

**REPORT TO: POLICY & RESOURCES COMMITTEE – 11<sup>th</sup> SEPTEMBER 2017**  
**REPORT ON: MARKETS IN FINANCIAL INSTRUMENTS DIRECTIVE (MiFID II)**  
**REPORT BY: EXECUTIVE DIRECTOR OF CORPORATE SERVICES**  
**REPORT NO: 296-2017**

**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 Committee are asked to note the content of the report and the intention for Dundee City Council officers to apply to “opt-up”, thus electing to be treated as “professional” (rather than “retail”) clients.

**3 FINANCIAL IMPLICATIONS**

None.

**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 Financial Conduct Authority (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, including a finalised position for the client categorisation of Local Authorities, which will come into effect as part of the full introduction of MiFID II on 3rd January 2018.

**5 SUMMARY**

**5.1 July Policy Statement**

Under MiFID II, the FCA is obliged to treat all Local Authorities as “retail clients” under European Union legislation by default (Local Authorities are currently treated as professional investors). 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.

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.

## 5.2 Opt-Up Criteria

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. To be considered as a Professional Client Local Authorities will need to make their election to opt-up in writing and demonstrate that they meet the criteria of an Elective Professional Client.

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

### Qualitative test

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 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.

## 5.3 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 3<sup>rd</sup> 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.

## **6 ACTIONS TO BE UNDERTAKEN**

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 Dundee City Council Officers have the requisite knowledge and experience to meet the criteria required to gain professional investor status.

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.

An officer from Dundee City Council is representing Scottish Local Authorities on this multi-discipline working group to develop appropriate documentation for local authorities across Britain.

## **7 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.

## **8 CONSULTATIONS**

The Council's Management Team have been consulted in the preparation of this report.

## **9 BACKGROUND PAPERS**

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

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**1 SEPTEMBER 2017**

