**MiFID II Best Execution requirements for repo and SFTs:**
**The challenges and (im)practicalities**

***Discussion paper***
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**Background**

Under MiFID (I), investment firms were obliged to take "all reasonable steps" to achieve the best possible results for their clients with respect to orders for equity based transaction; under MiFID II, firms are required to take "all sufficient steps" including orders for non-equities. Cost will remain one of the key factors when assessing execution quality for both retail and professional clients (i.e. the price at which the trade is executed plus any additional commissions or fees). Firms are also expected to take into account and disclose commissions and costs related to executing an order on eligible venues.

MiFID II Best Execution obligations require investment firms to establish and implement an order execution policy, which must be disclosed to, and consented on by, the firm's clients. Importantly, **trading venues, systematic internalisers, market makers, and other liquidity providers** are required to make data available to the public, on a regular basis, at no cost, on the quality of transaction execution.[1] Furthermore, investment firms are required to publish annually information on the quality of execution obtained on their top five execution venues, based on volumes (by class of instrument).[2]

MiFID II Best Execution obligations are due to be implemented from January 2018.

**MiFID II Best Execution and securities financing transactions**

It is unclear as to whether securities financing transactions (SFTs) are intended to be in-scope of MiFID II best execution obligations. RTS 27 (which outlines reporting requirements for execution venues executing client orders in MiFID financial instruments) does not mention SFTs. Also, SFTs are not in themselves MiFID financial instruments; rather, they are a type of transaction (secured financing transactions). Furthermore, SFTs do not fit easily, if at all, into the reporting templates provided by the regulation, and, to the extent that they could be *forced* into the reporting templates, the information provided would at best be useless, and at worst could corrupt the data being provided for outright (as opposed to financing) transactions in financial instruments.

With respect to RTS 28 (which outlines the reporting requirements for investment firms executing client orders on execution venues), the regulation does specify SFTs (as distinct from outright transactions) and provides for a separate reporting obligation. However, the benefits of this data are likely to be limited from a best execution assessment perspective.

This paper discusses the practicalities of trying to apply MiFID Best Execution requirements to SFTs. It also highlights the urgent necessity for the relevant authorities to clarify whether or not SFTs are in fact intended to be in-scope of MiFID II RTS 27 and 28 (as distinct from the reporting requirements under the SFT-Regulation). And, to the extent that SFTs are in scope, the relevant authorities should promptly provide detailed clarification and granular technical guidance on how they are to be reported, consistently and meaningfully, particularly in the case of RTS 27.

[1] RTS 27
[2] RTS 28

**RTS 27**

RTS 27 outlines the reporting requirements for trading venues, including systematic internalisers, market makers, and other liquidity providers, to evidence that they have taken "all sufficient steps" to obtain the best possible result for the client when executing orders.Trading venues (regulated markets, multilateral trading facilities, organized trading facilities), systematic internalisers, market makers, and other liquidity providers are required to make available to the public (in machine-readable electronic format), at no charge, data relating to the quality of execution of transactions on that venue on at least an annual basis (**quarterly for execution venues**). Reports should include details about the price, costs, speed, and likelihood of execution for each individual financial instrument.

***Does this apply to repo and SFTs?***

Currently there is no official guidance on whether SFTs should be reported under RTS 27, or, in the event that they should, how this could be achieved in a clear, consistent, and meaningful way. While RTS 27 does not specifically mention repurchase agreements ('repo') or other securities financing transactions (SFTs), neither does it explicitly exclude them (it applies to the execution of client orders in MiFID instruments). Furthermore, while the regulation is explicit about trading venues (exchanges, MTFs, and OTFs), and systematic internalisers (it is clear that firms cannot be systematic internalisers for SFT transactions), it is less clear what is meant by the terms 'market maker'[3] or 'liquidity provider'[4] in the context of SFTs, and whether these would fall under the definition of 'execution venue'.[5] Where investment firms routinely show prices in SFTs to their clients, would this put them in scope of the obligations, and, if so, to what extent? Furthermore, where trading venues are supporting inter-dealer (and so 'non-client') SFT markets, would these transactions be in scope of RTS 27?

For now, in order to explore this question, we will assume that investment firms that provide pricing to their clients in SFTs are in scope of the regulation, and consider the practical implications of this from an implementation perspective.

**The reporting requirements of RTS 27**

The regulation outlines the information that in-scope entities are required to make publicly available. This information is grouped into 6 main data sets:

(i) Information on execution venue and financial instrument

[3] MiFID II defines a market maker as: "a person who holds himself out on the financial markets on a continuous basis as being willing to deal on own account by buying and selling financial instruments against that person's proprietary capital at prices defined by that person." MIFID II defines 'execution venues' as including market makers and other liquidity providers.

[4] The regulation defines 'other liquidity providers' as including "firms that hold themselves out as being willing to deal on own account, and which provide liquidity as part of their normal business activity, whether or not they have formal agreements in place or commit to providing liquidity on a continuous basis."

[5] MiFID II defines execution venues as: "trading venues, systematic internalisers, market makers, and other liquidity providers."

(ii) Price
(iii) Costs
(iv) Likelihood of execution
(v) Additional information for continuous auction order book and continuous quote driven execution venues
(vi) Additional information for request for quote execution venues

The regulation provides standardized reporting templates for each of these categories.[6]

Information on execution venue and financial instrument (Article 3)

Execution venues are required to publish for each market segment and for each financial instrument, not subject to the trading obligation in Article 23 and 28 of MiFIR,[7] information on the type of execution venue, as outlined in Table 1 below.

Information includes:

- Name and venue identifier of the execution venue
- Country and location of the national competent authority (NCA)
- Name and market segment and market segment identifier
- Date of the trading day
- Nature, number, and average duration of any outage (per trading day)
- Nature, number, and average duration of any scheduled auctions (per trading day)
- Number of failed transactions (per trading day)
- Value of failed transactions as a % of value of total executed transactions (per trading day)

Presumably, for SFT 'market makers' or 'other liquidity providers', this would require identifying themselves as the execution venue, along with their location and NCA, for each trading day. The remainder of the data fields, in this context do not appear to be applicable.

[6] Provided for in Annex to RTS 27
[7] Article 23 provides for managing conflicts of interest arising from client orders; Article 28 provides for circumstances where investment firms may deviate from best execution policy in order to obtain more favourable terms for clients.

**Table 1 - identification information to be published in accordance with Article 3**

| | | | |
|---|---|---|---|
| Venue | Name | Identifier (ISO 10383 Market Identifier Code (MIC) or the Legal Entity Identifier (LEI) | |
| Country of Competent Authority | Name | | |
| Market Segment | Name | Identifier (ISO 10383 market segment MIC) | |
| Date | ISO 8601 | | |
| Outages | Nature | Number | Average duration |
| Scheduled Auction | Nature | Number | Average duration |
| Failed Transactions | | Number | Value (as % of total value of transactions executed on that day) |

Article 3 further requires that execution venues publish for each market segment they operate and each financial instrument (not subject to Articles 23 and 28 of MiFIR), information on the financial instruments, as outlined in Table 2.

Where the instruments do not have identifiers (e.g. ISINs), the reporting firm must provide the "name and a written description of the instrument, including the currency of the underlying instrument, price multiplier, price notation, quantity notation and delivery type".

**Table 2 - identification information to be published in accordance with Article 3**

| | | |
|---|---|---|
| Financial Instrument | Name | Identifier(ISO 6166) |
| Written description of financial instrument, if no identifier available (including the currency of the underlying instrument, price multiplier, price notation, quantity notation and delivery type) | | |
| Instrument classification | (ISO 10962 CFI code) | |
| Currency | (ISO 4217) | |

***What does Article 3 imply for repo and SFTs as 'financial instruments'?***

Clearly, repo and other forms of SFTs are not in themselves 'financial instruments'; rather they are transaction types, based on underlying financial instruments. Furthermore, repo is a non-standardized transaction type, with no security identifier in its own right.

A repo transaction consists of: (i) a defined start date and end date; and (ii) a specific underlying security or a defined range of securities. Both of these factors will be important considerations in pricing the transaction.

*Dates*
While some start dates for repo are far more active than others (e.g. T+1 or T+2), and, similarly, some end dates are far more common (e.g. next-day, 1-week, 1-month, 3-months), the fact is that repos can be, and are, negotiated, priced, and transacted for any manner of bespoke dates. In this respect, for the data to be meaningful, execution venues would need to provide data on every single different term of repo quoted, for each trading day.

*Underlying collateral*
Repos are also defined (and priced) by the securities underlying the transaction. In many cases these can be specific instruments ('specials') which trade at levels that are specific to that particular security for the specified dates of the transaction. Often, however, they will be defined by a range or basket of underlying securities ('general collateral'). This could be defined quite narrowly (e.g. 'German government securities with maturities between 6 months and 10 years'), or quite broadly (e.g. 'any Eurozone government bond, except Greece'). Finally, this could be a 'triparty' transaction, where the underlying collateral is subject to a specified collateral schedule (including asset type, security rating, security maturity, as well as security and issuer concentration limits). While some of these collateral schedules are standardized, many are negotiated on a bilateral basis.

*Other considerations*
Other features that can make repos difficult to compare from a 'best execution' perspective, can include the addition of a 'call' (allowing for early termination), rights of substitution (allowing for the ability to change the underlying securities), open trades (effectively a rolling end-date), and 'ever green' structures (which allow for the ability to extend the term of the trade). Some more complex repo structures could also include imbedded puts or calls that are contingent on other security reference prices (such as CDS levels).

It soon becomes clear that from a Best Execution reporting perspective, identifying every unique repo transaction that could be quoted over the course of a year is operationally challenging, and could require the identification of hundreds-of-thousands of unique 'instruments' per firm. This also presents issues in terms of comparing repo 'instruments' between different execution venues, and ensuring some form of consistency in their definitions. Narrowing repo types as much as possible (such as through date ranges or underlying collateral type groups) could make reporting easier, but the down side to this is that the usefulness of the information is lost.

<u>Price (Article 4)</u>

Execution venues are required to publish for each market segment they operate and each financial instrument (not subject to Article 23 and 28 of MiFIR), price information for each trading day orders that were executed, both on an intraday and daily basis.

*Intraday*

The required information, for each instrument, is the simple average executed price[8] and total value of trades executed during the two minutes starting at each of the following reference times: 9.30.00, 11.30.00, 13.30.00, and 15.30.00 UTC. Where no transaction occurred during the first two minutes of the relevant time periods, they are required to report the first transaction executed after the time period, including time of execution, transaction size (in terms of value), the trading system and trading mode used, the platform on which it was traded, and the best bid and offer (or suitable reference price) at the time of execution. This is outlined in Table 3.

**Table 3 - price information to be published in accordance with Article 4(1)(a)**

| | Size Range | All trades executed within first two minutes after time T | | First transaction after time T (if no transactions within first two minutes after time T) | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Time (T) | | Simple average executed price (excluding commissions and accrued interest) | Total value executed | Price | Time of execution | Transacti on size | Trading System | Trading Mode | Trading platform | best bid and offer or suitable reference price at time of execution |
| 09.30.00 | 1 | | | | | | | | | |
| | 2 | | | | | | | | | |
| | 3 | | | | | | | | | |
| 11.30.00 | 1 | | | | | | | | | |
| | 2 | | | | | | | | | |
| | 3 | | | | | | | | | |
| 13.30.00 | 1 | | | | | | | | | |
| | 2 | | | | | | | | | |
| | 3 | | | | | | | | | |
| 15.30.00 | 1 | | | | | | | | | |
| | 2 | | | | | | | | | |
| | 3 | | | | | | | | | |

Article 9 outlines reporting ranges in terms of transaction sizes, with different ranges applying to: (i) all financial instruments other than money market instruments; (ii) illiquid shares, exchange traded funds, or certificates; and (iii) money market instruments. Market makers and liquidity providers are only required to provide information related to the smallest defined range within these instrument types.

*Daily*

The required information, for each instrument, is the simple average and volume-weighted average transaction price (if more than one transaction occurred), as well as the highest and lowest executed price (if more than two transactions occurred). This is outlined in Table 4.

[8] It is assumed that repo rates will be applicable as ‘price’

**Table 4 - price information to be published in accordance with Article 4(1)(b)**

| | |
|---|---|
| simple average transaction price | |
| volume-weighted transaction price | |
| highest executed price | |
| lowest executed price | |

***What does Article 4 imply for repo with respect to 'price'?***

To the extent that SFTs are in scope of RTS 27, it is clear that they will be subject to the intra-day reporting requirements of Article 4. However, from a 'best execution' perspective, the value of this information will be limited, and even potentially corruptive.

*What to report?*

Article 4 provides for the reporting of price information relating to financial instruments. As already highlighted, SFTs are not in themselves financial instruments. Furthermore, they do not have prices, per se. Rather, SFTs are quoted and transacted as 'rates': usually as a yield (e.g. -0.65%), a spread (e.g. eonia-0.25%), or a fee (e.g. 25bp), reflective of their nature as financing transactions. This raises the question of how to report SFTs, and how to compare different quoting methodologies (e.g. an outright rate vs a spread to a refence rate)?

One possible workaround is to use the price assigned to the collateral underlying the SFT. Usually this price includes accrued interest (in the case of fixed income), and is stated as a dirty-price (known as the 'all-in price'). Most likely, this would need to be adjusted to a clean price. However, while this price should be close to market, for valuation purposes, it is not in itself a key ex-ante consideration in the transaction (rather, it is usually determined ex-post). Presumably, for basket or triparty trades, the price of each individual underlying security would also need to be reported (again, ex-post, when the collateral is eventually allocated and valued – bearing in mind that this could be substituted on an ongoing basis, including intra-day).

The next complication with using prices is in the case of haircuts. These effectively alter the price assigned to the collateral underlying the transaction, to ensure over- or under-collateralization of the SFT (depending on the direction of the haircut). This raises the question of whether to adjust the reported price for any haircuts.

Another variation on this workaround (despite the relatively low value of reporting the price used in an SFT) is the possibility of treating the SFT as two separate market transactions (i.e. a sale or purchase for 'near' settlement, and a purchase or sale for 'far' settlement). For most SFTs there is no price attached to the far leg, however, it could be possible to impute an 'end-price' based on the SFT rate and so the due cash settlement proceeds on the end-date. However, this is only possible in the case of fixed-rate SFTs (not variable), and where the end-date is known (so it would exclude open trades, for example). Furthermore, whereas the start price is usually close to market (before adjustment for haircuts), the end price is determined by the SFT rate, and is therefore almost certainly going to be off-market.

Quickly it becomes clear that using the price assigned to the collateral is extremely complicated and does not provide any meaningful data for the purposes of best execution. If anything, including these prices in Article 4 reporting would only pollute the entire reported data universe, completely undermining the value of the reporting. One solution might be to flag prices reported under SFTs, so that anybody referencing the reported data can remove any SFT data. But if it is necessary to remove SFT related data to depollute the best execution data, this leads back to the question of why report it in the first place?

*Drivers of SFT pricing*

It would seem more meaningful to report SFT 'prices' as rates (yields, spreads, or fees). However, as discussed previously, the pricing of a repo is very much dependent on the term and underlying collateral related to the specific repo. This makes individual SFTs, for the most part, relatively unique, which presents further complications for reporting SFTs in Table 3. One solution could be to aggregate SFTs, say by maturity ranges or underlying security type. But the more one tries to broaden categories of SFTs along these parameters, the less meaningful the price information becomes.

A further consideration is that pricing, to a significant extent, is also (like any other financing) counterparty specific. In other words, even for the same dates and same underlying securities, two counterparties cannot necessarily expect the same pricing. This is because repo is an on-balance sheet product, subject to counterparty risk weightings, as well as other liquidity and capital considerations, such as Leverage Ratio (LR) or Net Stable Funding Ratio (NSFR). Thus RWA and NSFR impacts, which are counterparty specific, will influence the pricing. Similarly, the ability to net repo transactions under LR or NSFR with counterparties (say with an offsetting, opposite trade) will also influence the price (e.g. comparing a trade executed through a central counterparty with the same trade executed bilaterally could result in very different prices).

Another consideration is the application of haircuts. Repo market makers usually have the flexibility to increase haircuts, as well as their prices. Where they can negotiate a higher haircut with their counterparty, economically this could justify transacting at a more competitive rate. Without the visibility of haircuts (as well as the RWA advantage for the market maker resulting from the haircut), it is difficult to compare repo prices as 'like-for-like'.

*Reporting ranges*

It is not clear how the intraday reporting ranges are to be applied to SFTs, and whether they fall under the category of 'money market instruments' or 'financial instruments other than money market instruments'. If the latter, then the ranges are determined by factors such as Size Specific to the Instrument (SSTI) and Large in Scale (LIS), which apply to bonds, but do not apply directly to SFTs. If SFTs fall under 'money market instruments', then the ranges are: (1) €0 to €10M; (2) >€10M to €50M; (3) > €50M. Given that SFTs are treated as money market instruments under MiFIR, then **only trades within the size range of €0 to €10M will need to be reported**. If SFTs are treated as money market instruments, then what should be the appropriate treatment of SFTs with maturities longer than 12 months?

<u>Costs (Article 5)</u>

Execution venues are required to publish for each market segment they operate and each financial instrument (not subject to Article 23 and 28 of MiFIR), information as regards costs applied by the execution venues to any members or users of the venue. Information required includes a description of the nature and level of all components of costs, such as execution fees, fees for order modification, fees related to access to market data, any third party clearing and settlement fees. This is outlined in Table 5.

**Table 5 - costs information to be published in accordance with Article 5**

| Information required under Article 5(a) to (d) | (Description) |
|---|---|
| Total value of all rebates, discounts, or other payments offered (as % of total traded value during the reporting period) | % |
| Total value of all costs (as a % of total traded value during the reporting period volume) | % |
| Link to a website or other source where further information on costs is available | |

***What does Article 5 imply for repo with respect to 'costs'?***

Given that repo market makers, for the most part, provide direct principal pricing to clients, rather than executing orders on a matched-principal or agency basis, for most transactions at least, requirements under Article 5 could be extremely complicated. For instance, how does one break-out costs related to principal liquidity provision, such as market data provision, clearing fees, or settlement costs?

Likelihood of execution (Article 6)

Execution venues are required to publish for each market segment they operate and each financial instrument (not subject to Article 23 and 28 of MiFIR), information related to the likelihood of execution for each trading day. The information required is set out in Table 6, and includes:

- Number of orders or request for quotes (RFQs) received
- Number and value of transactions executed (if more than one)
- Number of orders or RFQs cancelled or withdrawn (excluding passive orders with instructions to expire)
- Number of orders or RFQs that were modified
- Median transaction size on the date (if more than one)
- Median size of all orders or RFQs on the date (if more than one)
- Number of designated market makers

**Table 6 - price information to be published in accordance with Article 6**

| | |
|---|---|
| Number of orders or request for quotes received | |
| Number of transactions executed | |
| Total value of transactions executed | |
| Number of orders or request for quotes received cancelled or withdrawn | |
| Number of orders or request for quotes received modified | |
| Median transaction size | |
| Median size of all orders or requests for quote | |
| Number of designated market makers | |

***What does Article 6 imply for repo with respect to 'likelihood of execution'?***

To the extent that SFTs are in scope of RTS 27, it would seem that market makers for repo are required to publish data related to the 'likelihood of execution' for each individual repo 'instrument' they quote, although some of the data fields may be irrelevant (e.g. number of designated market makers).

Additional information for continuous auction order book and continuous quote driven execution venues (Article 7)

***What does Article 7 imply for repo with respect to 'additional information'?***

Given that most (if not all) repo market makers do not maintain continuous auction order books or continuous quote drive execution venues, the requirements under Article 7 are unlikely to apply.

Additional information for request for quote execution venues (Article 8)

Execution venues operating under a request for quote trading system, or any other type of trading system for which the information is available, are required to publish for each market segment they operate and each financial instrument (not subject to Article 23 and 28 of MiFIR), the following additional information:

- Mean and median amount of time elapsed between the acceptance of a quote and execution for all transactions
- Mean and median amount of time elapsed between an RFQ and provision of any corresponding quotes, for all quotes

This is outlined in Table 9.

**Table 9 – information to be published as referred to in Article 8**

| | |
|---|---|
| Mean time elapsed between acceptance and execution | |
| Median time elapsed between acceptance and execution | |
| Mean time elapsed between request and provision of any corresponding quotes | |
| Median time elapsed between request and provision of any corresponding quotes | |

### *What does Article 8 imply for repo with respect to 'additional information'?*

Given that most repo market makers effectively operate a 'request for quote' trading system, it is likely that they will be required to provide this additional information for each individual repo 'instrument' they quote. However, in the case of SFTs, the time elapsed between requests, quote provision, and or/ execution, is contingent on a number of factors, not least the necessity for counterparties to check their respective counterparty and collateral credit lines. Thus, recording and reporting this data does not provide any useful information from a best execution perspective.

### *Summary of best execution data likely to be required from repo market makers*

To the extent that SFTs are considered in scope of RTS 27, market makers and liquidity providers for repo are likely to be required to provide the following information for each individual repo 'instrument' they quote, for each day:

- All repo 'instruments' for which they are a market maker or liquidity provider.
- For each of these instruments, details on up to 8 daily intraday prices (assume rates, but not clear), including time of execution and bid/offer (or suitable reference rate) at the time of execution, where the trade is outside of the designated 2-minute windows: although only for transactions of up to €10M in size (assuming treatment as money market instruments).
- The daily simple average transaction and volume-weighted prices (rates), as well highest and lowest executed prices (rates).
- Details of any costs related to executing the client order through a platform or other transaction venue (in the few instances that this is relevant).
- The number of orders received, the number of transactions executed, the number of orders cancelled, modified, or withdrawn, and the median size of RFQs and transactions.
- The mean and median amount of time elapsed between the acceptance of a quote and execution.
- The mean and median amount of time elapsed between a request for quote and the provision of any corresponding quote.

### **Periodicity**

Execution venues are required to publish the information quarterly and no later than three months after the end of each quarter, as follows:

- 1 Jan to 31 Mar: by 30 Jun
- 1 Apr to 30 Jun: by 30 Sep
- 1 Jul to 30 Sep: by 31 Dec
- 1 Oct to 31 Dec: by 31 Mar

**Conclusion: a lot of work and expense to produce a lot of meaningless data**

'Repo' and other SFTs are not standardized financial instruments,[9] and SFTs can have varying start and end dates, as well as a vast range of different underlying securities, or baskets of securities. This makes comparing 'like for like', in most instances, challenging. Furthermore, as a balance sheet transaction, with counterparty exposure, repos between different counterparties are likely to be priced very differently to account for the related counterparty specific cost of capital or liquidity costs arising from each specific transaction. Thus it is almost impossible to compare the repo quote for one counterparty with that for a different counterparty, even for the same term and underlying collateral.

To the extent that the data required under RTS 27 is designed to help market participants assess best execution at an instrument level, it is highly questionable as to how this will inform best execution for SFTs. With this in mind, from an implementation perspective, it may be advantageous to minimize the repo transaction types by aggregating as much as possible (across both term and underlying securities/collateral). However, even this is unlikely to add any more value, and may only create unnecessary noise for those assessing execution quality. The most sensible conclusion would therefore seem to be the exclusion of SFTs from the reporting requirements under RTS 27, not least given that SFTs are not specifically mentioned in RTS 27, nor are they in themselves 'financial instruments'.

[9] Under MiFID, they are not even financial instruments

## RTS 28

RTS 28 outlines the requirements designed to increase transparency related to executing client orders on trading venues, including systematic internalisers, market makers or other liquidity providers, intended to improve investor protection. RTS 28 deals with the content and the format of information to be published by investment firms. Investment firms who execute client orders are required to summarise and make public on an annual basis, for each class of financial instrument, the top five execution venues[10] in terms of trading volumes where they executed client orders in the preceding year, as well as information on the quality of the execution obtained.

Investment firms are required to publish this information on their website, in specified templates (including one specifically for SFTs), on an annual basis, in machine-readable form.

### ***Does this apply to repo and SFTs?***

Unlike RTS 27, RTS 28 specifically acknowledges SFTs, recognizing that they are a different transaction type to other securities transactions and outlining separate reporting requirements:

Recital 10 of RTS 28 states: *'In order to comply with the legal obligation of best execution, investment firms, when applying the criteria for best execution for professional clients, will typically not use the same execution venues for securities financing transactions (SFTs) and other transactions. This is because the SFTs are used as a source of funding subject to a commitment that the borrower will return equivalent securities on a future date and the terms of SFTs are typically defined bilaterally between the counterparties ahead of the execution. Therefore, the choice of execution venues for the case of other transactions, given that it depends on the particular terms defined in advance between the counterparties and on whether there is a specific demand on those execution venues for the financial instruments involved. It is therefore appropriate that investment firms summarise and make public the top five execution venues in terms of trading volumes where they executed SFTs in a separate report so that that a qualitative assessment can be made of the order flow to such venues. Due to the specific nature of SFTs, and given that their large size would likely distort the more representative set of client transactions (namely, those not involving SFTs), it is also necessary to exclude them from the tables concerning the top five execution venues on which investment firms execute other client orders.'*

### The reporting requirements of RTS 28 with respect to SFTs

<u>Top 5 execution venues</u>

Article 3(2) outlines the reporting requirements with respect to SFTs. Investment firms are required to publish the top five execution venues in terms of trading volumes for all executed client orders in SFTs by class of financial instrument, including:

- Volume of client orders executed on that execution venue as a % of total executed volume
- Number of client orders executed on that execution venue as a % of total executed orders
- Confirmation of whether it has executed an average of less than one trade per business day in the previous business year (in that class of instrument)

[10] Including trading venues, systematic internalisers, market makers, and other liquidity providers, including such execution venues in third countries

The classes of financial instruments are outlined in the Annex to RTS 28. Most pertinent to SFTs are likely to be:

- Debt instruments
  - (i) Bonds
  - (ii) Money market instruments
- Equities – Shares & Depository Receipts
  - (i) Tick size liquidity bands 5 and 6 (from 2000 trades per day)
  - (ii) Tick size liquidity bands 3 and 4 (from 80 to 1999 trades per day)
  - (iii) Tick size liquidity bands 1 and 2 (from 0 to 79 trades per day)

Table 3 (below) is the reporting template for SFTs under RTS 28:

**Table 3**

| | | |
|---|---|---|
| Class of Instrument | | |
| Notification if <1 average trade per business day in the previous year | **Yes / No** | |
| Top 5 Venues ranked in terms of volume (descending order) | Proportion of volume executed as a percentage of total in that class | Proportion of orders executed as percentage of total in that class |
| Name and Venue Identifier(MIC or LEI) | | |
| Name and Venue identifier(MIC or LEI) | | |
| Name and venue identifier(MIC or LEI) | | |
| Name and venue identifier(MIC or LEI) | | |
| Name and venue identifier(MIC or LEI) | | |

<u>Analysis and conclusions</u>

Under Article 3(3) firms are further required to publish, for each class of financial instrument, a summary of the analysis and conclusions they draw from their detailed monitoring of the quality of execution obtained on the execution venues where they executed all client orders. This information includes considerations such as, and explanation of the relative importance the firm gave to, the execution factors of price, costs, speed, likelihood of execution or any other consideration including qualitative factors when assessing the quality of execution; and an explanation of whether other criteria were given precedence over immediate price and cost when executing retail client orders and how these other criteria were instrumental in delivering the best possible result in terms of total consideration to the client.

### *Practical considerations of applying RTS 28 for SFTs*

The first practical consideration with respect to reporting SFT transactions under RTS 28 is to which investment firms will it apply. Most sell-side firms (namely banks) provide SFT liquidity to their clients and counterparts directly as principal, rather than working client orders. Meanwhile, buy-side firms may need to establish where they are executing SFTs on behalf of clients, rather than transacting for their own account.

Furthermore, most buy-side firms will transact SFTs directly with banks in the OTC market (rather than via trading venues), with the choice of counterparty being determined by a combination of factors, not least of these being the existence of legal agreements as well as mutual credit lines. Given the balance sheet and liquidity constraints on certain SFT activity conducted by banks, buy-side firms' ability to select execution venues is also likely to be restricted. In many instances, 'price' may be the least significant consideration when determining best execution of SFTs. Thus, the qualitative information relating to analysis and conclusions (Article 3(3)) will be particularly pertinent when reporting SFTs under RTS 28.

**Conclusion: how is RTS 28 different to RTS 27 with respect to SFTs?**

RTS 28 explicitly acknowledges that SFTs are very different transactions to outright securities transactions, and creates a separate reporting requirement. Furthermore, within the fairly broad scope of class of (underlying) instrument, the reporting requirement provides for the aggregation of all SFTs executed under client orders for each execution venue used. In this respect, it could be argued that applying RTS 28 to SFTs could serve a useful purpose, albeit extremely limited, with the more qualitative information relating to selection of venue being an essential requirement in terms of supporting any meaningful analysis of the data.

RTS 27, however, does not specifically mention SFTs as a distinct transaction type, and it is difficult to see how these transactions can be meaningfully reported under the reporting specifications and templates of RTS 27; not least given the vast range of different individual SFTs (as determined by dates and underlying collateral), most of which being bespoke and non-comparable.

In summary: with respect to SFTs, any data reported under the requirements of RTS 28 may have some potential, albeit limited, relevance; whilst any data reported under the requirements of RTS 27 will at best be useless, and at worst corruptive.

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