, using the broker to counter hedge positions, but also for the broker themselves in order not to lose money. And this is always about touching the risk, which is utility, which is the financial risk, which is the experience and the knowledge of the people who are placing an order in general. Yes, more or less confident. I think it's from time to time a little bit overregulated. But if we talk about this topic, we are having the interview right now, maybe I think it's necessary to be regulated quite precisely.
- SPEAKER1 22:39 And I mean, the UK in the EU with the second Markets in Financial Instruments Directive in April in some pretty big changes in relation to firms that are engaging electronic trading, and a lot of the requirements actually came from the from Germany's Hochfrequenzhandelsgesetz. Yeah. And they you know, they were the big influence, the Germans were the big influence in trying to put more controls, whereas the British sort of influence has always generally been a little bit more laissez faire. Do you think maybe you know what you're talking about with the additional burdens that you're subject to? Do you think broadly speaking, we're getting the

balance right between innovation in the market and, you know, trying to protect customers' interests? Or are you sensing a direction towards that? Actually, you know, maybe some of these issues are not really that well understood and actually that the physical use of the market might be vulnerable, maybe because they don't understand so well how some of these new entrants into the market actually operate and could take advantage of them.

SPEAKER2 24:05 Yeah, I mean, the development of the market and these dynamics on the one side and finding the regulations or do have a bit safer or a better understanding and also better understanding for charting the risks. This is like these computer programs and viruses, so one is keen on making a computer program which should help, and at the same time you have the other side to try to put a virus in in order to put some pressure on. So, and who is now programming faster? This is a good question. And of course, we switch dynamics. We are in right now if innovation is coming up and then it takes 10 years to try to see where is exactly which risk and what regulations have to be defined in order to handle this correctly. This might be a little bit tricky. So, I think the innovations are maybe a bit ahead of thorough regulation and protecting the people, using them at the end of the day. But if Germany is now a bit ahead with these regulations or and as per your example, England, a little bit more or less fair, this is something I have no insight in that. So, I don't know.

SPEAKER1 25:43 OK, coming towards the end, I mean, is your company a member of any sort of industry association? And are you aware of any sort of, you know, expression of concern at that industry association about these types of changes to the markets?

SPEAKER2 26:04 Let's put it that way to the customers we are working with and the ones where we then also need to price fix, for example, on the LME. This is a let's say, a good handful and the other. With them, we also talk over these kinds of topics a little bit, though, when we hear something from the market. OK, maybe we should be careful over this might change its approach. I mean, when it changes today, the cash price bids. For three months, had been just one price and notable for the patients, for example. But these are basic, basic things with the older market participants to just inquire, need a price? Maybe we have a price for all of them so they can also follow whether what we are calculating is correct or not but at the end of the day, they are interested in having the right material at the right time, on the right place, at the price, which is OK and fair. And so, it is not that complex where we are members or a pattern that I don't know exactly the words in English where we have a partner, not membership in associations, able to maybe talk a little bit more about our experience

or our impression or also our fears about what's going on in the markets.

SPEAKER1 27:50 And finally, what would your principal concerns for the future be?

SPEAKER2 27:57 My principal concern for the future is certainly that we have to be careful, not only working and moving ourselves on the artificial platforms or electronic platforms like now during the pandemic, you have with your calls, your phone calls, you write emails, but having personal contact with human beings, with people who live and breathe. And we have to be careful not to become anonymous at the end of the day. Whatever you turn, it doesn't matter where infeasible, whether in the physical markets or also in the financial markets, it's always people behind it. And at the end of the day, I think you can be sustainable if you can have a certain trust in people, if you can rely on people. And I think this would not be possible with, let's say, this artificial platform whatsoever.

SPEAKER1 29:11 OK. That concludes the interview. Thank you very much for your time. I'm just going to switch off the recording now. Thank you.