

By: Chairman Superannuation Fund Committee  
Corporate Director of Finance

To: Superannuation Fund Committee – 8 September 2017

Subject: **IMPLEMENTATION OF THE MARKETS IN FINANCIAL INSTRUMENTS DERIVATIVE (MiFID II)**

Classification: Unrestricted

Summary: The Committee is asked to note the impact of MiFID II and approve elections for professional client status

## **FOR DECISION**

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### **INTRODUCTION**

1. This report outlines the impact of the implementation of the Markets in Financial Instrument Directive 2014/65 (“MiFID II”) and in particular the risk to KCC of becoming a retail client on 3<sup>rd</sup> January 2018 and recommends that the Committee agree that elections for professional client status should be made on behalf of the Council immediately.

### **BACKGROUND**

2. Under the current UK regime, KCC is automatically categorised as a ‘per se professional’ client in respect of both MiFID and non-MiFID scope business.
3. Following the introduction of MiFID II from 3 January 2018, this will change and KCC must be classified as a “retail client” unless the Council is opted-up by financial services firms to “elective professional client” status.

### **POTENTIAL IMPACT ON KCC**

4. A move to retail client status would mean that all financial services firms like banks, brokers, advisers and fund managers will have to treat KCC the same way they do non-professional individuals and small businesses. While this provides a higher standard of protection it also involves more work and potential costs for both the firm and the Council, for the purpose of proving to the regulator that all such requirements have been met.
5. Retail status would also significantly restrict the range of financial institutions and instruments available to the Council. Many institutions currently servicing KCC 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.

### **ELECTION FOR PROFESSIONAL CLIENT STATUS**

6. 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 which must be

met by the client when being assessed by the financial institution: the qualitative and the quantitative test.

7. Details of the tests are covered in Chapter 8 Client categorisation on pages 64 to 74 of the FCA Markets in Financial Instruments Directive II Implementation – Policy Statement at: <https://www.fca.org.uk/publication/policy/ps17-14.pdf>

## **8. Qualitative test**

- 8.1 A firm is permitted to treat a local authority as an elective professional client if it has assessed that the person authorised to carry out transactions on the local authority's behalf has the expertise, experience and knowledge to give reasonable assurance in light of the nature of the transactions or services envisaged, that they are capable of making their own investment decisions and understanding the risks involved.
- 8.2 The qualitative test can be performed on KCC as a collective rather than an individual. The persons who invest on behalf of the pension fund are elected members of the Superannuation Fund Committee. Firms may take a collective view of the expertise, experience and knowledge of Committee members, taking into account any assistance from officers and external advisers where it contributes to the expertise, experience and knowledge of those making the decisions.
- 8.3 In order for a firm to undertake the assessment required for the purposes of the qualitative test, KCC will be required to complete an 'Elective Professional Client - Status Assessment' and officers will shortly be requesting the necessary information from Committee members.

## **9. Quantitative test**

- 9.1 A firm may treat a local authority as an elective professional client if the size of their investment portfolio (including cash deposits) exceeds £10 million; and at least one of the following is true:
  - (a) the local authority has carried out transactions, in significant size, on the relevant market at an average frequency of ten per quarter over the previous four quarters;
  - (b) the person authorised to carry out transactions on behalf of the local authority works or has worked in the financial sector (including as a treasury manager) for at least one year in a professional position, which requires knowledge of the services envisaged; or
  - (c) the local authority is a Local Government Pension Scheme administering authority and is acting in that capacity.
- 9.2 The test recognises the status of KCC, as an LGPS administering authority, as providing a 'pass' for the quantitative test.

10. KCC must complete the election to professional status with all financial institutions prior to the change of status on 3<sup>rd</sup> January 2018. Failure to do so 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 Council.
11. KCC is 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.

### **ACCESS POOL**

12. The ACCESS Funds are renting the services of an Operator for the Common Investment Vehicle (CIV) and they will be a professional investor in their own right. KCC will need to opt up in order to access the full range of services and sub-funds on offer.
13. Elections to professional status will be needed for every financial institution that KCC continues to use outside of the pool, both existing and new, together with a continuing review of all elections.

### **RECOMMENDATIONS**

14. Members are asked:
  - (a) To note the potential impact on investment strategy of becoming a retail client with effect from 3<sup>rd</sup> January 2018.
  - (b) In electing for professional client status, to acknowledge and agree to forgo the protections available to retail clients.
  - (c) To agree to the immediate commencement of applications for elected professional client status with all relevant institutions in order to ensure KCC can continue to implement an effective investment strategy.
  - (d) To agree to approve delegated responsibility to the Treasury and Investments Manager for the purposes of completing the applications.
  - (e) To agree that the Chairman sign the minutes relating to the above recommendations at the end of today's meeting.

**Alison Mings**  
**Treasury and Investments Manager**  
**Tel 03000 416488**  
**Email: [alison.mings@kent.gov.uk](mailto:alison.mings@kent.gov.uk)**