

# WIRRAL COUNCIL

## PENSIONS COMMITTEE

18 SEPTEMBER 2017

<b>SUBJECT:</b>	<b>MARKETS IN FINANCIAL INSTRUMENTS DIRECTIVE (MIFID) CONSULTATION</b>
<b>WARD/S AFFECTED:</b>	<b>NONE</b>
<b>REPORT OF:</b>	<b>MANAGING DIRECTOR DELIVERY</b>
<b>KEY DECISION?</b>	<b>NO</b>

### 1.0 EXECUTIVE SUMMARY

- 1.1 A report was brought to this Committee in January 2017, setting out the implications for the Fund of the implementation of the Markets in Financial Instrument Directive 2014/65 (“MiFID II”) and in particular the risk to the administering authority of becoming a retail client on 3<sup>rd</sup> January 2018. This report recommends that the committee agree that elections for professional client status should be made on behalf of the authority immediately.

### 2.0 BACKGROUND AND KEY ISSUES

- 2.1 Under the current UK regime, local authorities are automatically categorised as per se professional clients in respect of non-MiFID scope business and are categorised as ‘per se’ professional clients for MiFID scope business if they satisfy the MiFID Large Undertakings test. Local authorities that do not satisfy the Large Undertakings test may opt up to elective professional client status if they fulfil certain ‘opt up criteria’. The Markets in Financial Instruments Directive (MiFID) is the EU legislation that regulates firms who provide services to clients linked to ‘financial instruments’ (shares, bonds, units in collective investment schemes and derivatives), and the venues where those instruments are traded.
- 2.2 Following the introduction of the Markets in Financial Instrument Directive 2014/65 (“MiFID II”) from 3 January 2018, firms will no longer be able to categorise a local public authority or a municipality that (in either case) does not manage public debt (“local authority”) as a “per se professional client” or elective eligible counterparty (ECP) for both MiFID and non-MiFID scope business. Instead, all local authorities must be classified as “retail clients” unless they are opted-up by firms to an “elective professional client” status.
- 2.3 Furthermore, the FCA has exercised its discretion to adopt gold-plated opt-up criteria for the purposes of the quantitative opt-up criteria, which local authority clients must satisfy in order for firms to reclassify them as an elective professional client.

## **Potential impact**

- 2.4 A move to retail client status would mean that all financial services firms like banks, brokers, advisers and fund managers will have to treat local authorities the same way they do non-professional individuals and small businesses. That includes a raft of protections ensuring that investment products are suitable for the customer's needs, and that all the risks and features have been fully explained. This provides a higher standard of protection for the client but it also involves more work and potential cost for both the firm and the client, for the purpose of proving to the regulator that all such requirements have been met.
- 2.5 Such protections would come at the price of local authorities not being able to access the wide range of assets needed to implement an effective, diversified investment strategy. Retail status would significantly restrict the range of financial institutions and instruments available to authorities. Many institutions currently servicing the LGPS are not authorised to deal with retail clients and may not wish to undergo the required changes to resources and permissions in order to do so.
- 2.6 Even if the institution secures the ability to deal with retail clients the range of instruments it can make available to the client will be limited to those defined under Financial Conduct Authority (FCA) rules as 'non-complex' which would exclude many of the asset classes currently included in LGPS fund portfolios. In many cases managers will no longer be able even to discuss ('promote') certain asset classes and vehicles with the authority as a retail client.

## **Election for professional client status**

- 2.7 MiFID II does allow for retail clients which meet certain conditions to elect to be treated as professional clients (to 'opt up'). There are two tests which must be met by the client when being assessed by the financial institution. the quantitative and the qualitative test.
- 2.8 The Local Government Pension Scheme Advisory Board (SAB) and the Local Government Association (LGA) along with the Department of Communities and Local Government (DCLG) and the Investment Association (IA) have successfully lobbied the FCA to make the test better fitted to the unique situation of local authorities.
- 2.9. The new tests recognise the status of LGPS administering authorities as providing a 'pass' for the quantitative test while the qualitative test can now be performed on the authority as a collective rather than an individual. A summary of and extracts from the FCA policy statement which set out these new tests is attached as APPENDIX 2
- 2.10 The election to professional status must be completed with all financial institutions prior to the change of status on 3rd January 2018. Failure to do so by local authorities would result in the financial institution having to take 'appropriate action' which could include a termination of the relationship at a significant financial risk to the authority.

- 2.11. The SAB and the LGA have worked with industry representative bodies including the IA, the British Venture Capital Association (BVCA) and others to develop a standard opt up process with letter and information templates. This process should enable a consistent approach to assessment and prevent authorities from having to submit a variety of information in different formats...
- 2.12. A flowchart of the process is attached as APPENDIX 3 and the letter and information templates are attached as APPENDICES 4 and 5
- 2.13. Authorities are not required to renew elections on a regular basis but will be required to review the information provided in the opt up process and notify all institutions of any changes in circumstances which could affect their status. Examples would be if the membership of the committee changed significantly resulting in a loss of experience or if the relationship with the authority's investment advisor was terminated.
- 2.14. In order to continue to effectively implement the authority's investment strategy after 3rd January 2018, applications for election to be treated as a professional client should be submitted to all financial institutions with whom the authority has an existing or potential relationship with in relation to the investment of the pension fund.
- 2.15. The officer named in the recommendations should be granted the necessary delegation to make applications on the authority's behalf and to determine the nature of the application on either full or single service basis.

### **3.0 RELEVANT RISKS**

- 3.1. As set out in sections 2.4 – 2.6, if the current proposals are implemented and local authorities are reclassified as retail investors there will be serious consequences for the effective implementation of pension fund strategies going forward

### **4.0 OTHER OPTIONS CONSIDERED**

- 4.1. There are no other options as, once MIFID II takes effect from 3 January 2018, it will be a mandatory requirement.

### **5.0 CONSULTATION**

N/A

### **6.0 OUTSTANDING PREVIOUSLY APPROVED ACTIONS**

- 6.1. There are no outstanding previously approved actions.

### **7.0 IMPLICATIONS FOR VOLUNTARY, COMMUNITY AND FAITH GROUPS**

- 7.1. There are no implications arising directly from this report.

### **8.0 RESOURCE IMPLICATIONS: FINANCIAL; IT; STAFFING; AND ASSETS**

- 8.1 The Fund has a significant number of relationships and considerable time and effort will be involved in corresponding with them and resolving issues that may arise.

## **9.0 LEGAL IMPLICATIONS**

- 9.1 MIFID II is due to take effect on 3 January 2018.

## **10.0 EQUALITIES IMPLICATIONS**

- 10.1 Has the potential impact of your proposal(s) been reviewed with regard to equality?

(b) No because there is no relevance to equality.

## **11.0 CARBON REDUCTION AND ENVIRONMENTAL IMPLICATIONS**

- 11.1 There are no carbon usage implications, nor any other relevant environmental issues arising from this report.

## **12.0 PLANNING AND COMMUNITY SAFETY IMPLICATIONS**

- 12.1 There are no planning or community safety implications arising from this report.

## **13.0 RECOMMENDATION/S**

- 13.1 That Pensions Committee

- i. Notes the potential impact on investment strategy of becoming a retail client with effect from 3rd January 2018
- ii. Agrees to the immediate commencement of applications for elected professional client status with all relevant institutions in order to ensure it can continue to implement an effective investment strategy.
- iii. In electing for professional client status acknowledges and agrees to forgo the protections available to retail clients attached as APPENDIX 1.
- iv. For the avoidance of doubt, agrees to approve delegated responsibility to Director of Pensions for the purposes of completing the applications and determining the basis of the application.

## **14.0 REASON/S FOR RECOMMENDATION/S**

- 14.1 That members are kept informed of the potential implications of MIFID II and the requirement to opt up to professional status.

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## **APPENDICES**

- APPENDIX 1 – Retail client protections
- APPENDIX 2 – Summary of FCA policy statement
- APPENDIX 3 – Opt up process flowchart
- APPENDIX 4 – Opt up letter template
- APPENDIX 5 – Opt up information template

## **BACKGROUND PAPERS/REFERENCE MATERIAL**

MIFID II FCA [www.fca.org.uk](http://www.fca.org.uk)

Local Government Pension Scheme Advisory Board - Response to Markets in

Financial Instruments Directive II Implementation Consultation Paper III

Local Pensions Partnership submission to HM Treasury 15 December 2016

## **BRIEFING NOTES HISTORY**

<b>Briefing Note</b>	<b>Date</b>

## **SUBJECT HISTORY (last 3 years)**

<b>Council Meeting</b>	<b>Date</b>
<b>Pensions Committee</b>	January 2017