

**SURREY COUNTY COUNCIL**

**PENSION FUND COMMITTEE**

**DATE: 2 JUNE 2017**

**LEAD OFFICER: SHEILA LITTLE, DIRECTOR OF FINANCE**

**SUBJECT: MIFID II**



#### **SUMMARY OF ISSUE:**

The second Markets in Financial Instruments Directive (MiFID II) builds on the original MiFID and is the framework of European legislation governing investment firms providing certain investment services to clients and the organised trading of financial instruments. MiFID II takes effect from 3 January 2018 and the proposed changes to the FCA Handbook will have significant implications for LGPS administering authorities.

#### **RECOMMENDATIONS:**

It is recommended that the Pension Fund Committee:

- 1 Note the report.
- 2 Approve officers to undertake the opting up to elective professional status process when the proposed Regulations come into force.

#### **REASON FOR RECOMMENDATIONS:**

The Pension Fund Committee must approve all legislative processes reference the pension fund.

#### **DETAILS:**

##### **Background**

- 1 Under MiFID II, UK local authorities will be re-classified as "retail" clients as opposed to their current classification of "professional per se" clients. If the local authority retains the retail client classification, they will be restricted in the investment managers they can use and the investments they can make as there are fewer investment managers permitted to deal with retail clients and certain investments are not deemed suitable for retail clients.
- 2 There is an option for local authorities to opt up to "elective professional"<sup>1</sup> client status with individual asset managers in order to continue 'complex' investments. This procedure will include both a qualitative and quantitative test to be assessed by the asset manager. It is proposed that the opt up

<sup>1</sup> There is an important distinction between "professional per se" and "elective professional" as the latter receives more regulatory protections.

criteria will be applied separately for local authorities depending on the capacity in which they are acting (i.e. either as treasury managers or as pension fund administrators).

- 3 At the end of October 2016, the FCA published its consultation on their third set of implementation proposals for MiFID II. It received more than 200 responses specifically focused on the opt up criteria, including the Surrey Pension Fund.

### **Opt Up to Elective Professional Status**

- 4 The Financial Conduct Authority's (FCA) policy objective is to provide a clear and straightforward path to opt-up which enables LGPS administering authorities to attain "elective professional" status. This will be achieved via two tests: qualitative and quantitative.

#### **Qualitative Test**

- 5 The qualitative test states that:

Firms must undertake an adequate assessment of the expertise, experience and knowledge of the client to give 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 (COBS 3.5.3R(1))<sup>2</sup>.

- 6 The existing COBS 3.5.4 states that:

If the client is an entity, the qualitative test should be performed in relation to the person authorised to carry out transactions on its behalf.

- 7 The FCA has indicated that they are comfortable with investment firms taking a collective view of the decision making process when undertaking the assessment of an LGPS administering authority. This should enable firms to take into account the relevant committee together with the relevant officers and professional advisors in order to reflect the different decision making processes that currently exist within LGPS administering authorities.

- 8 The qualitative test will reference the key officer individual but will make clear that this can include the legal entity rather than just individual persons, i.e., the collective decision making structure can be taken into account (officers, consultants and the decision making committee).

#### **Quantitative Test**

The quantitative test (based on COBS 3.5.3R(2)) requires that the criteria in paragraph (a) and the criteria in paragraphs (b), (c) or (d) must be satisfied:

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

---

<sup>2</sup> COBS: Conduct of Business Sourcebook

- (b) the client has carried out transactions, in significant size, on the relevant market at an average frequency of ten 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.
- (d) the client is an administering authority of the LGPS<sup>3</sup>.

- 9 It is expected that asset managers will take the opt up questionnaire information at the outset, approve the document if satisfactory, and periodically review the information, probably annually.

### **Implications for Border to Coast Pensions Partnership (BCPP)**

- 10 All BCPP partner Funds will need to satisfy the criteria in order to opt up to “elective professional” status for existing investments from 3 January 2018. BCPP will have to assess each partner Fund to determine whether they meet the criteria for opting up to “elective professional” status.

#### **CONSULTATION:**

- 11 The Chairman of the Pension Fund has been consulted and offered full support for the proposals.

#### **RISK MANAGEMENT AND IMPLICATIONS:**

- 12 The overall objective of MiFID II is to reduce the risk of mis-selling by the investment industry. By classifying local authority clients as “retail” clients by default, thus requiring the elective professional opt up process, asset managers are required to assess the knowledge of the collective decision making group before taking them on as clients.

#### **FINANCIAL AND VALUE FOR MONEY IMPLICATIONS**

- 13 There are no financial and value for money implications.

#### **DIRECTOR OF FINANCE COMMENTARY**

- 14 The Director of Finance is satisfied that all material, financial and business issues and possibility of risks have been considered and addressed and that the proposed MiFID II process offers a clear structure to opting up to elective professional status.

#### **LEGAL IMPLICATIONS – MONITORING OFFICER**

- 15 The opt up to elective professional status is a statutory requirement.

#### **EQUALITIES AND DIVERSITY**

<sup>3</sup> (d) inserted after the publication of the initial consultation draft.

- 16 The opt us process will not require an equality analysis, as the initiative is not a major policy, project or function being created or changed.

#### **OTHER IMPLICATIONS**

- 17 There are no potential implications for council priorities and policy areas.

#### **WHAT HAPPENS NEXT**

- 18 The following next steps are planned:
- Await final draft of Regulations due on 25 May 2017.
  - Officers to complete the opt up to elective professional status documents for submission.

---

**Contact Officer:**

Phil Triggs, Strategic Finance Manager (Pension Fund and Treasury)

**Consulted:**

Pension Fund Committee Chairman

**Annexes:**

None

**Sources/background papers:**

None

---