

Global Market Structure – Europe

Execution Excellence

October 5, 2017

MiFID II: Trading Capacities

Briefing Note

What is happening?

- MiFID II defines three capacities in which investment firms can report their trading, whether on a proprietary basis, with, or on behalf of their clients. These are:
 - DEAL - when a firm deals on own account
 - MTCH - when a firm trades in a matched principal capacity
 - AOTC - when a firm trades in any other trading capacity which is not DEAL or MTCH e.g. Agency
- The new framework will replace the existing taxonomy of 'Agency', 'Riskless Principal' and 'Principal' which are currently used to define the trading capacities of investment firms.
- While the new MiFID II taxonomy does not offer a like-for-like replacement for the existing terms, it is also not entirely inconsistent with the current approach. Having said that, buy side firms still need to assess the impact of the new capacities on their obligations (including reporting obligations) and their ability to continue with their current trading style in a MiFID II world. See Appendix 1 for mapping of existing taxonomy to MiFID II capacities.
- There is an obligation to set trading capacities correctly and apply them consistently across several parts of the legislation, e.g. order keeping requirement for trading venues (RTS 24), transaction reporting (RTS 22), order record keeping for HFT activity (RTS 6) etc.
- This document highlights various issues arising from the introduction of new trading capacities.

What topics are discussed in this document?

- Impact on Commission Sharing Arrangements complying with Section 28(e), US Securities Exchange Act: Buy side firms who request that we administer their European Commission Sharing Agreement (CSA) in a manner consistent with US Securities Exchange Act's Section 28(e) Safe Harbour for Brokers, should be aware that certain Riskless Principal executions under MiFID II will have to be flagged in a 'DEAL' capacity, which also indicates 'Principal' trading under MiFID II.
- Transaction Reporting for Cash Equity DEA Flow: For cash equity DEA flow, buy side firms will be required to submit transaction reports for each market fill.
- Transaction Reporting for Non DEA Flow: For non DEA orders filled by brokers, whether buy side firms will have to submit transaction reports at market fill level, order level, or allocation level depends upon the manner in which they contract with their broker.



What is DEAL capacity?

- An investment firm is said to be trading in DEAL capacity when it 'deals on own account'. Dealing on own account is defined in Level 1¹ text as *'trading against proprietary capital resulting in the conclusion of transactions in one or more financial instruments'*.
- When a firm trades in DEAL capacity, it should be reported as either a buyer or seller in the corresponding transaction report.
- An investment firm may trade in DEAL capacity when executing either its own proprietary trades or acting on own account with a view to filling client orders. Where the firm executes client orders, both the market side transaction report and the client side transaction report should reflect its trading capacity as DEAL. Time and price values on both sides can be different.
- Riskless Principal – DEAL applies when an investment firm is acting to fill a client order.
- Principal – DEAL applies when an investment firm undertakes a risk facing trade. When firms act as Systematic Internalisers (SI), they will trade in a Principal - DEAL capacity.
- ESMA Guidance confirms that DEA providers cannot report trades executed via DEA in DEAL capacity – they may only report MTCH or AOTC.²

What is MTCH capacity?

- An investment firm is said to be trading in MTCH capacity when it conducts matched principal trading. Matched Principal Trading is defined in Level 1³ as *"transaction where the facilitator interposes itself between the buyer and the seller to the transaction in such a way that it is never exposed to market risk throughout the execution of the transaction, with both sides executed simultaneously"*.
- Therefore, firms executing in MTCH capacity should not appear as the buyer or seller in the transaction reports to reflect that such trades have not resulted in any risk positions.
- For purposes of transaction reporting, the client on whose behalf the transaction was undertaken should be reported in the buyer/seller field and the venue or counterparty (e.g. CCP of the exchange) should be indicated as the corresponding seller/buyer in the transaction.
- Transaction reports will need to be submitted on a market fill basis.

What is AOTC capacity?

- All other activity which is not characterised as DEAL or MTCH is required to be reported as "any other trading capacity" – AOTC. This includes trading taking place on an agency basis.
- Transaction reporting of agency trades is similar to trading in MTCH capacity where the client is reported as the buyer/seller and venue or counterparty (e.g. the CCP of the exchange) is reported as the corresponding seller/buyer. The differentiating factor is the capacity of the executing firm – MTCH (matched principal) vs AOTC (agency).

How will DB administer buy side's request to administer their CSA programme in a manner consistent with Section 28(e) of the US Securities Exchange Act?

- Section 28(e) of the US Securities Exchange Act specifies that only agency or riskless principal trades may be used to form the basis of soft dollar credits or commission sharing. Therefore, transactions executed by DB in Principal – DEAL capacity, regardless of the venue of the execution, will not be eligible for commission sharing.
- This means that buy side firms abiding by Section 28(e) of the US Securities Exchange Act will not be able to include fills in their CSA where DB executes orders in an SI capacity.

¹ Article 4(1)(6), MiFID II.

² [ESMA Guidance on Transaction Reporting, Order Record Keeping and Clock Synchronisation under MiFID II 2016/1452](#), pg 21 and 162.

³ Article 4(1)(38), MiFID II.

- DB will offer the ability to default a client's execution preference to exclude Principal – DEAL.
- DB will default this preference to "No" ('allow any execution capacity') unless requested to be enabled by the client. This preference can be overridden on a trade-by-trade basis at the client's request.

How will transaction reporting work for cash DEA trades?

- According to ESMA guidance, DEA providers may only act in MTCH or AOTC capacity. DB does not support AOTC capacity for cash DEA. Therefore, all cash DEA will have to be reported as MTCH by DB.
- Every market fill will be eligible for a separate transaction report by both DB and the buy side firm. This means that buy side firms' transaction reports will need to match DB's transaction reports on an individual market fill level.
- Buy side firms should report themselves or their clients (as the case may be) as buyer/seller in the transaction and should indicate DB as the corresponding seller/buyer.

How will transaction reporting work for non DEA flow?

- Non DEA orders will be filled by DB in a DEAL capacity.
- DB will generate separate market side transaction reports for trades executed on trading venues on a market fill basis and client side transaction reports on a client allocation basis.
- Buy side firms have the option to populate their transaction reports on a market fill basis, an order level basis or an allocation basis. Therefore, their transaction reports should tie in with DB's transaction reports at an aggregate level and not necessarily at an individual market fill level.
- This arrangement affords the buy side firms the flexibility to devise their own transaction reporting approach that is independent of DB's – the only condition being that their reports should match with DB's at an aggregated level.

Other documents in this series may be accessed here:

- [An Overview of MiFID II](#)
- [Topic 1, Update 1, MiFID II](#) – Trade and Transaction Reporting
- [Topic 2, Update 1, MiFID II](#) – Systematic Internalisers, Trading Obligation and Matched Principal Trading
- [Topic 3 MiFID II](#) – Best Execution
- [Topic 4, Update 1, MiFID II](#) – Direct Electronic Access, Algorithmic Trading and Self-Assessment
- [Topic 5 MiFID II](#) – Research Unbundling
- [Topic 6, Update 1, MiFID II](#) – Impact on Non Equities
- [Topic 7, MiFID II](#) – Extraterritoriality
- [Briefing Note – Transparency for Equity Derivatives](#)
- [Briefing Note – Changing Landscape of Equity Trading](#)
- [Briefing Note – Definition of Systematic Internalisers and Industry Feedback to EC Consultation](#)
- [Directory of Documents](#)

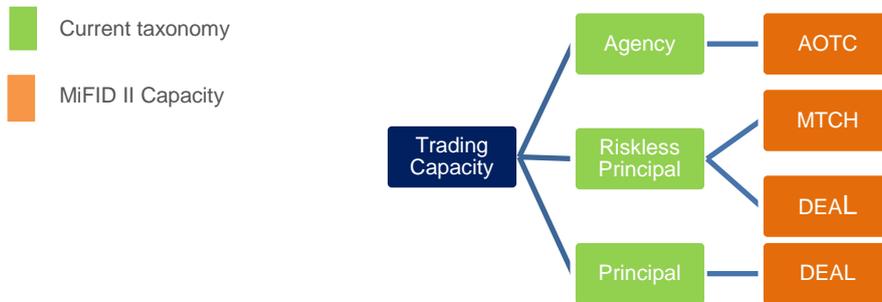
Global Market Structure- EMEA

Stephen McGoldrick
stephen.mcgoldrick@db.com
+44(20)754-75552

Gargi Purandare
gargi.purandare@db.com
+44(20)754-70168

Appendix 1

Mapping of current taxonomy to MiFID II capacity



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