

PENSIONS COMMITTEE
6 OCTOBER 2017**IMPLEMENTATION OF THE MARKETS IN FINANCIAL
INSTRUMENTS DERIVATIVE (MiFID II)**

Recommendation

- 1. The Chief Financial Officer recommends that he be granted delegated authority in consultation with the Chairman and Vice-Chairman to elect for professional client status for Worcestershire County Council as Administering Authority for the Worcestershire County Council Pension Fund, subject to opt-up applications review.**

Background

2. Under the current UK regulations, local authorities are automatically categorised as 'per se professional' clients in respect of non-MiFID scope business and are categorised as 'per se professional' clients for MiFID scope business if they satisfy the MiFID Large Undertakings test. Local authorities that do not satisfy the Large Undertakings test may 'opt up' to elective professional client status if they fulfil certain 'opt-up criteria'
3. Following the introduction of the Markets in Financial Instrument Directive 2014/65 ("MiFID II") from 3 January 2018, firms will no longer be able to categorise a local public authority or a municipality that (in either case) does not manage public debt ("local authority") as a 'per se professional client' or elective eligible counterparty (ECP) for both MiFID and non-MiFID scope business. Instead, all local authorities must be classified as "retail clients" unless they are opted up by firms to an 'elective professional client' status.
4. Furthermore, the Financial Conduct Authority (FCA) has exercised its discretion to adopt "gold-plated" opt-up criteria for the purposes of the quantitative opt-up criteria, which local authority clients must satisfy in order for firms to reclassify them as an elective professional client.

Retail Client Status

5. Retail client status would mean that all financial services firms such as banks, brokers, advisers and fund managers will have to treat Worcestershire county Council as they do non-professional individuals and small businesses. This would include applying a series of protections to ensure that investment products are suitable for the customer's needs, and that all the risks and features have been fully explained.
6. Such protections would prevent the Council being able to access the wide range of assets needed to implement an effective, diversified investment strategy for the Worcestershire County Council Pension Fund, as retail status would significantly restrict the range of financial institutions and instruments available. Many institutions currently

servicing the LGPS are not authorised to deal with retail clients and may not wish to undergo the required changes to resources and permissions in order to do so.

7. Even if an institution secured the ability to deal with retail clients, the range of instruments it could make available to the client will be limited to those defined under FCA rules as 'non-complex' which would exclude many of the asset classes currently included in Fund's portfolio. In many cases managers will no longer be able to even discuss ('promote') certain asset classes and vehicles with the local authority as a retail client

Election for professional client status

8. MiFID II allows for retail clients which meet certain conditions to elect to be treated as professional clients (to 'opt up'). There are two tests that must be met by the client when being assessed by the financial institution: the quantitative and the qualitative test.

9. The Local Government Pension Scheme Advisory Board (SAB) and the Local Government Association (LGA) along with the Department of Communities and Local Government (DCLG) and the Investment Association (IA) have successfully lobbied the FCA to make the test better fitted to the unique situation of local authorities.

10. The new tests recognise the status of LGPS administering authorities as providing a 'pass' for the quantitative test while the qualitative test can now be performed on the local authority as a collective rather than on an individual in the local authority.

11. The election to professional status must be completed with all financial institutions prior to the change of status on 3 January 2018. Failure to do so by local authorities would result in the financial institution having to take 'appropriate action' which could include a termination of the relationship at a significant financial risk to the Fund.

12. The SAB and the LGA have worked with industry representative bodies including the IA, the British Venture Capital Association (BVCA) and others to develop a standard opt-up process with letter and information templates. This process should enable a consistent approach to assessment and prevent authorities from having to submit a variety of information in different formats.

13. Applications can be made in respect of either all of the services offered by the institution (even if not already being accessed) or a particular service only. A local authority may wish to do the latter where the institution offers a wide range of complex instruments which the authority does not currently use and there is no intention to use the institution again once the current relationship has come to an end, for example, if the next procurement is achieved via the LGPS pool. It is recommended that Fund officers determine the most appropriate basis of the application, either via full or single service.

14. Authorities are not required to renew elections on a regular basis but will be required to review the information provided in the opt-up process and notify all institutions of any changes in circumstances which could affect their status, for example, if the membership of the Committee changed significantly resulting in a loss of experience, or if the relationship with the authority's investment financial advisor was terminated.

LGPS Central

15. LGPS Central will be a professional investor in its own right so will not need to opt up with the external institutions it uses. Worcestershire County Council will however need to opt up with LGPS Central in order to access the full range of services and sub-funds on offer.

16. Elections to professional status will be needed for every financial institution that the authority uses outside of LGPS Central, both existing and new, together with a continuing review of all elections. If all new purchases are made via fund structures within LGPS Central then no new elections will be required, only an ongoing review of the elections made with LGPS Central and any legacy external institutions, the number of which would reduce as assets and cash are transferred into LGPS Central.

Next Steps

17. In order to continue to effectively implement the Fund's investment strategy after 3 January 2018, applications for election to be treated as a professional client should be submitted to all financial institutions with whom the authority has an existing or potential relationship in relation to the investment of the pension fund.

18. This process should commence as soon as possible in order to ensure completion in good time and avoid the need for appropriate action to be taken by institutions in relation to the Fund's investments.

Contact Points

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Background Papers

In the opinion of the proper officer (in this case the Chief Financial Officer) there are no background documents to this report.