

Impact of MIFID II on Possibility to Enter into Repo Transactions with Retail Clients

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Introduction. On January 3, 2018 new EU directive Market in Financial Instruments No 2014/65/EU (MIFID II) entered in force. MIFID II in combination with MIFIR is compared to a hurricane that affects all aspects of investment activities and services. As a result, investment service providers shall make re-designing of the services offered to customers. Investor protection is one of the cornerstones of MIFID II.

Aim, Materials and Methods. The aim of the research was to clarify the possible impact of MIFID II on Repo transactions, e.g. whether Repo transactions could be offered to retail clients. The research is based upon empirical data obtained as a result of practical observations and theoretical analysis of relevant provisions of MIFID II.

Results. There is legal uncertainty in the application of the Article 16 (10) of MIFID II. The Article states 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”. Repo transactions could be classified as transactions that contain title transfer collateral arrangements and belong to securities financial transactions in the meaning of the Regulation (EU) 2015/2365 of the European Parliament and of the Council of 25 November 2015 on transparency of securities financing transactions and of reuse and amending Regulation (EU) No 648/2012 (SFTR).

The results show that similar transactions by economical nature are treated differently in respect to retail clients: Repo transaction prohibited but other types of securities lending transaction are allowed if Article 16 (10) shall literally apply. When interpreting article 16 (10), the following criteria must be observed: the reasons of including article into regulation and treatment of Repo transactions and true sell vs pledged collateral, as well as legal peculiarities of Repo transaction applied to a certain market.

Conclusion. The article maintains the position that the aim of the article 16 (10) was not to prohibit the entering into Repo transactions with retail clients, but to protect the investors from the insolvency risks of investment services provider in case of their default when investment services provider held financial instruments on title transfer basis and in Latvian realities Repo could be concluded with retail clients. In Latvia there is no such practice to hold assets on title transfer basis, but some Latvian banks changed their policies in respect of Repo transactions, the regulator has no opinion of its own and is waiting for the European Securities Markets Authorities (ESMA) comments in that regard, but to avoid potential compliance problems the International Association of Capital Markets suggests retail client electing another MIFID status – professional client and thus obtain less investor protection. The article argues that ICMA suggestion is practically applicable, but does not corresponds to the nature of MIFID and Repo.