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**REPORT FOR: CABINET**

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<b>Date of Meeting:</b>	12 October 2017
<b>Subject:</b>	Implementation of the Markets in Financial Instruments Directive (MiFID II)
<b>Key Decision:</b>	No
<b>Responsible Officer:</b>	Dawn Calvert – Director of Finance
<b>Portfolio Holder:</b>	Councillor Adam Swersky, Portfolio Holder for Finance and Commercialisation
<b>Exempt:</b>	No
<b>Decision subject to Call-in:</b>	No as the decision is reserved to full Council
<b>Wards affected:</b>	All
<b>Enclosures:</b>	Appendix 1: Protections available to retail clients Appendix 2: Opt up Process Flowchart

**Section 1 – Summary and Recommendations**

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

## **Recommendations:**

### **That Cabinet**

- i. Notes the potential impact on the treasury investment strategy of becoming a retail client with effect from 3<sup>rd</sup> January 2018.
- ii. Recommends to Council that it agrees to the immediate commencement of applications for elected professional client status with all relevant institutions in order to ensure it can continue to implement an effective investment strategy.
- iii. Recommends to Council that it delegates responsibility to the Director of Finance, following consultation with the Portfolio Holder for Finance and Commercialisation, for the purposes of completing the applications and determining the basis of the application as either full or single service.

### **Reasons**

- (a) To comply with the Markets in Financial Instruments Directive.
- (b) To adhere to the Financial Regulations set out in the Council's Constitution.

## **Section 2 – Report**

### **Context**

1. Under the current UK regime, 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'.
2. Following the introduction of the Markets in Financial Instruments 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. The extra protections applied to "retail clients" are set out in **APPENDIX 1**.
3. 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.

### **Potential impact**

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 local authorities the same way

they do non-professional individuals and small businesses. That includes a raft of protections ensuring that investment products are suitable for the customer's needs, and that all the risks and features have been fully explained. This provides a higher standard of protection for the client, but it also involves more work and potential cost for both the firm and the client, for the purpose of proving to the regulator that all such requirements have been met.

5. Such protections would come at the price of local authorities not being able to access the wide range of assets needed to implement an effective, diversified investment strategy. Retail status would significantly restrict the range of financial institutions and instruments available to authorities. Many institutions currently servicing local authorities 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.
6. Even if the institution secures the ability to deal with retail clients, the range of instruments it can 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 and financial instruments included in the Council's current treasury management strategy. In many cases, managers will no longer be able to even discuss ('promote') certain asset classes and vehicles with the authority as a retail client.

### **Election for professional client status**

7. 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 quantitative and the qualitative test.
8. 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.
9. The qualitative test can now be performed on the authority as a collective rather than an individual. The election to professional status must be completed with all financial institutions prior to the change of status on 3<sup>rd</sup> January 2018. Failure to do so by local authorities could 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 authority.
10. 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.
11. A flowchart of the process is attached as **APPENDIX 2**.
12. 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.

13. 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 advisor was terminated.

### **Options considered**

14. It is open to the Council not to apply to 'opt up'. However, this will adversely affect the Council's ability to access the widest possible range of investments and is therefore not recommended.

### **Next steps**

15. In order to continue to effectively implement the authority's investment strategy after 3<sup>rd</sup> January 2018, applications for election to be treated as a professional client should be submitted to all financial institutions with which the authority has an existing or potential relationship in relation to prescribed "Complex" investments within the treasury management strategy.
16. This process should commence as soon as possible in order to ensure completion in good time and avoids the need for appropriate action to be taken by institutions in relation to the authority's pension fund investments.
17. The officer named in the recommendations should be granted the necessary delegation to make applications on the authority's behalf and to determine the nature of the application on either full or single service basis.
18. The Pension Fund Committee approved the opting up to professional status at its meeting on 18<sup>th</sup> September 2017 and referred the report to Council which endorsed the recommendation on 28<sup>th</sup> September. A separate decision is required for the Council's treasury management activity.

## **IMPLICATIONS OF THE RECOMMENDATIONS**

19. The recommendations do not affect the Council's staffing / workforce and have no equalities or community safety impact.

## **LEGAL IMPLICATIONS**

20. The report has been reviewed by the Legal Department and comments received are incorporated into the report.

## **FINANCIAL IMPLICATIONS**

21. In addition to supporting the Council's revenue and capital programmes, the Treasury Management budget is an important part of the General Fund budget. Any savings achieved, or overspends incurred, have a direct impact on the achievements of the budgetary policy.

## PERFORMANCE ISSUES

22. The Council meets the requirements of the CIPFA Code of Practice for Treasury Management and therefore is able to demonstrate best practices for the Treasury Management function.
23. As part of the Code, the Council must agree a series of prudential indicators and measure its performance against them.

## ENVIRONMENTAL IMPACT

24. There are no direct environmental impacts.

## RISK MANAGEMENT IMPLICATIONS

25. The identification, monitoring and control of risk are central to the achievement of the treasury objectives. Potential risks are included in the Directorate risk register and are identified, mitigated and monitored in accordance with treasury practice notes approved by the Treasury Management Group.

## EQUALITIES IMPLICATIONS

26. There is no direct equalities impact.

## CORPORATE PRIORITIES

27. This report deals with the Treasury Management Strategy which plays a significant part in supporting the delivery of all the Council's corporate priorities.

### Section 3 - Statutory Officer Clearance

Name: Dawn Calvert	<input checked="" type="checkbox"/>	Director of Finance
Date: 27 September 2017		
Name: Caroline Eccles	<input checked="" type="checkbox"/>	on behalf of the Monitoring Officer
Date: 28 September 2017		

<b>Ward Councillors notified:</b>	<b>NO</b>
<b>EqIA carried out:</b>	<b>NO</b>
<b>EqIA cleared by:</b>	<b>N/A</b>

## **Section 6 - Contact Details and Background Papers**

**Contact: Iain Millar** (Treasury and Pensions Manager) Tel: 020-8424-1432 / Email: iain.millar@harrow.gov.uk

**Background Papers:** None

**Call-In Waived by the Chair  
of Overview and Scrutiny  
Committee**

*NOT APPLICABLE – COUNCIL  
DECISION*