

## CLWYD PENSION FUND COMMITTEE

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| <b>Date of Meeting</b> | Thursday 16 February 2017                     |
| <b>Report Subject</b>  | Markets in Financial Instruments Directive II |
| <b>Report Author</b>   | Clwyd Pension Fund Manager                    |

### EXECUTIVE SUMMARY

The Financial Conduct Authority (FCA) defines Markets in Financial Instruments Directive (MiFID ) as the EU legislation that regulates firms who provide services to clients linked to “financial instruments” (shares, bonds, units in collective investment schemes and derivatives), and the venues where those instruments are traded.

MiFID was applied in the UK from November 2007, and is now being revised with the aim of improving the functioning of financial markets in light of the financial crisis and to strengthen investor protection. The changes are due to take effect from 3 January 2018, with the new legislation being known as MiFID II.

The main impact is LGPS funds will be categorised as retail investors instead of professional investors. The potential implications of this are discussed in the report and a presentation will be given to the Committee by the Fund’s Investment Consultant, JLT.

The LGPS pools are forming a small group of practitioners to discuss MiFID II with the FCA. Practitioners at the Clwyd Fund have agreed to represent the Wales Pool.

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### RECOMMENDATIONS

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| 1 | That the Committee note and discuss the content of the presentation provided by the Fund’s Investment Consultant. |
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## **REPORT DETAILS**

| <b>1.00</b> | <b>INVESTMENT AND FUNDING RELATED MATTERS</b>  |
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| 1.01        | <p>The Markets in Financial Instruments Directive (MiFID) is the EU legislation that regulates firms who provide services to clients linked to “financial instruments” (shares, bonds, units in collective investment schemes and derivatives), and the venues where those instruments are traded. MiFID was applied in the UK from November 2007, and is now being revised with the aim of improving the functioning of financial markets in light of the financial crisis and to strengthen investor protection. The changes are due to take effect from 3 January 2018, with the new legislation being known as MiFID II.</p>   |
| 1.02        | <p>The Financial Conduct Authority (FCA), who is responsible for implementing MiFID II in the UK, recently consulted on this. This specific consultation covered the impact on local authorities (including LGPS funds) and sought views on a number of areas of implementation. The MiFID regime uses client “categories” to recognise that investors have different levels of experience, knowledge and expertise, and looks to tailor the regulatory protections accordingly.</p> <p>Under the current MiFID regime Local Authorities are classified as “per se professional” investors provided they meet the appropriate criteria in the FCA Conduct of Business rules. Where these criteria are not met the ability to “Opt-up” is available provided a different set of criteria is met. Under the new proposals Local Authorities will be classified as “retail” clients.</p>  |
| 1.03        | <p>The consequences for LGPS funds being classified as a retail investor are potentially significant, and could severely limit the range of investments and portfolio management tools available; many investment managers currently only work with professional clients.</p> <p>The FCA consultation received a range of high profile responses all making similar points about the potential impact on Local Government Pension Schemes, the potential pit falls of the opt up process and the effect that it could all have on the pooling agenda. The response from the Pensions and Lifetime Savings Association (PLSA) was particularly strong and highlighted the impact that it could have on the Government’s desire for LGPS funds to invest more in Infrastructure.</p> <p>The consultation closed on 4 January 2017, and it is expected that a response will be received from the FCA towards the end of the first quarter of 2017.</p> <p>Currently the focus is on investment management, however, there could be wider implications as it is understood that this will also impact on</p> |

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|      | whether certain investment consultants can advise retail investors.  |
| 1.04 | <p>The Fund's investment consultant advises that the MiFID II implementation as it currently stands does pose significant issues to LGPS funds such as Clwyd, and the operating models of each of the 8 pools will need to ensure that they can still deliver to the underlying funds. However, they also believe that given the level of response the FCA will have received, and the strength of the arguments being made, it is likely that the criteria will be modified as a result of the consultation.</p> <p>JLT understand that the FCA did not intend to impose a process on the LGPS that will be unworkable, and they have stated as much at their meeting with the LGPS and within the text of the consultation. We believe it is more likely that they were unaware of the implications of the proposal.</p> <p>JLT remain reasonably confident that they will hear the representations being made and make changes to their proposals. Whether the result is separately classifying LGPS funds as per se professional clients, or whether it is ensuring the opting up process is simpler, is yet to be seen. However, either outcome would make the implementation of MiFID II much easier for LGPS funds.</p> |
| 1.05 | <p>The LGPS pools are forming a group of practitioners to communicate the issues to the FCA and the Clwyd Fund has agreed to represent Wales. The Clwyd Pension Fund Manager has raised the issue with the legal advisors for the Wales Pool so any risks to the current procurement process for an operator are considered.</p>   |

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| <b>2.00</b> | <b>RESOURCE IMPLICATIONS</b>              |
| 2.01        | None directly as a result of this report. |

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| <b>3.00</b> | <b>CONSULTATIONS REQUIRED / CARRIED OUT</b>   |
| 3.01        | <p>Updates to policies and procedures sometimes require consultation with interested stakeholders, such as employers. Should any policies requiring consultation be updated as a result of the new MiFID regime, then appropriate consultation will be carried out.</p> |

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| <b>4.00</b> | <b>RISK MANAGEMENT</b>   |
| 4.01        | <p>The following risk on the Fund's Risk Register may be affected by the implementation of the new Directive:</p> <ul style="list-style-type: none"> <li>Investment and/or funding objectives and/or strategies are no longer fit for purpose – legislation changes (funding &amp; investment risk reference 6, current impact: critical/likelihood: very high) –</li> </ul> |

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|  | concern that external factors (e.g. implementation of MiFID II) can affect the Fund's ability to implement its investment strategy, which could ultimately increase employer costs. |
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| <b>5.00</b> | <b>APPENDICES</b> |
| 5.01        | None              |

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| <b>6.00</b> | <b>LIST OF ACCESSIBLE BACKGROUND DOCUMENTS</b>   |
| 6.01        | A copy of the full FCA consultation paper can be provided on request.<br><br><b>Contact Officer:</b> Philip Latham, Clwyd Pension Fund Manager<br><b>Telephone:</b> 01352 702264<br><b>E-mail:</b> philip.latham@flintshire.gov.uk |
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| <b>7.00</b> | <b>GLOSSARY OF TERMS</b>  |
| 7.01        | <p>(a) <b>CPF – Clwyd Pension Fund (The Fund)</b> – The Pension Fund managed by Flintshire County Council for local authority employees in the region and employees of other employers with links to local government in the region.</p> <p>(b) <b>PFC – Clwyd Pension Fund Committee (the Committee)</b> – the Flintshire County Council committee responsible for the majority of decisions relating to the management of the Clwyd Pension Fund.</p> <p>(c) <b>LGPS – Local Government Pension Scheme</b> – the national scheme, which Clwyd Pension Fund is part of.</p> <p>(d) <b>FCA – Financial Conduct Authority</b> – the conduct regulator for 56,000 financial services firms and financial markets in the UK.</p> <p>(e) <b>MiFID – Market in Financial Instruments Directive</b> – European legislation that regulates firms who provide services to clients linked to 'financial instruments' (shares, bonds, units in collective investment schemes and derivatives), and the venues where those instruments are traded.</p> |