PENSIONS AND LIFETIME SAVINGS ASSOCIATION

MIFID II – TOP FIVE ACTIONS THAT PENSION SCHEMES NEED TO TAKE

The European Union's revised Markets in Financial Instruments Directive and Markets in Financial Instruments Regulation (together MiFID II) will start to apply from 3rd January 2018. MiFID II introduces a wide-ranging series of changes affecting financial services regulation in the EU. These changes will impact on UK pension schemes and the way in which they use and pay for fund management services. Trustees, scheme managers and other senior decision-makers will need to be aware of, and take action on, these issues.

This document is designed to support you in thinking about what action you might need to take both in the run-up to the MiFID II implementation deadline and in the first few months afterwards.

1 ASSESS THE VALUE OF INVESTMENT RESEARCH

MiFID II rules mean fund managers will be required to pay investment banks and brokers directly for analyst research, instead of combining the cost with trading commission. Fund managers will now either pay for research from their own account or via a ring-fenced client research-payment account.

Several fund managers have committed to absorbing the costs of research, but some will pass the costs directly on to investors. You should check your investment management agreements (IMAs) and ask your manager about their policy on research payments. You may also want to compare and contrast fund managers' approaches to this issue. Investment advisers can help.

Schemes may want to take advantage of the improved research transparency to assess where purchasing investment research adds value to their decision-making and returns and to compare the cost of different services.

> This document is a high-level overview of complex legislative provisions and, being only a guide, PLSA accepts no liability for its use. This document is not intended as a substitute for formal advice.

2 LOCAL GOVERNMENT SCHEMES: OPT-UP

Under MiFID II local authorities will automatically be categorised as 'retail' instead of 'professional' clients. Retail clients cannot access some fund classes or products e.g. infrastructure. This could have an impact on funds' investment strategies.

The FCA outlined a series of qualitative and quantitative tests which LGPS clients will need to pass to 'opt up' to professional client status. We would expect the fund manager to contact their clients where this change will impact the relationship or investment strategy. However it is for clients to proactively contact their managers and provide a completed application letter and questionnaire; managers should not initiate this process by part completion of templates or letters. Template forms can be found on the LGA website[1].

The revised opt-up process allows for public sector clients to be assessed as a 'collective' on skills and expertise. However, you may need to specifically consider your approach to training on specialist areas including alternative investments such as private equity and infrastructure; alternatives managers are likely to be keen to see concrete details of the training conducted or planned before agreeing to opting-up.

Over the longer-term, closer attention will be paid to fund governance changes e.g. personnel changes,as this may have implications for the opt-up assessment. It is funds' responsibility to inform their managers of any such developments.

3 IDENTIFY YOUR LEGAL ENTITY IDENTIFIER (LEI)

MiFID II means more organisations (entities) will need to obtain a Legal Entity Identifier (LEI). This is a unique 20-character code assigned to each legally distinct entity which engages in financial transactions. From 3 January 2018, firms subject to MiFID II transaction reporting obligations will not be able to execute trades on behalf of clients which are required to have a LEI but do not.

Whether you need a LEI will depend on whether you use the services of a financial institution which has to fulfil reporting obligations under MiFID II. Further information can be found on the FCA's website[2] and in its September Market Watch[3] issue.

You may already have a LEI. To find out, you could ask your investment managers and advisers, or also check the global register of LEI holders on the database[4]. If you need a LEI but do not have one, the London Stock Exchange is in charge of issuing them. You will need to apply and can either do this yourself or through your fund managers.

The London Stock Exchange is expecting a high volume of LEI applications both immediately before the deadline and in the months afterwards, so you should ensure you do this as soon as possible.

4 GET TO GRIPS WITH NEW DISCLOSURES: BEST EXECUTION AND COSTS

Investment firms now have a strengthened duty to take *all sufficient* steps to obtain the best result when executing client orders under MiFID II[5]. Firms also have to report on a more stringent basis to clients about the quality of their execution.

On costs disclosure, MiFID II places new duties upon fund managers including full point-of-sale (*ex ante*) disclosure and annual post-sale (ex post) disclosure. Costs must be aggregated and expressed both as a percentage amount and a monetary value.

Schemes should use this opportunity to conduct due diligence on their managers, using this new information, as well as to consider further steps to achieve greater value for money.

5 THINK ABOUT YOUR INVESTMENT MANAGEMENT AGREEMENTS

IMAs document the relationship between pension scheme trustees and fund managers. IMAs include Investment Guidelines, setting out the agreed trustee investment objectives, strategy and any restrictions on the manager. These terms can be tailored to reflect scheme requirements[6].

MiFID II will require updates to IMAs to reflect changes such as the new requirements on disclosure and best execution. The onus is on the manager to ensure compliance but schemes may wish to contact their managers to learn about future developments.

As MiFID II aims at investor protection, it is likely that fund managers will present the changes to the IMA unilaterally. Schemes may wish to ask their managers what approach will be taken to any changes. Schemes may also wish to use this opportunity to think about their IMA more broadly and prepare for the next IMA review together with their legal and investment advisers.

For further information on MiFID II or related issues, please contact our Investment and DB Policy Lead: ***caroline.escott@plsa.co.uk***.

[1] www.lgpsboard.org/index.php/schemedata/mifidii
[2] www.fca.org.uk/markets/mifid-ii/legal-entity-identifier-lei-update
[3] www.fca.org.uk/publication/newsletters/market-watch-53.pdf
[4] www.gleif.org
[5] ESMA has confirmed this is a higher bar of compliance than previous requirements to take all reasonable steps.
[6] For further information, please see the *NAPF Guide to Investment Management Agreements (IMAs)*, March 2015

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