



ICMA EUROPEAN REPO and COLLATERAL COUNCIL

Mr. Tilman Lueder
Head of Securities Markets Unit (DG FISMA)
Rue de Spa 2
1000 Brussels
Belgium

31 January 2017

Dear Tilman,

Urgent request for clarification on MiFID II Best Execution and securities financing transactions

In my capacity as the Chairman of the International Capital Market Association's (ICMA's) European Repo and Collateral Council (ERCC), and following on from our December e-mail exchange, I am writing to you with an urgent request for clarification regarding MiFID II best execution obligations and the extent to which securities financing transactions (SFTs) are in or out of scope of the reporting requirements outlined in RTS 27 and 28 of the regulation.

Having considered this carefully, we have concluded that logically best execution reporting obligations under RTS 27 are not intended to apply to SFTs, yet in the absence of official clarity on this issue there is growing confusion amongst our membership – both with respect to whether SFTs are in scope or not, and, in the event that they in fact are, as to how they are intended to be reported.

The urgency for this clarity is driven by the fact that in the event that SFTs are deemed to be in scope of MiFID II best execution (in particular regarding RTS 27) the market will require: (i) comprehensive technical guidance from the authorities on how SFTs should then be reported in a consistent and meaningful way; and (ii) to make significant, time consuming investment into technological build, in order to comply with such regulatory obligations with respect to SFTs.

It is the firm view of the ICMA ERCC Committee that RTS 27 (which outlines reporting requirements for execution venues executing client orders in MiFID financial instruments) ought not to be intended to apply to SFTs. This is based on several factors:

- (i) RTS 27 does not make any reference to SFTs;
- (ii) SFTs are not financial instruments as defined under MiFID (Annex I, Section C) – although executed through transfers of securities SFTs are secured financings;
- (iii) the reporting templates to support RTS 27 are designed for outright transactions in securities, and not for SFTs;
- (iv) it is unclear as to how SFTs could be reported using the RTS 27 templates, at least in a way that is consistent and meaningful;

- (v) to the extent that SFT data could be forced into the reporting templates, it appears to us that the data would be at best useless, and at worst misleading;
- (vi) to the extent that SFT data were to be mixed with data from outright transactions, all data reported under RTS 27 would be corrupted; and
- (vii) the reporting of SFTs is already covered in detail by the EU SFT Regulation.

However, in the absence of official clarity, many firms (including trading venues and repo market liquidity providers) are uncertain as to whether they are in fact required to report SFT data under RTS 27. Also, in the event that they are, they are very unclear as to how this can be done in a consistent and meaningful way; and applicable resources are already committed to the challenging implementation of SFTR reporting. Furthermore, we also understand that a number of significant national regulatory authorities are yet to express a clear opinion or guidance on this matter.

We therefore request that the European Commission provide urgent clarity on this issue, including an explanation of why our view is wrong and as to why it is that such best execution obligations are to be applied to SFTs. Furthermore, in the event that SFTs are to be reported under RTS 27, we ask for comprehensive, detailed technical guidance on exactly how SFTs are to be reported in the various templates in a way that is consistent across all reporting entities, and that provides data that is meaningful for firms in assessing best execution.

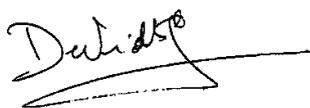
With respect to RTS 28 (which outlines the reporting requirements for investment firms executing client orders on execution venues), the regulation does clarify that SFTs are to be reported, and also provides a separate reporting template for this purpose. However, the ERCC questions the value of this data with respect to clients assessing best execution. As you may appreciate, SFTs are not only difficult to compare on a like-for-like basis, given different durations and varying underlying collateral, but they also involve specific counterparty considerations, as well as capital and liquidity footprints that are affected by the counterparties to the transaction. These are critical considerations, not only in determining the price of the SFT, but also in the choice (to the extent that it is a *choice*) of counterparty. Thus, the data reported under RTS 28 is unlikely to be of much use for clients assessing their best execution.

We would therefore also request that, since it will provide very little value and thus appears to be a disproportionate burden, RTS 28 also should not apply to SFTs.

To assist you in the assessment of these ICMA ERCC requests the practicalities (and impracticalities) of trying to apply RTS 27 and RTS 28 to SFTs are outlined in the accompanying discussion paper and presentation, which we have prepared and hope that you will find helpful.

In closing, on behalf of the ICMA ERCC, I kindly request the opportunity to meet with you, along with an ERCC delegation comprising both buy- and sell-side member firms, at your earliest possible convenience, to discuss these issues in more detail. Particularly given the urgency for clarification on this important matter an early meeting would be much appreciated.

Yours sincerely,



Godfried De Vidts

Chairman

ICMA European Repo and Collateral Council

Copy: **Mr. Olivier Guersent**, Director General, DG Financial Stability, Financial Services and Capital Markets Union, European Commission;

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Mr. Fabrizio Planta, Head of Post-Trading Unit, Markets Department, European Securities and Markets Authority

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Mr. Michel Stubbe, Head of Division, Financial Operations Services Division, DG Market Operations, European Central Bank

Mr. Markus Ferber, Member of the European Parliament

Ms. Kay Swinburne, Member of the European Parliament

Appendix:

ICMA ERCC Background

Since the early 1990's, the [International Capital Market Association](#) (ICMA) has played a significant role in promoting the interests and activities of the international repo market, and of the product itself.

The European Repo Council (ERC) was established by the ICMA in December 1999, to represent the cross-border repo market in Europe and has become the industry representative body that has fashioned consensus solutions to the emerging, practical issues in a rapidly evolving marketplace, consolidating and codifying best market practice.

Consistent with the fact that it is repo desks which can increasingly be equally considered to be collateral desks, it has been the ICMA ERC which has served to guide the ICMA's work on collateral, providing support to its broader efforts and driving many of the ICMA's specific collateral related initiatives. Thus, just as repo and collateral are intimately related in the market, so the ICMA ERC and the ICMA's work on collateral are also intimately related. In recognition of these intimate relationships, with effect from 4 December 2015, the ICMA ERC has been renamed as the ICMA ERCC, the "[European Repo and Collateral Council](#)".

The ICMA ERCC also plays a significant role in nurturing the development of the repo market and supporting its wider use in Europe, particularly among banks, by providing education and market information. The ICMA [bi-annual survey of the European repo market](#) has become established over more than a decade as the only authoritative indicator of market size and structure and the dominant trends.

ICMA is an active force in the standardisation of repo documentation. The [Global Master Repurchase Agreement](#) (GMRA) is the most predominantly used standard master agreement for repo transactions in the cross border repo market.

[Membership of the ERCC](#) is open to ICMA members who transact repo and associated collateral business in Europe. The ICMA ERCC currently has around 100 members, comprising the vast majority of firms actively involved in this market.

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

Discussion paper
January 2017

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.

Price (Article 4)

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 price⁸ and total value of trades executed during the two minutes starting at each of the following reference times: 09.30.00, 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)

| Time (T) | 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) | | | | | | |
|----------|------------|--|----------------------|---|-------------------|------------------|----------------|--------------|------------------|---|
| | | Simple average executed price (excluding commissions and accrued interest) | Total value executed | Price | Time of execution | Transaction 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 reference 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?

Costs (Article 5)

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 venues¹⁰ 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

Top 5 execution venues

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 | Yes / No | |
|--|--|--|
| Notification if <1 average trade per business day in the previous year | | |
| 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) | | |

Analysis and conclusions

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.

MiFID II/R RTS 27 & Securities Financing Transactions

January 2017

RTS 27

Data to be published by execution venues on the quality of execution of transactions

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.

RTS 27 deals with the content, format, and periodicity of data on execution quality to be published by trading venues.

RTS 27 & SFTs: Key points

- Securities financing transactions (SFTs) should be out of scope of the best execution reporting obligations under RTS 27.
- RTS 27 relates to transactions in MiFID instruments; SFTs are not in themselves instruments, rather they are types of transactions.
- SFTs do not fit logically into the reporting templates of RTS 27 which are designed for outright transactions in MiFID instruments.
- Any SFT data reported under RTS 27 is likely to be at best meaningless, and at worst misleading.
- RTS 27 (unlike RTS 28) does not specifically mention SFTs.
- SFT-Regulation is designed to cover the reporting of SFTs.

Likely reporting requirements for SFTs under RTS 27

In case SFTs are considered in scope of RTS 27, trading venues, market makers, and liquidity providers for SFTs are likely to be required to provide the following information for each individual SFT '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 repo rates), 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.
- 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).

* This assumes that the transaction size reporting ranges for money market instruments are applied to SFTs; if the ranges for bonds are applied, then the reporting size is likely to be significantly smaller again (\leq SSTI)

Likely reporting requirements for SFTs under RTS 27 (cont.)

- 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.

Practical considerations: ***Information on financial instrument***

- How do we define SFTs as ‘financial instruments’? **SFTs are not in themselves financial instruments.** They are a financing transaction type, defined by (i) negotiable start and end-dates; (ii) different underlying instruments, or baskets of instruments.
- Other unique features of SFTs could include rights of substitution for the underlying instruments, or imbedded options either to extend the transaction or to terminate early.
- Given the lack of standardization of SFTs, execution venues may quote hundreds, or even thousands, of unique SFTs per day, the vast majority of which being non-comparable.

Practical considerations: *Price*

- SFTs are not quoted in terms of price. Rather they are quoted as rates (yields), spreads, or fees.
- A number of unique considerations can impact SFT rates, which make comparing even similar SFT transactions challenging:
 - The term (dates) of the transaction
 - The underlying collateral (and collateral confidence factor)
 - The ability to substitute collateral
 - Options for either counterparty to extend or terminate early the transaction
 - Timing considerations: such as month-end or year-end (and related balance sheet or liquidity constraints)
- Most SFTs executed with clients are arranged bilaterally, and the pricing is driven by a number of **unique counterparty-specific considerations**, including:
 - The existence of legal agreements (e.g. GMRA, GMSLA)
 - The existence and availability of mutual credit lines
 - Counterparty credit rating
 - Any applicable haircuts
 - The transaction impact on balance sheet (and the ability to net)
 - The capital (RWA) impacts of the counterparty
 - Contingent transactions
 - The overall 'footprint' of the counterparty across the firm's business model

Practical considerations: *Reporting*

- Given the specified transaction size reporting ranges for intra-day reporting, only SFT transactions $\leq \text{€}10\text{M}^*$ would be reported. For most SFTs, particularly for general collateral or more liquid specific underlying instruments, such transaction sizes would be considered 'odd lots', and would in many instances be priced accordingly.
- If SFTs are treated as money market instruments, what should be the reporting treatment of SFTs with maturities longer than 12 months?

* This assumes that the transaction size reporting ranges for money market instruments are applied to SFTs; if the ranges for bonds are applied, then the reporting size is likely to be significantly smaller again ($\leq \text{€}1\text{M}$)

Example 1 (specifics)

- Dec 28: Fund A needs to borrow €50mm of DBR 0.5% 2/26 'spot-next' (Dec 30 – Jan 2) to make good on the delivery of a sale.
- Bank B also needs to borrow €100mm of DBR 0.5% 2/26 for the same dates to cover in-house short sales (as hedges).
- Agency lender C is looking to lend €7mm of DBR 0.5% 2/26 for spot value on 'open' (effectively spot-next on a rolling basis, with both parties having a 24 hour option to close the trade). Agency C lends securities as 'borrow pledges', which is collateral vs collateral, on a fee basis (under a securities lending agreement).
- At 9.30am CET, Brokertec is quoting S/N DBR 0.5% 2/26 as: -6.00%/-7.00% €100mm x €150mm. This repo quote is for clearing through a CCP (LCH). German government general collateral, at the same time, is quoted -4.50%/-5.00% for S/N.
- At 9.31am, Lender C asks Bank B to show a bid for its €7mm of DBR 0.5% 2/26. Bank B is happy to pay 150bp, the equivalent of the bid side of the centrally cleared interbank market, particularly as the trade would be off balance sheet (borrow pledge). However, Lender C 'charges' a 105% hair-cut, so Bank B adjusts the bid to 100bp. At 9.32am Lender C and Bank B agree and execute the trade.

Example 1 (cont.)

- At 9.35am, Fund A sends a Bloomberg message to its 5 key dealers with whom it has repo agreements and credit lines (including Bank B), asking for a repo offer in €50mm of DBR 0.5% 2/26 S/N. 3 of the dealers are unable to show an offer due to year-end balance sheet restrictions, while the 1 dealer who is axed to 'sell' has reached its credit line limit with Fund A. One of the dealers informs Fund A of the current interbank market on Brokertec.
- Bank B is a borrower itself, but, under pressure from its sales management to show Fund A an offer, it adjusts the interbank screen offer of -7.00% for balance sheet and target spread, and shows an offer of -9.00%. Fund A is happy to get an offer and lifts it.
- Seconds later, Bank B lifts the screen offer of -7.00% in €143mm.
- In total, €1.7bn of DBR 0.5% 2/26 S/N trades that day on Brokertec (centrally cleared, interbank), in a range of -4.00% to -8.00%, and at a weighted average of -6.55%.
- On March 31, Fund A downloads historical best execution data from Brokertec and Bank B for DBR 0.5% 2/26. It sees that on Dec 28, the weighted average price on Brokertec was -6.55%. It also sees that Bank B transacted a borrow pledge S/open at 100bp fee. This does not alter the fact that on Dec 28, Fund A transacted its order at the best available rate of -9.00%.

Example 2 (general collateral)

- Dec 28: Bank D needs to fund €100mm of inventory over year-end, which it looks to do via 'selling' triparty 'spot-week' (Dec 30 - Jan 6).
- S/W Euro GC (government bonds) is quoted on TP Repo as -2.00%/-3.00% €250mm x €250mm.
- Bank D calls the 4 money market funds with whom it has triparty agreements, and offers its €100mm at -2.00%. 3 of the funds have no interest in locking-in their cash over year-end, and will only place cash S/N or S/open. 1 fund, who has a very broad collateral profile (including listed equities and investment grade corporate bonds), shows a bid of -0.40%. Bank D agrees and executes the trade.
- Later that day, S/W Bund GC trades in the interbank centrally cleared market at -2.25%.
- On March 31 Bank D sees that on Dec 28, S/W German government GC traded on TP Repo at -2.25% (centrally cleared). This does not alter the fact that on the same day it transacted its €100mm of a unique triparty profile for the same period, with the only counterparty that it could transact with, bilaterally, at what was effectively the best available rate of -0.40%.

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