

LONDON METAL EXCHANGE

From the Chief Executive

16 April 2003

The Financial System and
Major Operational Disruption
FSM team
Room 4/16
HM Treasury
1 Horse Guards Road
London SW1A 2HQ

Dear Sirs

THE FINANCIAL SYSTEM AND MAJOR OPERATIONAL DISRUPTION

Introduction

1. The LME welcomes the opportunity to respond to the Treasury's consultation paper. The issues raised in the consultation paper are important and ought to be discussed widely.
2. The LME believes that its most useful contribution to the debate would be to focus on the operations of the LME itself rather than include the separate concerns of its members and market participants. These operate across a number of exchanges and OTC markets and may respond either themselves or through representative organisations to which they belong. For this reason, the LME has not consulted with its members or other participants in its metals markets before drafting this response.
3. We have chosen not to give specific replies to the thirty-one questions set out in the consultation paper. We think that the points that we will make later on in this letter provide a more coherent response. These are divided into general comments on the proposal for new legislation and particular comments on the position of the LME.

General

4. We agree that consideration should be given to how the City might respond to an event like that experienced by New York City on 11 September 2001. We are participating in the current initiatives on business continuity planning, sponsored by the Treasury, the FSA and the Bank of England. Initiatives like this concentrate on how organisations like the LME can prepare to be able to deal with a major

disruption. We appreciate that the consultation paper is concerned with aspects of a major disruption that City institutions would not be able to deal with themselves.

5. We understand, from the comparisons with the events of 11 September 2001, that the Treasury's main concern is with situations where institutions, like the LME, may know what they would like to do but do not have the legal power to do so. We do not imagine that the Treasury believes that there will be situations where it knows how to deal with a problem facing an institution but the institution itself has no idea how to deal with it. Assuming that we are not wrong, this might be a point that the Treasury might like to emphasise. We are aware that concern has been expressed in certain quarters that new legislation might be used by the Treasury to force institutions to take action that they do not believe should be taken.

6. One aspect of the consultation paper that we appreciate is difficult, is the unforeseen nature of problems that arise after a major disruption. We recognise that it is difficult for the Treasury to identify now the gaps in the legal framework that legislation might be able to fill in the future. We think that this may be an insuperable obstacle to drafting legislation. It is very difficult to define a solution where the problem is so difficult to define.

LME

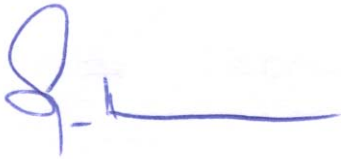
7. The first point that we would make is that no organisation can make preparations before a major disruption that would allow it to carry on afterwards as if nothing had happened. The LME rules and regulations give the LME emergency powers to suspend trading on its markets and to take other actions that are binding on both parties to any LME contract. We believe that these powers are sufficient to maintain order on our markets. The LME accounts for over 95 percent of the exchange trading in seven base metals. The LME's official published prices are the world reference prices for those metals. Our concern is therefore not just to keep order on our markets but also to ensure that we only permit trading that will produce valid reference prices based on proper supply and demand driven trading.

8. We understand that, in the case of a stock exchange, suspending on-exchange trading may not be effective without trying to suspend OTC trading in the same securities. Although we believe that the same argument can be applied to a financial futures and options exchange, we do not think that that argument should be applied to a commodity exchange. LME's contracts are investments but the seven base metals that underlie those contracts are not. Trading in these metals is global with no restriction on the location or time zone of those who trade. We do not see what value there would be in attempting to restrict that trade or how it could be successfully achieved.

9. Chapter 7 of the consultation paper discusses direction powers over recognised investment exchanges. Box 7.1 proposes an example where an exchange ought to suspend trading to prevent a disorderly market but the exchange is reluctant to do so for fear of legal claims. We would be interested to know why you think that the immunity under section 291 of the FSMA would not apply?

10. We support the view, expressed in paragraph 7.29 of the consultation paper, that any new legislative powers of direction should be limited to dealing with a major catastrophe. We also believe that such powers should only be used in respect of the LME's markets either with the support of the LME or where the LME was unable to act. There should not be an assumption in legislation that the LME, whose job is to regulate its markets, is not best placed to know how to do so.

Yours faithfully

A handwritten signature in blue ink, consisting of a stylized initial 'S' followed by a horizontal line and a small flourish.

S J N Heale