

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.

[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.

However, in its [Q&A](#) on MiFID II and MiFIR investor protection and intermediaries topics, published in July 2017, ESMA clarifies that **the best execution reporting requirements set out in RTS 27 should not apply to SFTs.**

ESMA also states that irrespective of the clarification concerning the application of RTS 27 to SFTs, **the MiFID II best execution requirements otherwise apply to investment firms when carrying out SFTs.** For example, this would suggest that Article 64(4) of MiFID II, which requires that *when executing orders or taking decision to deal in OTC products including bespoke products, the investment firm shall check the fairness of the price proposed to the client, by gathering market data used in the estimation of the price of such product and, where possible, by comparing with similar or comparable products*, would also apply to SFTs.

The Q&A also clarifies that RTS 28 explicitly requires investment firms to report, inter alia, on order routing behaviours specifically with respect to SFTs and to provide a summary on the quality of execution obtained, and that investment firms should also note that RTS 28 already makes specific reference to how data concerning SFTs should be published.

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.

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.

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 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.

Q8. Are repos (and other SFTs) in scope of MiFID II/R requirements for order record keeping?

Article 16(6) of MiFID II requires that:

“An investment firm shall arrange for records to be kept of all services, activities and transactions undertaken by it which shall be sufficient to enable the competent authority to fulfil its supervisory tasks and to perform the enforcement actions under this Directive, Regulation (EU) No 600/2014, Directive 2014/57/EU and Regulation (EU) No 596/2014, and in particular to ascertain that the investment firm has complied with all obligations including those with respect to clients or potential clients and to the integrity of the market.”

In the updated [Q&A](#) on MiFID II/MiFIR investor protection and intermediaries (November 2017), ESMA clarified that Article 16(6) has a general application and does not provide for exclusions of particular types of transactions and that **SFTs are therefore inside the scope of the MiFID II record keeping requirements.**

This document is provided for information purposes only and should not be relied upon as legal, financial, or other professional advice. While the information contained herein is taken from sources believed to be reliable, ICMA does not represent or warrant that it is accurate or complete and neither ICMA nor its employees shall have any liability arising from or relating to the use of this publication or its contents.

© International Capital Market Association (ICMA), Zurich, 2017. All rights reserved. No part of this publication may be reproduced or transmitted in any form or by any means without permission from ICMA.

Prepared by Andy Hill
Updated November 2017