



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;

- secured lending transactions - reuse of the collateral to cover a customer's short position; and reuse of the collateral in a repo transaction with collateral substitution right;
- received collateral used to cover short positions;
- ability to return collateral; and
- adjustment of HQLA - relevance of rehypothecated collateral for the unwind mechanism.

Money Market Funds' Regulation

On page 42 of Issue no 44 of ICMA Quarterly Report there is a short report on specific provisions of the new EU MMF Regulation as they relate to repo. As formally published in the *Official Journal*, dated 30 June, the text of the EU MMFR was subsequently finally signed off by the European Parliament and the Council. This has not changed any of the wording associated with the provisions highlighted in Issue no 44, but has led to renumbering of the referenced Articles.

On 24 May, ESMA launched a related consultation, for comment by 7 August. Of greatest significance from a repo perspective, this includes a section regarding technical advice on "the liquidity and credit quality requirements applicable to assets received as part of reverse repurchase agreements". This is the subject of Chapter 3 of the consultation (pages 14-30). This describes different options for both credit and liquidity requirements and identifies ESMA's currently preferred options.

Secured benchmarks/indices

On 15 June, an important market consultation was published by the European Money Markets Institute (EMMI), in relation to their ongoing work on a new transaction-based repo index for euro-denominated debt. The ICMA ERCC has been a strong supporter of this EMMI project since its inception. Two members of the ICMA ERCC Committee were also members of the Joint Task Force that explored the feasibility of the new repo index, actively contributing to that work and regularly reported back to the ICMA ERCC Committee. Many other bilateral contacts were had with EMMI colleagues, who provided regular updates of their work at the meetings of the ICMA ERCC - most recently at its 2017 AGM, held on 20 March, in Zurich.

The ICMA ERCC believes that a successful launch of the new repo index as a market wide tool would open many interesting opportunities for the wider financial community. Appropriate market feedback will be critical to make sure that the new index can meet these expectations. Accordingly, the ICMA ERCC is encouraging all its members to carefully review the proposals and to submit their comments by the, 14 July, deadline.
