
MARKETS IN FINANCIAL INSTRUMENTS DIRECTIVE- (MiFID II)

Report by Chief Financial Officer
SCOTTISH BORDERS COUNCIL

28 September 2017

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 3rd 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 Council being unable to invest any financial instrument including the Council’s current investments as set out in the Treasury Strategy. To allow continued investment in the required classes the Council requires applying 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 Council will be able to utilise for the “opt up” process.

2 RECOMMENDATIONS

- 2.1 It is recommended that the Scottish Borders Council:**
 - (a) Notes the pending reclassification of the Council to “retail” status under MiFID II; and**
 - (b) Agrees the Council will complete the required documentation to “opt up” to “professional” status.**

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 Financial Conduct Authority (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, local authorities investing in regulated products such as such as Certificates of Deposit, Gilts, Corporate Bonds and investment funds, including Money Market Funds would be affected.
- 3.4 Some of the above products would not be available to retail investors, and would thus require to be sold if holders retained retail client status. In relation to investments in Money Market Funds, early indications received by the Council's treasury advisors (Capita Asset Services), following discussions with a range of Money Market Fund providers, suggest that fee levels for retail share classes would be somewhere in the region of 0.70%. These costs are nearly double the returns currently received for funds invested, thus rendering the investment unviable in the current low yield environment, and would thus result in limiting the counterparties available, and subsequent returns achieved. This would have detrimental impact on local authority loans fund rates, and ultimately on revenue budget management.
- 3.4 The FCA does however offer the option to "opt up" to an Elective Professional Client for individual Local Authorities if they meet certain criteria. The tests as to whether Local Authorities meet the required criteria will be carried out by each respective investment firm and it will then be for them to gather sufficient evidence to satisfy that the tests have been met in relation to each client.

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 Council 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 FCA provides clarity in assessing this criteria for Local Authorities for investment firms that they may reasonably assess that a professional treasury manager who has worked in the financial sector for at least one year, if their role provides knowledge of the provision of services envisaged, will meet the purpose of the test. This 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 the risks involved. The FCA also agree that adherence to CIPFA Codes or undertaking other relevant training or qualifications may assist in demonstrating knowledge and expertise as part of this qualitative test.
- 4.4 The FCA’s final Policy Statement gives greater clarity on what actions must be taken for local authorities to be opted-up to professional status, and the officers are comfortable that Scottish Borders Council Officers have the requisite knowledge and experience to meet the criteria required to gain professional investor status.
- 4.5 The LGA is working with CIPFA to formulate some standard documentation for local authorities and investment managers to use when assessing local authorities for opt up to professional status for their Treasury management activities. Once these documents are agreed and become available, the officers will complete and submit, however in the meantime, officers will inform investment managers of the Council’s intentions 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

If the Council chooses not to, or is unable to, opt-up to professional status the Council would be required to notify its current treasury providers. This may result in investment opportunities such as Money Market Funds which currently form part of the Treasury Strategy being unavailable or price prohibitive. The use of these funds is a risk mitigation measure to ensure the safeguarding and security of Council funds. To reduce availability of funds would result in increased risk and its general bank deposits which would not produce the returns or risk profile required to meet the Councils objectives.

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)

Name	Designation and Contact Number
Kirsty Robb	Capital & Investment Manager, 01835 825249

Background Papers:

Previous Minute Reference:

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Contact us at: Treasury & Capital Team, Council Headquarters, Newtown St Boswells, Melrose, TD6 OSA Tel: 01835 825016 Fax 01835 825166. email:

treasuryteam@scotborders.gov.uk