

REPORT TO: PENSION SUB-COMMITTEE OF THE POLICY & RESOURCES COMMITTEE & PENSION BOARD – 4th SEPTEMBER 2017

REPORT ON: MARKETS IN FINANCIAL INSTRUMENTS DIRECTIVE (MiFID II)

REPORT BY: EXECUTIVE DIRECTOR OF CORPORATE SERVICES

REPORT NO: 289-2017

1 PURPOSE OF REPORT

This report provides information on the rules for implementation of the Markets in Financial Instruments Directive (“MiFID II”), effective from 3 January 2018.

2 RECOMMENDATIONS

The Sub-Committee are asked to note the content of the report and the intention for Tayside Pension Fund officers to apply to “opt-up”, thus electing to be treated as “professional” (rather than “retail”) clients.

3 FINANCIAL IMPLICATIONS

There are no financial implications.

4 BACKGROUND

The European Commission instigated a review of MiFID 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, which is to take effect from 3 January 2018.

During 2016 and early 2017, the FCA consulted on the implementation proposals for MiFID II. On 3 July, the FCA published a policy statement setting out the final rules on a number of matters.

5 SUMMARY

5.1 July Policy Statement

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 LGPS Funds would face a reduced investment opportunity set and the potential need to offload assets in advance of MiFID II coming into effect. However, 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 LGPS pension fund to opt-up to professional client status”.

5.2 Opt-Up Criteria

The opt-up criteria will be a combination of quantitative and qualitative tests as follows:

Quantitative test

To pass the quantitative test, local authorities must meet a portfolio size requirement of £10m, (this amount reflects a lowering of the previous portfolio size threshold of £15m).

AND

One of the following tests:

- 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.
- The 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 of Schedule 3 of The Local Government Pension Scheme (Scotland) Regulations 2014 in force at 1 January 2018, and is acting in that capacity.

Qualitative test

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 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.

4.1 Transitional arrangements & communication

Funds that are invested in asset classes that are deemed as being unsuitable for retail investors will be required to complete the upgrade to professional client status before 3rd January 2018.

Professional clients will also now have a responsibility to keep investment firms informed about any changes that would affect their categorisation; and that if a client no longer fulfils the initial conditions that made it eligible to be opted-up to professional, "appropriate action" must be taken, which may result in drop in categorisation and forced sale of asset.

4 ACTIONS TO BE UNDERTAKEN

The FCA's final Policy Statement gives greater clarity regarding LGPS Funds and what actions must be taken for local authorities to be opted-up to professional status, and the officers are comfortable that Tayside Pension Fund have the requisite knowledge and experience to meet the criteria required to gain professional investor status.

The LGA is developing a reporting template with the Investment Association that should simplify the opting-up process for investment managers. Once these documents become available, the officers of the fund will complete and submit, however in the meantime, officers will inform investment managers of the fund's intentions to opt-up to professional status.

5 POLICY IMPLICATIONS

This report has been screened for any policy implications in respect of Sustainability, Strategic Environmental Assessment, Anti-Poverty, Equality Impact Assessment and Risk Management.

There are no major issues.

6 CONSULTATIONS

The Chief Executive and Head of Democratic and Legal Services have been consulted in the preparation of this report.

7 BACKGROUND PAPERS

Markets in Financial Instruments Directive II Implementation – Policy Statement II (Financial Conduct Authority July 2017)

<https://www.fca.org.uk/publication/policy/ps17-14.pdf>

GREGORY COLGAN
EXECUTIVE DIRECTOR OF CORPORATE SERVICES

29 AUGUST 2017