

## Report of the Section 151 Officer

Local Pension Board – 5 September 2017

### MARKETS IN FINANCIAL INSTRUMENTS DIRECTIVE II (MIFID II)

<b>Purpose:</b>	To update the Local Pension Board on MIFID II and its potential impact on the LGPS nationally and locally
<b>Report Author:</b>	Jeff Dong Chief Treasury & Technical Officer
<b>Finance Officer:</b>	Jeff Dong Chief Treasury & Technical Officer
<b>Legal Officer:</b>	Stephanie Williams
<b>Access to Services Officer:</b>	N/A

#### FOR INFORMATION

## 1 Background

1.1 The Markets in Financial Instruments Directive ('MiFID'), part of the European Commission's Financial Services Action Plan, is legislation for the regulation of investment services within the European Economic Area which came into force in November 2007. The Directive replaced the Investment Services Directive. It was designed to:

- Achieve harmonisation throughout the economic area
- Aid transparency
- Protect investors
- Improve efficiency
- Increase competition

1.2 The European Commission instigated a review of the directive due to increasing complexity of financial products and issues related to the 2008 financial crisis. The outcome of the review was a revised Directive, MiFID II. The Financial Conduct Authority ('FCA') is now consulting on its third set of implementation proposals for MiFID II, which are due to take effect from 3 January 2018. The proposed changes to the FCA Handbook will have a significant impact on LGPS administering authorities.

## 2 Potential Impact on the LGPS

- 2.1 The main issue that administering authorities could face is a re-classification from 'per se professional' to 'retail' client status. If no action were taken, administering authorities could see restrictions as retail clients e.g. in terms of the universe of investment funds they may invest in.
- 2.2 The good news is that administering authorities will have the opportunity to "opt-up" to 'elective professional client', i.e. professional client status. The FCA believes that the ability to access financial markets will not be fundamentally affected by broader changes if classified as a professional client. The specific procedure for opting-up will include both qualitative and quantitative assessments, as outlined in the next section.

## 3 Assessment

- 3.1 The proposed assessment required to be undertaken by the fund manager of the client involves :

- 3.2 Qualitative Assessment

The qualitative assessment will require:

*"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 above should not present a major hurdle for the majority of LGPS administering authorities. Indeed, it is expected that those in positions of authority will be suitably qualified and possess the necessary experience to fulfil their roles. Administering authorities will, however, need to have sufficient evidence to demonstrate that the qualitative assessment is satisfied.

- 3.3 Quantitative Assessment

Quantitative test a), below and one of b) or c) must be satisfied:

a) the size of the client's financial instrument portfolio, defined as including cash deposits and financial instruments, exceeds **£15m**

b) the client has carried out transactions, in significant size, on the relevant market at an average frequency of 10 per quarter over the previous four quarters

c) the client works or has worked in the financial sector for at least one year in a professional position, which requires knowledge of the transactions or services envisaged

- 3.4 Given the sizes of funds under management across the local government sector, criteria a) is not likely to present an issue. Criteria b) will present a major issue for the majority of administering authorities, with quarterly transaction activity typically not close to this level. Reliance will need to be placed on the remaining test to ensure an administering authority can consider opting-up to professional client status. It is not entirely clear how changes in team should be reflected in criteria c). For example, it may be possible that the qualitative assessment will need to be re-run each time there is a material personnel change.

#### **4 Financial Conduct Authority Consultation**

- 4.1 The FCA is currently consulting on proposed changes to the FCA handbook in light of the new directive. The full consultation document is available via this link below:

<https://www.fca.org.uk/sites/default/files/cp16-29.pdf>

The LGA has responded to the consultation on behalf of Administering Authorities, Councils and other public sector bodies affected by the changes. The response is attached at Appendix 1.

#### **5 Way Forward**

- 5.1 In light of the responses it has received from the consultation, the FCA has engaged with the LGA and CIPFA with a view to addressing compliance at a national level or mitigating the impact of the criteria outlined in the initial directive. The City & County of Swansea Pension Fund is confident of satisfying the assessment criteria in either instance.

#### **6 Legal Implications**

- 6.1 The legal implications of non-compliance are indicated within the Directive

#### **7 Financial Implications**

- 5.1 There are no financial implications arising from this report

#### **8 Equality and Engagement Implications**

- 6.1 There are no equality and engagement implications arising from this report.

**Background Papers:** None.

**Appendices:** Appendix 1 - LGA response.