

Agenda Item No 7(d)

DERBYSHIRE COUNTY COUNCIL

CABINET

26 October 2017

Report of the Director of Finance & ICT

**IMPLEMENTATION OF THE MARKETS IN FINANCIAL INSTRUMENT
DIRECTIVE (MiFID II)
(COUNCIL SERVICES)**

1 Purpose of the Report

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 the Authority of being classified as a retail client from 3 January 2018 and recommends that the Cabinet agree that elections for professional client status should be made on behalf of the Authority.

2 Information and Analysis

Context

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’.

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.

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

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 series 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.

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 the Authority 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.

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 currently included in the Authority's 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

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.

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.

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 authority.

The LGA have worked with industry representative bodies 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.

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. It is recommended that officers determine the most appropriate basis of the application, either via full or single service.

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.

Next steps

In order to continue to effectively implement the authority'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 Authority.

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 investments.

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.

3 Considerations

In preparing this report the relevance of the following factors has been considered: financial, legal and human rights, human resources, equality and diversity, health, environmental, transport, property, social value and prevention of crime and disorder considerations.

4 Background Papers

Papers held in Technical Section, Finance & ICT, Room 137.

5 Key Decision?

No.

6 Is it necessary to waive the call-in period?

No.

7 Officer's Recommendations

- 7.1 The Cabinet note the potential impact on investment strategy of becoming a retail client with effect from 3 January 2018.
- 7.2 The Cabinet 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.
- 7.3 In electing for professional client status, the Cabinet acknowledges and agrees to forgo the protections available to retail clients.
- 7.4 The Cabinet agrees to approve delegated responsibility to the Director of Finance & ICT for the purposes of completing the applications and determining the basis of the application as either full or single service.

PETER HANDFORD

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