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## **MARKETS IN FINANCIAL INSTRUMENTS DIRECTIVE- (MiFID II)**

**Report by Chief Finance Officer**

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### **JOINT PENSION FUND COMMITTEE AND PENSION FUND BOARD**

**14 September 2017**

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#### **1 PURPOSE AND SUMMARY**

- 1.1 This report provides information on the rules for implementation of the Markets in Financial Instruments Directive (MiFID II), which is effective from 3 January 2018.**
- 1.2 Following a review by the European Commission the rules for Markets in Financial Instruments Directive (MiFID) is due to change on 3<sup>rd</sup> January 2018. The change will result in all UK Local Authority pension funds being automatically reclassified from "professional investors" to "retail" clients by default.
- 1.3 The re-classification of "retail" will result in the Fund being unable to invest any financial instrument including the Fund's current investments as set out in Funds Investment Strategy. To allow continued investment in the required classes the Fund requires to apply to "opt-up" to "professional" status.
- 1.4 The Local Government Association is currently developing a reporting template in conjunction with the Investment Association, which the Fund will be able to utilise for the "opt up" process.

#### **2 RECOMMENDATIONS**

- 2.1 It is recommended that the Pension Fund Committee:**
  - (a) Notes the pending reclassification of the Fund to "retail" status under MiFID II**
  - (b) Agrees the Fund will complete the required documentation to "opt up" and:**
  - (c) Agrees to notify the Fund's Investment Managers and the Custodian of the intention to "opt-up"**

### **3 BACKGROUND**

- 3.1 The European Commission has previously instigated a review of MiFID due to the increasing complexity of financial products and issues related to the 2008 financial crisis. The outcome of the review was a revised Directive, MiFID II, which is to take effect from 3 January 2018.
- 3.2 During 2016 and early 2017, the FCA consulted on the implementation proposals for MiFID II. On 3 July 2017, the FCA published a policy statement setting out the final rules on a number of matters.
- 3.3 It is a MiFID II requirement for local authorities (currently treated as professional investors) to be classified as “retail” clients by default. Under such a classification, Fund managers would be unable to deal with the Council acting on behalf of the fund; LGPS Funds would face a reduced investment opportunity set in future and face the potential need to sell assets in advance of MiFID II coming into effect.
- 3.4 The FCA has acknowledged this and, recognising that the LGPS already has its own governing regulations and oversight bodies, has revised its criteria for opting-up with the aim of making it easier for local authorities investing on behalf of a local government pension fund to opt-up to “professional” client status.

### **4 NEXT STEPS**

- 4.1 To ensure the Fund can continue to access a wide range of investment opportunities required to maintain the returns the Pension Fund will require to apply to Opt-up to “professional” status.
- 4.2 The FCA has established a combination of quantitative and qualitative tests. These are shown below

Quantitative test  
Portfolios minimum size requirement of £10m

AND

One of the following tests:

- has carried out transactions, in significant size, on the relevant market at an average frequency of ten per quarter over the previous four quarters.
- Person authorised to carry out transactions on behalf of the client works, or has worked in the financial sector for at least one year in a professional position which requires knowledge of the provision of services envisaged.
- The client is an “administering authority” of the Local Government Pension Scheme within the meaning of the version of Schedule 3 of The Local Government Pension Scheme Regulations 2013 or, (in relation to Scotland) within the meaning of the version Schedule 3 of The Local Government Pension Scheme (Scotland) Regulations 2014 in force at 1 January 2018, and is acting in that capacity.

- 4.3 The qualitative test requires an adequate assessment of the expertise, experience and knowledge of the client that gives reasonable assurance, in light of the nature of the transactions or services envisaged that the client is capable of making his own investment decisions and understanding of the risks involved. However, in acknowledgement to typical LGPS governance arrangements (including the role of the elected committees), the final policy statement states that firms may take a collective view of the expertise, experience and knowledge of committee members, taking into account any assistance from authority officers and external advisers where it contributes to the expertise, experience and knowledge of those making the decisions.
- 4.4 The FCA's final Policy Statement gives greater clarity regarding LGPS funds and the actions to be taken for local authorities to opt up to professional status. Officers are comfortable that the Pension Fund has the requisite knowledge and experience to meet the criteria required to gain professional investor status.
- 4.5 The LGA are developing a reporting template with the Investment Association to simplify the opting-up process for investment managers. Once these documents become available, officers will complete them and apply for professional status. In the meantime the Chief Financial Officer will inform Investment Managers of the funds intention to opt-up to professional status.

## **5 IMPLICATIONS**

### **5.1 Financial**

There are no direct financial implications arising from this report

### **5.2 Risk and Mitigations**

- (a) If the Fund chooses not to, or is unable to, opt-up to professional status the fund would be required to disinvest from all fund managers. The only option for investment under this scenario would be Term deposits or general bank deposits which would not produce the returns or risk profile required to meet the Fund's objectives.
- (b) The custodian Northern Trust has notified all its clients that it is unable under the FCA rules to provide services to "retail" status clients. To ensure the Fund is able to retain the services of Northern Trust requires the Fund to Opt-up to professional status.

### **5.3 Equalities**

It is anticipated that there are no adverse impact due to race, disability, gender, age, sexual orientation or religion/belief arising from the proposals in this report.

### **5.4 Acting Sustainably**

There are no direct economic, social or environmental issues with this report which would affect the Council's sustainability policy.

### **5.5 Carbon Management**

There are no direct carbon emissions impacts as a result of this report.

**5.6 Rural Proofing**

It is anticipated there will be no adverse impact on the rural area from the proposals contained in this report.

**5.7 Changes to Scheme of Administration or Scheme of Delegation**

There are no changes to the Scheme of Administration of Scheme of Delegation are required as a result of this report.

**6 CONSULTATION**

- 6.1 The Monitoring Officer, the Chief Legal Officer, the Chief Officer Audit and Risk, the Service Director HR and the Clerk to the Council have been consulted and their comments have been included in the report.

**Approved by**

**David Robertson**  
**Chief Financial Officer**

**Signature**

**Author(s)**

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**Background Papers:**

**Previous Minute Reference:**

**Note** – You can get this document on tape, in Braille, large print and various computer formats by contacting the address below. The Treasury & Capital Team can also give information on other language translations as well as providing additional copies.

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