Leicestershire County Council

CABINET 10 OCTOBER 2017

IMPLEMENTATION OF THE MARKETS IN FINANCIAL INSTRUMENTS DIRECTIVE (MiFID II)

REPORT OF THE DIRECTOR OF CORPORATE RESOURCES

PART A

Purpose of the Report

1. The purpose of this report is to recommend action that will ensure that the County Council can continue to access a full range of relevant investment opportunities following implementation of the Markets in Financial Instrument Directive 2014/65 (MiFID II).

Recommendations

2. It is recommended that the Cabinet:

   (a) Notes the potentially detrimental impact onto the County Council's treasury management and other investment activities if it becomes classed as a 'retail client' in accordance with Markets in Financial Instrument Directive 2014/65 with effect from 3rd January 2018;

   (b) Authorises the Director of Finance to commence the relevant applications for the County Council to seek to opt-up to elected professional client status with all relevant institutions in order to enable it to continue to implement an effective treasury management strategy and other investment activities;

   (c) Notes that if it is successful in its applications to obtain elected professional client status, the County Council will forgo those protections available to retail clients as listed in the appendix attached to this report.

Reasons for Recommendation

3. Unless the County Council seeks to 'opt-up' to elected professional client status there will be a detrimental impact on the investments it can access either as part of its treasury management function, or as part of any other investment activity. Retail investors (which, under the new Directive, the County Council will become classified as without the opt-up) will not be able to

access some of the investment options that are currently available, and there is a possibility that some of the existing investments (most notably the pooled property funds currently held) may be forcibly sold if the County Council is reclassified as a retail investor.

Timetable for Decisions

4. MiFID II becomes effective on 3rd January 2018 and, in order to ensure that there is no possibility of a detrimental impact on the County Council, the opt-up process will need to be completed before this date.

Policy Framework and Previous Decisions

5. Treasury management is an integral part of the County Council's finances. The Treasury Management Policy Strategy for 2017/18 was agreed by the full Council in February 2017 as part of its Medium Term Financial Strategy 2017/18 – 2020/21(MTFS). If the Authority does not secure elected professional client status, some of the investments permitted under this Strategy will not be available.

6. Within the County Council's MTFS is provision for investment in three pooled property funds. It is recommended that the Authority seeks to attain the elected professional client status to avoid the possibility of it being forced to sell these holdings.

Resource Implications

7. There are no additional resource implications arising from this report. However, failure to opt-up to professional investor status is likely to have a detrimental effect on the ability of the County Council to maximise the performance of its treasury management portfolio and to invest in other opportunities which are considered appropriate.

Circulation under the Local Issues Alert Procedure

8. None

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PART B

Background

9. MiFID II introduces fundamental changes to how local authorities are classified for investment purposes. Under the current UK regime, local authorities are automatically categorised as 'per se professional' clients in respect of non-MiFID scope business (such as the placing of cash deposits) and are categorised as 'per se professional' clients for MiFID scope business (anything that could be considered as a more complex investment) if they satisfy the MiFID Large Undertakings test. The County Council satisfies the Large Undertakings test and so, currently, it can invest in the full range of such business without restriction.

10. Following the introduction of MiFID II, as from 3rd January 2018 all local authorities must be classified as 'retail clients' by their asset managers for MiFID scope business and this could impose significant limitations on the investments the Council can make and severely restrict its ability to continue to make some of the investments currently permitted under its existing 'per se professional' client status. This is unless the Authority is accepted as an 'elected professional client' by the relevant counterparties and investment managers, as detailed below.

11. The purpose of MiFID II is to protect unsophisticated investors from investing in assets where they do not properly understand the potential risks.

The potential effect of MiFID II on the County Council and the option to 'opt-up'

12. Reclassification as a retail investor would make it very difficult for the County Council to implement an effective, diversified treasury management strategy as Money Market Funds (which are routinely used) could potentially be classed as unsuitable for retail investors. In addition, certificates of deposit, which are allowable under the Council's Treasury Management Policy although not used to any great extent, will only be available to professional investors.

13. The County Council can request to be re-categorised, i.e. 'opted-up' to professional client status. To do this it must meet certain criteria and the decision rests with investment firms.

14. The County Council currently invests in three pooled property funds, and it will be at the discretion of the investment managers as to whether the Authority needs to be opted-up to allow it to continue to invest in these funds. If the opt-up is not sought by the County Council and agreed by the investment managers, and they take the view that their fund is not suitable for retail investors, they will ultimately have the ability to redeem the units held by the County Council. Becoming a forced seller is never a good position to be in.

15. There is a possibility that the County Council will want to make future investments that are not available to retail investors. Even if the need to opt-up was not required at present it would be sensible to ‘future-proof’ the ability for the Council to access any future investment opportunities it deems to be suitable.

16. Retail investors benefit from certain protections that are not available to professional investors, and these are protections that the County Council does not currently have as a ‘per se professional’ investor under MiFID. It is considered that these protections (which are listed in the Appendix to this report) are insignificant in comparison to the potential risk to the Authority of not seeking to opt-up, which will deny access to many investment opportunities and potentially force the sale of some existing investments.

17. The opt-up process is relatively straightforward and standard templates and letters have been agreed that are relevant to local authorities. Crucially, part of the documentation requires evidence that the relevant ‘committee’ has agreed that the opt-up is appropriate. For County Council investments this is the Cabinet.

18. Whilst MiFID II is relevant to the County Council it is far more significant an issue for the Leicestershire Pension Fund, given the range of investments it holds. The Local Pension Committee approved the opt-up for the Pension Fund at its meeting on 1 September 2017.

Conclusion

19. Given the restrictions faced by the County Council when MiFID II comes into force, it is sensible for the Authority to seek to be re-categorised and ‘opt-up’ to professional client status to ensure it can maintain sufficient options to manage its investments in an optimal manner. For the avoidance of doubt, opt-up to professional status would not be required if the only investment activity undertaken was the placing of cash deposits.

Appendix

Appendix - Warnings – loss of protections for the Local Authority if categorised as a Professional Client

Background Papers

Report to the Local Pension Committee – 1 September 2017 – Implementation of the Markets in Financial Instruments Directive (MiFID II)
http://politics.leics.gov.uk/ieListDocuments.aspx?CId=740&MId=4905&Ver=4

Equality and Human Rights Implications

20. There are no equality and human rights implications directly arising from this report.