MiFID II/R implementation: securities financing transactions

Introduction

There are a number of areas where securities financing transactions (SFTs), including repos and securities lending transactions, are explicitly or potentially implicitly in scope of MiFID II/R. ICMA has focused its advocacy efforts where the regulatory requirements are ambiguous, disproportionately burdensome on SFT liquidity providers and users, or simply inappropriate. In particular, ICMA has focused on:

- transaction reporting;
- pre- and post-trade transparency; and
- best execution reporting.

Since September 2016, ICMA has maintained an FAQ on MiFID II/R and SFTs on its website aimed at keeping members informed of the relevant issues and ongoing developments.

Transaction reporting

RTS 22 of MiFID II/R provides a specific exclusion for transaction reporting for SFTs where these are already in scope of the transaction reporting requirements of EMIR and SFTR. However, the notable exception to this exemption is with respect to SFTs transacted with central banks in the European System of Central Banks (ESCB), and these are in scope of the transaction reporting requirements of MiFID II/R. ICMA has advocated that this is unnecessary, and that SFTs with ESCB central banks should also be exempt. ESMA and the European Commission did not agree. However, they did agree that MiFID II/R transaction reporting for these SFTs would not be required until SFTR reporting comes into effect (so avoiding the necessity for firms to build separate reporting functionality).

Pre- and post-trade transparency

MiFID II/R was ambiguous with respect to the pre- and post-trade reporting and SFTs. ICMA advocated that SFTs should not be subject to pre- and post-trade transparency obligations. On 30 June 2016, an agreed amendment to MiFID II/R was published in the Official Journal that included an exemption for SFTs under Article 1 relating to pre- and post-trade transparency obligations.

Best execution reporting requirements

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 a quarterly basis. Reports should include details about the price, costs, speed, and likelihood of execution for each individual financial instrument. There are nine separate - and in many cases highly detailed - reporting templates, which apply to each single instrument, per trading day.

Until July 2017, there had been 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. ICMA has maintained that RTS 27 should not be applied to SFTs, since it would be unnecessarily onerous to comply with the reporting requirements, and the resulting data produced by banks would be meaningless at best, and misleading at worst.
ICMA first wrote to the European Commission outlining its concerns and the need for urgent clarification in October 2016. In January 2017, ICMA published a discussion paper which details the challenges and impracticalities of applying best execution reporting requirements to SFTs. At this time ICMA again reached out to the Commission, along with the FCA, and ESMA.

On 10 July 2017, ESMA published guidance with respect to RTS 27. ESMA clarified that, while best execution requirements apply to investment firms when carrying out SFTs, ESMA considers that the best execution reporting requirements set out in RTS 27 should not apply to SFTs.

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.

Members have questioned the value of RTS 28 with respect to SFTs, and ICMA flags the potential drawbacks in its discussion paper. However, SFTs are explicitly provided for in the RTS, and ESMA has clarified that SFTs are in scope of the reporting obligations.

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**European repo and collateral market developments**

**Liquidity Coverage Ratio (LCR)**

On 24 February 2017, the BCBS issued a second set of frequently asked questions and answers (FAQs) on Basel III’s Liquidity Coverage Ratio (LCR), responding to a number of interpretation questions received by the BCBS in relation to the January 2013 publication of the LCR standard. Compared to the set of NSFR FAQs previously issued, in April 2014, this new set of FAQs includes, among others, new items in relation to:

- secured transactions collateralised by a pool of assets;
- secured funding – scope of application; and preferential run-off rate;
- collateral treatment;
- excess collateral;