

Q1. What is MiFID II and MiFIR?

The Markets in Financial Instruments Directive (MiFID) is a European Union law that provides harmonized regulation for investment services across the 31 member states of the European Economic Area. The directive's main objectives are to increase competition and consumer protection in investment services. MiFID became effective in November 2007, and primarily related to equities markets. MiFID II (along with the Markets in Financial Instruments Regulation – MiFIR), replaces MiFID, and broadens its scope to non-equities, including bonds. Among the key aspects of MiFID II/R are provisions covering: transaction reporting, market structure, pre-trade transparency requirements, post-trade reporting, best execution reporting, and conduct of business rules. MiFID II/R entered into force in July 2014. The 'Level 2' regulatory and implementing technical standards were submitted to the European Commission by ESMA in September 2015. Following approval by the Commission, Council, and Parliament, it is expected to be implemented in January 2018.

Q2. What are the pertinent elements of MiFID II/R for repo?

The key aspects of the regulation that impact repo markets are **best execution reporting obligations**, **transacting with retail clients** and, to a limited extent, **transaction reporting**. There are no pre- or post-trade reporting (transparency) obligations with respect to securities financing transactions (SFTs).

Q3. What are the MiFID II/R best execution reporting obligations for repo?

[RTS 28](#) specifies reporting requirements for investment firms executing client orders related to the details and quality of execution for each class of financial instrument on their top five execution venues (including systematic internalisers, market makers, and other liquidity providers) in terms of trading volumes. Data includes the identity of the trading venues, volume and number of transactions (disaggregated by types of order), as well as a summary of analysis and conclusions drawn by the investment firm from their “detailed monitoring of the quality of execution obtained on all client orders”.

Investment firms are required to report information on an annual basis, using [specified templates](#). **Data related to SFT client orders are required to be reported separately** from client order flow in non-SFTs.

While RTS 28 is also intended to apply to certain SFTs, it remains unclear as to whether RTS 27 is also intended to apply to SFTs.

[RTS 27](#) specifies onerous and detailed reporting requirements for trading venues, systematic internalisers (SIs), market makers, and other liquidity providers,¹ to make publicly available, at no charge, data relating to the quality of execution of transactions on that venue (or with that liquidity provider). Details to be made available include price data (intraday and daily), costs related to execution, likelihood of execution, as well as additional information related to the type of venue.

Best execution data are required to be published quarterly, no later than three months at the end of each quarter, using [specified reporting templates](#), and should be made publicly available in machine-readable form.

While there is no specific mention of SFTs in RTS 27, and the reporting templates and requirements are not obviously suited to SFTs, there is nothing in the text that explicitly exempts SFTs. ICMA and others have requested clarification on (i) whether SFTs are intended to be in scope of RTS 27, and (ii), in the event that they are, (ii) detailed guidance on how to report them in a meaningful and consistent way. However, as at April 2017, no clarification has been provided.

Q4. Does MiFID II/R allow the transacting of repos with retail clients?

Article 16(10) of MiFID II specifies that “an investment firm shall not conclude title transfer collateral arrangements for the purpose of securing or covering present or future, actual or contingent or prospective obligations of clients”. This would seem to suggest that transacting repos and other SFTs (which facilitate title transfer) would no longer be permitted with “retail clients”.

MiFID II defines a “retail client” as a client who is not a professional client or an eligible counterparty. While most retail clients are unlikely to engage in repo transactions, counterparties excluded from the definition of professional client or eligible counterparty include **local authorities** and **municipalities**, who may. Such counterparties would accordingly need to elect to change their status to “professional” in order to continue transacting repo and other title transfer arrangements.

Q5. Are there any MiFID II/R transaction reporting requirements for repo?

MiFID II/R makes a distinction between trade reporting and **transaction reporting**. Trade reporting relates to the pre- and post-trade transparency obligations of trading venues (including systematic internalisers) to make public certain trading interests and transaction details. **Transaction reporting** entails more extensive reporting of trade details (including counterparties) by investment firms to the

¹ Other liquidity providers should include 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.

relevant regulatory bodies (the national competent authorities –NCAs). Transaction reports are primarily used by regulatory authorities to detect market abuse and the data is not made available to other market participants. The reporting requirements are set out in [RTS 22](#).

Importantly, **RTS 22, as currently proposed, provides a specific exclusion for transaction reporting for SFTs where these are already in scope of the transaction reporting requirements of EMIR and SFTR:**

“A transaction for the purposes of Article 26 of Regulation (EU) No 600/2014 [MiFIR] shall not include the following:

(a) securities financing transactions as defined in Article 3(11) of Regulation (EU) 2015/2365 [SFTR] of the European Parliament and of the Council;”

However, the notable exception to this exemption is with respect to **SFTs transacted with central banks in the ESCB** (European System of Central Banks), and these **are in scope of the transaction reporting requirements** of MiFID II/R [Article 2(5)].

It should be noted, however, that while the reporting requirements under RTS 22 shall apply from 3 January 2018, Article 17 stipulates that the reporting requirement for SFTs with ESCB counterparties (Article 2(5)), does not apply until “12 months after the date of entry into force of the delegated act adopted by the Commission pursuant to Article 4(9) of Regulation (EU) 2015/2365”. In other words, transaction reporting for SFTs with ESCB counterparties comes into force at the same time as SFTR reporting requirements.

Q6. Are repos (and other SFTs) in scope of MiFID II/R pre- and post-trade transparency obligations?

On June 30 2016, an [agreed amendment](#) to MiFIR was published in the Official Journal of the EU that included an exemption for SFTs under Article 1 relating to pre- and post-trade transparency obligations:

“Regulation (EU) No 600/2014 [MiFIR] is amended as follows: (1) in Article 1, the following paragraph is inserted: 5a. Title II and Title III of this Regulation shall not apply to securities financing transactions as defined in point (11) of Article 3 of Regulation (EU) 2015/2365 of the European Parliament and of the Council [SFTR]”.

In other words, SFTs, including repo, are not subject to pre- or post-trade reporting requirements.

Q7. Are repos (and other SFTs) in scope of MiFID II/R cost and charges disclosure requirements?

Article 24 of MiFID II outlines an obligation for investment firms to provide clients with detailed ex ante and ex post information related to the costs and associated charges of providing investment services, including the execution of client orders. It would also seem that this is intended to apply to situations where investment firms are providing client execution as principal risk-takers (market-makers), which is characteristic of bond and repo markets. Specifically, Article 59(4(m)) of the Level 2 [Delegated Regulation](#) provides an obligation for investment firms to disclose:

*a total sum of the commissions and expenses charged and, where the client so requests, an itemised breakdown including, where relevant, **the amount of any mark-up or mark-down imposed where the transaction was executed by an investment firm when dealing on own account**, and the investment firm owes a duty of best execution to the client*

In these instances, where any costs and charges are implicitly embedded in the dealer's price, this is likely to be extremely challenging, particularly from an ex ante perspective. This could entail estimating the value of the various elements that (implicitly) form a bid-ask spread, which could include: cost of capital, expected return on capital, the volatility of the instrument, financing costs, hedging costs, estimated liquidity of the instrument, as well as idiosyncratic elements such as the trader's market view or risk appetite (depending on instrument of the firm's business model). In the case of repo this can become even more complicated and variable, given that the capital and liquidity impacts of the trade are also counterparty specific.

Nonetheless, investment firms will need to decide how best to comply with the requirement, particularly as there is no detailed guidance provided by ESMA or the various NCAs. However, it is important to stress that there is no standardized or recommended approach to disclosing costs and charges embedded in market-makers' cash bond or repo prices, and it would seem that this is very much something that firms will need to establish for themselves based on their individual business models, while keeping in mind the principles outlined in the regulation.

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Prepared by Andy Hill
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