APPENDIX 2

HYMANS ROBERTSON

Sixty second summary

FCA Consultation: MiFID II implementation proposals

David Walker
Head of LGPS Investment

The FCA is currently consulting on implementation proposals for MiFID II which are due to take effect from 3 January 2018.

What is MiFID, and why does it matter?

The Markets in Financial Instruments Directive ('MiFID'), part of the European Commission's Financial Services Action Plan, is legislation for the regulation of investment services within the European Economic Area which came into force in November 2007. The Directive replaced the Investment Services Directive. It was designed to:

- Achieve harmonisation throughout the economic area
- Aid transparency
- Protect investors
- Improve efficiency
- Increase competition

The European Commission instigated a review of the directive 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. The Financial Conduct Authority ('FCA') is now consulting on its third set of implementation proposals for MiFID II, which are due to take effect from 3 January 2018. The proposed changes to the FCA Handbook will have a significant impact on LGPS administering authorities.

Potential impact on LGPS administering authorities

The main issue that administering authorities could face is a re-classification from 'per se professional' to 'retail' client status. If no action were taken, administering authorities could see restrictions as retail clients e.g. in terms of the universe of investment funds they may invest in.

The good news is that administering authorities will have the opportunity to "opt-up" to 'elective professional client', i.e. professional client status. The FCA believes that the ability to access financial markets will not be fundamentally affected by broader changes if classified as a professional client. The specific procedure for opting-up will include both qualitative and quantitative assessments, as outlined in the next section.

October 2016

Qualitative assessment

The qualitative assessment will require:

"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"

We do not believe the above will present a major hurdle for the majority of LGPS administering authorities. Indeed, we expect that those in positions of authority will be suitably qualified and possess the necessary experience to fulfil their roles. Administering authorities will, however, need to have sufficient evidence to demonstrate that the qualitative assessment is satisfied.

Quantitative tests

Quantitative test a), below and one of b) or c) must be satisfied:

a) the size of the client's financial instrument portfolio, defined as including cash deposits and financial instruments, exceeds **£15m**

b) the client has carried out transactions, in significant size, on the relevant market at an average frequency of 10 per quarter over the previous four quarters

c) the client works or has worked in the financial sector for at least one year in a professional position, which requires knowledge of the transactions or services envisaged

Given the sizes of funds under management across the local government sector, criteria a) is not likely to present an issue. Criteria b) will present a major issue for the majority of administering authorities, with quarterly transaction activity typically not close to this level. Reliance will need to be placed on the remaining test to ensure an administering authority can consider opting-up to professional client status.

It is not entirely clear how changes in team should be reflected in criteria c). For example, it may be possible that the qualitative assessment will need to be re-run each time there is a material personnel change.

Potential actions to take away

The FCA is currently consulting on proposed changes to the FCA handbook. The full consultation document, including details on how to respond to the consultation (by 4 January 2017) are available via the link below:

https://www.fca.org.uk/sites/default/files/cp16-29.pdf

Relationships between administering authorities, pools, asset managers and other providers should be identified so that the impact of the proposed changes can be considered in more detail.

Administering authorities should also start to engage with asset managers, and, if applicable, the pool they participate in. For example, will asset managers continue to work with an administering authority if classified as a retail client and, if so, what products will be available? Will there be set timescales for moving out of non-retail funds?

Administering authorities should also start the process of considering what evidence may be provided in order to demonstrate that the tests discussed above are satisfied, and who will be judged against the qualitative tests. We will seek to keep you updated on developments as this matter progresses.

London | Birmingham | Glasgow | Edinburgh

T 020 7082 6000 | www.hymans.co.uk | www.clubvita.co.uk