

	<h2>Pension Fund Committee</h2> <h3>6 September 2017</h3>
<p style="text-align: right;">Title</p>	<p>Barnet Council Pension Fund – Implementation of the Markets in Financial Instruments Derivative (MiFID II)</p>
<p style="text-align: right;">Report of</p>	<p>Director of Resources</p>
<p style="text-align: right;">Wards</p>	<p>n/a</p>
<p style="text-align: right;">Status</p>	<p>Public</p>
<p style="text-align: right;">Key</p>	<p>No</p>
<p style="text-align: right;">Enclosures</p>	<p>Appendix A – Retail client protections Appendix B – Summary of FCA policy statement Appendix C – Opt up process flowchart Appendix D – Opt up letter template Appendix E – Opt up information template</p>
<p style="text-align: right;">Officer Contact Details</p>	<p>George Bruce, Head of Treasury, CSG george.bruce@barnet.gov.uk - 0208 359 7126</p>

<h2>Summary</h2>
<p>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 Pension Fund of becoming a retail client on 3rd January 2018 and recommends that the committee agree that elections for professional client status should be made on behalf of the authority immediately.</p>

<h2>Recommendations</h2>
<ol style="list-style-type: none"> 1. That the Pension Fund Committee note the potential impact on investment strategy of becoming a retail client with effect from 3rd January 2018. 2. That the Pension Fund Committee agrees to the 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. 3. That subject top resolution two above the Pension Fund Committee acknowledges and agrees to forgo the protections available to retail clients attached as appendix 1. 4. That the Pension Fund Committee agree to approve delegated responsibility to the Chief Financial Officer for the purposes of completing the applications and determining the basis of the application as either full or single service.

1. WHY THIS REPORT IS NEEDED

- 1.1 Acting in its capacity as administering authority to the Barnet Pension Fund, it is the responsibility of London Borough of Barnet Council to ensure that the pension fund complies with legislation and effectively manages the Fund's financial affairs. The regulatory status of the Fund will determine the range of available investment opportunities and investment costs.
- 1.2 Under the current UK regime, local authorities are automatically categorised as 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'.
- 1.3 Following the introduction of the Markets in Financial Instrument Directive 2014/65 ("MiFID II") from 3rd January 2018, firms will no longer be able to categorise a local public 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.
- 1.4 Furthermore, the 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

- 1.5 A move to retail client status would mean that all financial services firms such as 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.
- 1.6 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 LGPS 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.
- 1.7 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 Financial Conduct Authority (FCA) rules as 'non-complex' which would exclude many of the asset classes currently included in LGPS fund portfolios.

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

- 1.8 MiFIDII does allow 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.
- 1.9 The Local Government Pension Scheme Advisory Board (SAB) and the Local Government Association (LGA) along with the Department for 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.
- 1.10 The new tests recognise the status of LGPS administering authorities as providing a 'pass' for the quantitative test while the qualitative test can now be performed on the authority as a collective rather than at an individual (person) level. A summary of and extracts from the FCA policy statement which set out these new tests is attached as appendix 2.
- 1.11 The election to professional status must be completed with all financial institutions prior to the change of status on 3rd 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.
- 1.12 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.
- 1.13 A flowchart of the process is attached as appendix 3 and the letter and information templates are attached as appendices 4 and 5.
- 1.14 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, for example, if the next procurement is achieved via the LGPS pool. It is recommended that officers determine the most appropriate basis of the application, either via full or single service.
- 1.15 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.

- 1.16 LGPS Pools, such as the London CIV, will be professional investors in their own right so will not need to opt up with the external institutions they use. LB Barnet will however need to opt up with the London CIV in order to access the full range of services and sub-funds on offer.
- 1.17 Discussions have commenced with all fund managers to identify the consequences of not opting up to professional status. It is thought unlikely that a fund manager would determine that the Pension Fund was unsuitable for a professional classification.
- 1.18 The Committee will wish to consider its capability (as the decision maker) to be treated as a 'professional' investor. The benefits of doing so; the increased access to advice and investment opportunities, together with lower investment costs have been outlined above. The process of opting up requires the Committee to provide evidence to each investment manager that it is capable of understanding the risks inherent in the investments being acquired. The evidence to be provided will be based on the (1) the Committee's experience of investing in and monitoring similar products, (2) the process by which investment decisions are reached, including training provided, and consideration of advice from advisors and officer, and (3) the experience and capability of advisors and officers to support the Committee. When documented, this evidence is expected to provide comfort to both external parties and the Committee that decisions are soundly based and risks understood before decisions are reached. The Committee has always operated on the basis that if members are unsure of an investment recommendation that the decision is deferred until additional evidence or training is provided. This approach will not change. The onus on ensuring that risks are explained will remain with advisors and officers rather than investment managers.
- 1.19 Election to professional status will be considered for every financial institution that the authority uses outside of the pool, both existing and new, together with a continuing review of all elections. If all new purchases are made via fund structures within the pool then no new elections will be required, only an ongoing review of the elections made with the pool and any legacy external institutions the number of which would reduce as assets are liquidated and cash transferred.

Next Steps

- 1.20 In order to continue to effectively implement the authority's investment strategy after 3rd 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 with in relation to the investments of the pension fund.

- 1.21 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.
- 1.22 The Chief Financial Officer 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,

2. REASONS FOR RECOMMENDATIONS

- 2.1 Opting up to professional status is required to continue to access investment options that are only available to institutional investors.

3. ALTERNATIVE OPTIONS CONSIDERED AND NOT RECOMMENDED

- 3.1 The report discusses the impact of retaining retail status. Although this offers greater levels of protection, there will be significant restrictions on the investment of scheme monies. Discussions are ongoing with all the scheme's investment managers to ascertain the impact of being classified as a retail investor. Feedback received so far is that investment managers will not be able to continue to offer the current mandates and terms.

4. POST DECISION IMPLEMENTATION

- 4.1 The Director of Resources will carry out any actions considered necessary.

5. IMPLICATIONS OF DECISION

5.1 Corporate Priorities and Performance

- 5.1.1 To ensure that the Pension Fund is being invested prudently and to the best advantage in order to achieve the required funding level. Effective monitoring of the Pension Fund by the Pension Fund Committee will ensure that long term investment targeted returns are achieved and will provide support towards the Council's corporate priorities (2015-2020).

5.2 Resources (Finance and Value for Money, Procurement, Staffing, IT, Property, Sustainability)

- 5.2.1 There are no direct Resources issues for the council as a result of MiFIDII. However, there would be additional costs for the Pension Fund that will eventually impact on employer contributions of a change to retail investor status.

5.3 Social Value

- 5.3.1 The Public Services (Social Value) Act came into force on 31st January 2013. It requires people who commission public services to think about how they can also secure wider social, economic and environmental benefits.

5.3.2 Before they start the procurement process, commissioners should think about whether the services they are going to buy, or the way they are going to buy them, could secure these benefits for their area or stakeholders.

5.3.3 The Act is a tool to help commissioners get more value for money out of procurement. It also encourages commissioners to talk to their local provider market or community to design better services, often finding new and innovative solutions to difficult problems.

5.3.4 There are no specific social value issues arising out of this report, however membership of the Pension Fund ensures the long term financial health of contributing employees on retirement.

5.4 Legal and Constitutional References

5.4.1 The LGPS Regulations 2013 place responsibility for the local administration of pensions and other benefits under these Regulations on the administering authority, which is LB Barnet.

5.4.2 Constitution - Under Part 15, Annex A - Responsibility for Functions, one of the terms of reference of the Pension Fund Committee is “appoint Pension Fund Investment Managers” and another function is “to determine the appropriate course of action on any matter not specifically listed above that pertains to the leadership and/or strategic management of the Pension Fund, in particular any matter which could materially affect its financial performance or long-term standing.”

5.4.3 The investor status of the administering authority / pension fund falls within the remit of the Pension Committee.

5.5 Risk Management

5.5.1 Risk management is central to the LGPS. LGPS pension funds are in themselves risk management tools, managing the risk that future employer income streams will be able to meet future pensions liabilities by creating a reserve from which future liabilities will be met.

5.5.2 Professional Clients are entitled to fewer protections under the UK and EU regulatory regimes than is otherwise the case for Retail Clients as they are assumed to be less capable of making complex investment decisions. The Pension Committee is supported by external advisors and by officers when considering investment issues. Training is provided in advance of key decisions. The structure in place to support the Committee places the onus on advisors and officers to ensure that the Committee is fully briefed before entering into financial transactions. There is no requirement to pass the onus on ensuring appropriateness of decisions to investment managers.

5.5.3 The CIPFA publication *Managing Risk in the Local Government Pension Scheme* (2012) provides more detail on the nature, identification and

management of risk in the LGPS.

5.6 Equalities and Diversity

5.6.1 Pursuant to the Equalities Act 2010, the Council is under an obligation to have due regard to eliminating unlawful discrimination, harassment, victimisation and any other conduct that is prohibited by or under the Act; advancing equality of opportunity between persons who share a relevant 'protected characteristic' and those who do not share it; and fostering good relations between persons who share a relevant 'protected characteristic' and persons who do not share it. The 'protected characteristics' are: age, disability, gender reassignment, pregnancy, and maternity, race, religion or belief, sex and sexual orientation.

5.6.2 The rules governing admission to and participation in the Pension Fund are in keeping with the public sector equality duty. The Public Sector Equality Duty requires public authorities in carrying out their functions, to have due regard to the need to achieve the objectives set out under s149 of the Equality Act 2010. Good governance arrangements and monitoring of the Pension Fund's managers will benefit everyone who contributes to the fund.

5.7 Consultation and Engagement

5.7.1 The Scheme's investment managers, the London CIV and Hymans Robertson in their role as investment consultant are being consulted on the impact of MiFID II. Those who have provided feedback to date have requested that the Scheme opt ups to professional status and that they could not offer the same opportunities at current fee levels should the scheme retain retail status.

5.8 Insight

5.8.1 Not applicable

6. BACKGROUND PAPERS

6.1 None