



**Pension Fund Sub-Committee**  
17 November 2015

**Report from the Chief Finance Officer**

For Information

Wards Affected:  
ALL

**The Impact of Markets in Financial Instrument Directive II (MiFID II)  
on Local Government Pension Schemes**

**1. RECOMMENDATIONS**

- 1.1 Members are asked to note the impact of MiFID II on the LGPS especially in relation to:
- a. The cost of fund management and advice
  - b. The impact on the asset classes that the LGPS will be able to access
- 1.2 Members are also asked to note the need for administering authorities to obtain information and advice from fund managers and fund consultants ahead of implementation in January 2017 on the specific implications of the above for their funds

**2. BACKGROUND TO MiFID II**

- 2.1 The Markets in Financial Instruments Directive (MiFID) is the European Union (EU) legislation that governs investment intermediaries (e.g. fund managers, banks, advisors etc.), providing services to clients in relation to shares, bonds, units in collective investment schemes and derivatives (collectively 'financial instruments') and the organised trading of financial instruments (e.g. stock markets)
- 2.2 EU directives are binding on all member states including the UK.
- 2.3 MiFID has been applied in the UK from November 2007. But it is now being comprehensively revised to improve the functioning of financial markets in light of the financial crisis and to strengthen investor protection. The changes known as MiFID II are expected to take effect in January 2017.

**3. WHAT ARE THE CHANGES**

- 3.1 The legislative document published in the Official Journal of the European Union (OJEU) stated that the financial crisis showed the limitation on non-retail clients to appreciate the risks associated with their investments.

- 3.2 In order to protect such clients MiFID II requires Public Local Authorities be removed from the client category of eligible counterparties and professionals and to be treated in the first instance as retail clients unless they opt to be treated as professional clients.
- 3.3 A series of qualitative and quantitative tests, based on client knowledge and expertise and the size of the portfolio, will be conducted to determine whether the opt up can be granted.
- 3.4 The tests are seeking to establish whether the LGPS (the client) is capable of making its own investment decisions and understands the risks involved.

#### **4. IMPACT OF RE-CATEGORISATION**

- 4.1 Prior to MiFID II there was a distinction between the day to day treasury management function of a Local Authority and the pension fund activities as an institutional investor. This meant that while for treasury purposes the LA was seen as a retail client the LGPS was treated as a professional client.
- 4.2 Retail clients are entitled to greater protection under the regulations. As a result fund managers and advisors would need to increase reporting and advice to ensure that the client understands the investment products resulting in higher fees.
- 4.3 It is not clear at present which asset classes will be affected but early indications are that many alternative investments such as infrastructure, property pooled funds and private equity funds will not be allowed under the new categorisation. It is expected that life funds, such as those which LGPS funds invest in to access passive equity pooled funds, will not be affected.
- 4.4 Some fund managers do not accept retail clients on their books.
- 4.5 There is uncertainty whether MiFID II will apply only to new business after the implementation in January 2017 or whether existing holdings will be affected. Will pension funds need to sell off asset classes to comply with being a retail client.

#### **5 NEXT STEPS**

- 5.1 The FCA has encouraged organisations to plan ahead for the changes that come into effect in January 2017. It is more or less a done deal.
- 5.2 The FCA is expected to confirm the opt up criteria in December
- 5.3 It is recommended that Local government pension schemes start seeking information and clarification from their fund managers and advisors regarding the impact of MiFID II on their existing investment holdings.

**6. FINANCIAL IMPLICATIONS**

6.1 These are included within the report.

**7. DIVERSITY IMPLICATIONS**

7.1 None.

**8. STAFFING IMPLICATIONS**

8.1 None.

**9. LEGAL IMPLICATIONS**

9.1 None.

**10. BACKGROUND INFORMATION**

10.1 The Official Journal of the European Union – 12 June 2014 (para. 104)  
Financial Conduct Authority – MiFID II

**11. CONTACT OFFICERS**

11.1 Persons wishing to discuss the above should contact the Investment and Pensions Section, Governance and Corporate Services, on 020 8937 1472 at Brent Civic Centre.

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