Market Watch

Markets Division: Newsletter on Trade Reporting Issues

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Introduction

Welcome to this special edition of Market Watch which aims to help firms in their approach to implement the Market in Financial Instruments Directive (MiFID) trade reporting requirements for certain worked client orders. As usual, this material does not represent formal FSA guidance, but sets out our interpretation of the relevant requirements. If a firm were to decide to adopt a different approach, it would need to be able to satisfy itself and us that its approach nonetheless fulfilled the requirements of MiFID.

MiFID trade reporting requirements: Dealing from own book

Several investment firms have asked us about the MiFID trade reporting obligations of a firm when, in working a client order, it fills the order not only from trades with third party sources but partly from its own proprietary dealing book.

For the tranches of the order that a firm executes on a regulated market (RM) or multilateral trading facility (MTF) the position is clear: those trades will be published immediately by the trading venue on which they take place, whether they take place on or off book.

The trade reporting obligations also require investment firms executing transactions outside an RM or MTF to publish those trades immediately. So, it is also clear that when a firm fills part of the order as a result of OTC trades with a third party then it should also publish these trades immediately.

However, the position is more complex when an investment firm executes part of a client order against its own proprietary dealing book, allocating tranches of shares to (or from) a client holding account as the order is worked. This is distinct from the situation where the tranches executed with third parties simply pass through the dealing book. In the former scenario, firms have suggested two different approaches to meeting their trade reporting obligations.

1. They would publish a trade report each time they allocate stock from the proprietary dealing book to the client internal account (or vice versa). In this case, there would be no publication of the aggregate client-side aggregate trade, provided that it mirrored the size and average price of its constituent parts.
2. They would not publish reports of these internal allocations. Instead, they would report the final aggregate trade booked to the client, on the basis that the internal allocations are essentially house-keeping, the final trade is a new trade and the average price is new.

In the following paragraphs we aim to help firms in their approach to order execution and trade reporting, but they do not constitute formal guidance.

Firms should take into account MiFID's general objectives of facilitating competition in trade execution on the basis of market-wide transparency. Of particular relevance here is MiFID's focus on:

- treating each point of execution (i.e. including an investment firm) as a trading venue that should provide transparency, and
- on the timeliness of the flow of trade information into the market.

In our view, the action of passing a specific quantity of risk, at a specified price, from a firm's dealing book to a client account (or vice versa) contains information that should be made public (unless subject to any other exemption). We also note the desirability of avoiding the over-reporting of trades and the need to avoid double-counting.

In view of these considerations, we believe that the second option above gives rise to material issues in terms of market transparency. In particular, the aggregation within a single 'final' trade report of allocations transferred from a firm's dealing book over a period of time effectively reduces the flow of volume and price information into the public domain.

In broader terms, we consider that publication as and when stock is allocated to a client internal account aligns more closely with risk management practice and the interests of clients wishing to monitor the progress of order execution.

If the second approach was to become widespread practice we would be concerned that it could lead to a significant deterioration in the quality and usefulness of publicly-available trading information.

It follows from the above that in cases where a firm allocates shares from (or to) its own dealing book only at the end (or close to the end) of the transaction it should still publish the allocation to (or from) the client as soon as it is made. If the allocation is priced away from the current market price in order to deliver the client a target price for the overall trade, this would carry the appropriate flag. However, there would be little informational benefit in publishing the final, aggregated client side trade, provided that it mirrored the size and average price of the parts.

However, in this case, it should be clear between firm and client, and consistent with the firm's terms and conditions, that until an allocation is made, risk does not pass to the client in respect of a client buy order, or to the firm for a client sell order. Clients would need to consider, in the context of a particular trade, whether this handling was consistent with their instructions, and firms would need to consider whether their conduct of the trade was consistent with their internal risk management.

In general, where a firm is working an order and filling it partly from its own book, we think it would be unusual for it not to be allocating tranches of shares to the client order periodically during the course of the working. So we would expect this kind of transaction to be characterised by several, rather than a single, report of fills involving the firm's own dealing book.

A further consideration is the action to be followed, on what we think are likely to be the relatively rare circumstances, when the parties agree that the client should be responsible for making public the trade. In this case, the investment firm executing the trade should inform the client immediately on making a new allocation to the client's account and the client should make public the information.

For any specific trade reporting queries please contact **James Woodley** in Markets Policy on **020 7066 5874** or **james.woodley@fsa.gov.u**k.

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This newsletter is produced regularly by the Market Conduct and Transaction Monitoring teams in our Markets Division. If you would like to receive this newsletter by email, or have any comments on it, please contact **market.watch@fsa.gov.uk**

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