

Chapter 4

Own funds requirements

4.15 K-DTF requirement

- 4.15.1** **R** Subject to **■** MIFIDPRU 4.15.11R, the *K-DTF requirement* of a MIFIDPRU investment firm is equal to the sum of:
- (1) 0.1% of average *DTF* attributable to cash trades; and
 - (2) 0.01% of average *DTF* attributable to derivatives trades.
- 4.15.2** **G**
- (1) The definition of *DTF* includes transactions that a firm enters into when *dealing on own account* or when executing *client* orders in the firm's own name.
 - (2) A firm that has permission to operate an organised trading facility may engage in:
 - (a) *matched principal trading* in certain types of financial instruments with *client* consent, in accordance with **■** MAR 5A.3.5R(1); and/or
 - (b) *dealing on own account* in illiquid sovereign debt instruments in accordance with **■** MAR 5A.3.5R(2).
 - (3) Where a firm engages in either activity in (2), it must include those transactions in the measurement of its *DTF*.
 - (4) Except for the transactions in (2), *DTF* does not include orders that a firm handles in the course of operating an organised trading facility. However, *DTF* includes transactions entered into by a firm in its own name through an organised trading facility where the firm is not operating that organised trading facility.
- 4.15.3** **R** A firm must calculate its *K-DTF requirement* on the first business day of each month.
- 4.15.4** **R**
- (1) A firm must calculate the amount of its average *DTF* as:
 - (a) taking the total *DTF* as measured throughout each business day in each of the previous 9 months;
 - (b) excluding the daily values for the most recent 3 months; and
 - (c) calculating the arithmetic mean of the daily values for the remaining 6 months.

- (2) When measuring the value of *DTF* for a particular *business day*, a *firm* must convert any amounts in foreign currencies on that date into the *firm's* functional currency.
- (3) For the purposes of the currency conversion in (2), a *firm* must:
- (a) determine the conversion rate by reference to an appropriate market rate; and
 - (b) record the rate that was chosen.
- 4.15.5** **G** (1) The effect of ■ MIFIDPRU 4.15.4R(2) is that when measuring the value of *DTF* at the end of each *business day*, a *firm* must apply the relevant conversion rate on that date to any amounts in foreign currencies forming part of the *DTF* attributable to that *business day*. The *DTF* for each preceding *business day* should continue to be measured by reference to the conversion rate that was applicable on that preceding day.
- (2) For the purposes of ■ MIFIDPRU 4.15.4R(3), where a *firm* is carrying out a conversion that involves sterling, the *FCA* considers that an example of an appropriate market rate would be the relevant daily spot exchange rate against sterling published by the Bank of England.
- 4.15.6** **R** (1) When measuring its *DTF*, a *firm* must use the sum of the absolute value of each buy order and sell order, as determined in accordance with this *rule*.
- (2) For *cash trades* relating to *financial instruments*, the value of the order is the amount paid or received on the trade.
- (3) For *derivatives trades* other than orders relating to interest rate derivatives, the value of the order is the notional amount of the contract, determined in accordance with ■ MIFIDPRU 4.14.20R(2).
- (4) For orders relating to interest rate derivatives, the value of the order is the notional amount of the contract determined in accordance with ■ MIFIDPRU 4.14.20R(2), adjusted in accordance with ■ MIFIDPRU 4.15.8R.
- 4.15.7** **G** For *cash trades* relating to exchange-traded options, the amount paid or received on the trade under ■ MIFIDPRU 4.15.6R(2) is the premium paid for the option.
- 4.15.8** **R** (1) For the purposes of ■ MIFIDPRU 4.15.6R(4), a *firm* must adjust the notional amount of an interest rate derivative by multiplying that notional amount by the duration.
- (2) For the purposes of (1), the duration must be determined in accordance with the following formula:
- $$\text{Duration} = \text{time to maturity (in years)} / 10$$

4.15.9 **G** When measuring *DTF* for the purposes of **■ MIFIDPRU 4.15.4R**, a *firm* must include transactions executed by a *firm* in its own name either for itself or on behalf of a *client*.

4.15.10 **R**

- (1) This *rule* applies where a *firm* has had a *daily trading flow* for less than 9 *months*.
- (2) For the purposes of its calculation of *average DTF* under **■ MIFIDPRU 4.15.4R**, a *firm* must use the modified calculation in **■ MIFIDPRU TP 4.11R(1)** with the following adjustments:
 - (a) in **■ MIFIDPRU TP 4.11R(1)(b)**, *n* is the relevant number of *months* for which the *firm* has had a *daily trading flow* (with the *month* during which the *firm* begins that activity being counted as *month zero*); and
 - (b) during *month zero* of the calculation, the *firm* must:
 - (i) use a best efforts estimate of expected *DTF* for that *month* based on its projections when beginning the new activity; and
 - (ii) use the estimate in (i) as its *average DTF*;
 - (c) during *month 1* of the calculation and each *month* thereafter, the *firm* must apply the approach in (a) using observed historical data from the preceding *months*;
 - (d) the modified calculation ceases to apply on the date that falls 9 *months* after the date on which the *firm* first had a *daily trading flow*.

Adjusted coefficient in stressed market conditions

4.15.11 **R**

- (1) This *rule* applies where a *firm's* measurement of its *DTF* under **■ MIFIDPRU 4.15.4R** includes a proportion of *daily trading flow* that occurred on a trading segment of a *trading venue* to which stressed market conditions (as defined in article 6 of the *Market Making RTS*) applied.
- (2) Where this *rule* applies, a *firm* may apply the following adjusted coefficients:
 - (a) for *cash trades*, a coefficient determined in accordance with (3) instead of the relevant coefficient in **■ MIFIDPRU 4.15.1R(1)**; or
 - (b) for *derivatives trades*, a coefficient determined in accordance with (4) instead of the relevant coefficient in **■ MIFIDPRU 4.15.1R(2)**.
- (3) For *cash trades*, the adjusted coefficient must be determined by using the following formula:

$$\text{CadjCash} = C * (\text{DTFexcl}/\text{DTFincl})$$
 where:
 - (a) CadjCash = the adjusted coefficient in (2)(a);
 - (b) C = the original coefficient in **■ MIFIDPRU 4.15.1R(1)**;
 - (c) DTFexcl = the *average DTF* of *cash trades* calculated in accordance with **■ MIFIDPRU 4.15.4R**, excluding the value of any *cash trade*

that occurred on a trading segment of a *trading venue* between the time at which the *trading venue* determined that:

- (i) stressed market conditions began to apply; and
- (ii) stressed market conditions ceased to apply;
- (d) DTFincl = the *average DTF* of all *cash trades* calculated in accordance with ■ MIFIDPRU 4.15.4R.

- (4) For *derivative trades*, the adjusted coefficient must be determined by using the following formula:

$$\text{CadjDer} = C * (\text{DTFexcl}/\text{DTFincl})$$

where:

- (a) CadjDer = the adjusted coefficient in (2)(b);
- (b) C = the original coefficient in ■ MIFIDPRU 4.15.1R(2);
- (c) DTFexcl = the *average DTF* of *derivative trades* calculated in accordance with ■ MIFIDPRU 4.15.4R, excluding the value of any *derivative trade* that occurred on a trading segment of a *trading venue* between the time at which the *trading venue* determined that:
 - (i) stressed market conditions began to apply; and
 - (ii) stressed market conditions ceased to apply;
- (d) DTFincl = the *average DTF* of all *derivative trades* calculated in accordance with ■ MIFIDPRU 4.15.4R.

4.15.12

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- (1) ■ MIFIDPRU 4.15.11R permits a *firm* to apply a reduced coefficient for the purposes of determining its *K-DTF requirement* where part of the *firm's average DTF* for the relevant period is attributable to transactions that took place on a segment of a *trading venue* to which stressed market conditions applied. The relevant coefficient must be calculated separately for *cash trades* and *derivative trades*.
- (2) ■ MIFIDPRU 4.15.11R permits a *firm* to substitute a reduced coefficient that applies to the *firm's average DTF* for the relevant calculation period. The size of the reduction is proportional to the value of trades that were placed on a segment of a *trading venue* during stressed market conditions within the calculation period, relative to the overall value of trades entered into by the *firm* during that period.

4.15.13

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- (1) The following is an example of how the adjusted coefficient in ■ MIFIDPRU 4.15.11R applies.
- (2) A *firm* executes total *cash trades* in its own name worth £9,600m during the *6-month* calculation period for determining *average DTF* under ■ MIFIDPRU 4.15.4R(1)(c). That *6-month* period includes 128 *business days*.
- (3) The total £9,600m of *cash trades* includes £375m of *cash trades* that were executed on *trading venues* during stressed market conditions (as defined in article 6 of the *Market Making RTS*).

(4) In this example:

$$DTFincl = \text{£}9,600\text{m} / 128 \text{ days} = \text{£}75\text{m}$$

$$DTFexcl = (\text{£}9,600\text{m} - \text{£}375\text{m}) / 128 \text{ days} = \text{£}9,225\text{m} / 128 \text{ days} = \text{£}72.07\text{m}$$

$$C = 0.1\%$$

$$CadjCash = 0.1\% \times (72.07 / 75) = 0.1\% \times 0.961 = 0.0961\%$$

(5) To calculate its *K-DTF requirement* for this calculation period, the *firm* multiplies the full amount of its *average DTF* for the period by the adjusted coefficient (CadjCash). Therefore:

$$K\text{-}DTF \text{ requirement for cash trades} = \text{£}75\text{m} \times 0.0961\% = \text{£}72,075$$