

Chapter 3

Client categorisation

3.5 Professional clients

3.5.1 **R** A professional client is a client that is either a *per se professional client* or an *elective professional client*.

[Note: article 4(1)(10) of MiFID]

Per se professional clients

3.5.2 **R** Each of the following is a *per se professional client* unless and to the extent it is an *eligible counterparty* or is given a different categorisation under this chapter:

- (1) an entity required to be authorised or regulated to operate in the financial markets. The following list includes all authorised entities carrying out the characteristic activities of the entities mentioned, whether authorised by an *EEA State* or a third country and whether or not authorised by reference to a directive:
 - (a) a *credit institution*;
 - (b) an *investment firm*;
 - (c) any other authorised or regulated financial institution;
 - (d) an insurance company;
 - (e) a collective investment scheme or the management company of such a scheme;
 - (f) a pension fund or the management company of a pension fund;
 - (g) a commodity or commodity derivatives dealer;
 - (h) a local;
 - (i) any other institutional investor;
- (2) in relation to *MiFID or equivalent third country business* a large undertaking meeting two of the following size requirements on a company basis:
 - (a) balance sheet total of EUR 20,000,000;
 - (b) net turnover of EUR 40,000,000;
 - (c) own funds of EUR 2,000,000;
- (3) in relation to business that is not *MiFID or equivalent third country business* a large undertaking meeting any of the following conditions:
 - (a) a *body corporate* (including a *limited liability partnership*) which has (or any of whose *holding companies* or *subsidiaries* has) (or

has had at any time during the previous two years) called up share capital or net assets of at least £5 million (or its equivalent in any other currency at the relevant time);

- (b) an undertaking that meets (or any of whose *holding companies* or *subsidiaries* meets) two of the following tests:
 - (i) a balance sheet total of EUR 12,500,000;
 - (ii) a net turnover of EUR 25,000,000;
 - (iii) an average number of employees during the year of 250;
- (c) a *partnership* or unincorporated association which has (or has had at any time during the previous two years) net assets of at least £5 million (or its equivalent in any other currency at the relevant time) and calculated in the case of a limited *partnership* without deducting loans owing to any of the *partners*;
- (d) a trustee of a trust (other than an *occupational pension scheme*, *SSAS*, *personal pension scheme* or *stakeholder pension scheme*) which has (or has had at any time during the previous two years) assets of at least £10 million (or its equivalent in any other currency at the relevant time) calculated by aggregating the value of the cash and *designated investments* forming part of the trust's assets, but before deducting its liabilities;
- (e) a trustee of an *occupational pension scheme* or *SSAS*, or a trustee or operator of a *personal pension scheme* or *stakeholder pension scheme* where the scheme has (or has had at any time during the previous two years):
 - (i) at least 50 members; and
 - (ii) assets under management of at least £10 million (or its equivalent in any other currency at the relevant time);
- (4) a national or regional government, including a public body that manages public debt at national or regional level, a central bank, an international or supranational institution (such as the World Bank, the IMF, the ECB, the EIB) or another similar international organisation;
- (5) another institutional investor whose main activity is to invest in *financial instruments* (in relation to the *firm's MiFID or equivalent third country business*) or *designated investments* (in relation to the *firm's other business*). This includes entities dedicated to the securitisation of assets or other financing transactions.

[Note: first paragraph of section I of annex II to *MiFID*]

3.5.2A **R** [deleted]

3.5.2B **R** A *firm* must categorise a local public authority or municipality which (in either case) does not manage public debt as a *retail client*, unless it is permitted to treat such a *person* as an *elective professional client* in accordance with **COBS 3.5.3BR** to **COBS 3.5.3ER**.

3.5.2C G As a result of ■ COBS 3.5.2BR, a local public authority or municipality which (in either case) does not manage public debt should not be treated as a *per se* professional client.

Elective professional clients

3.5.3 R A firm may treat a client other than a local public authority or municipality as an *elective professional client* if it complies with (1) and (3) and, where applicable, (2):

- (1) the firm undertakes an adequate assessment of the expertise, experience and knowledge of the client that gives reasonable assurance, in light of the nature of the transactions or services envisaged, that the client is capable of making his own investment decisions and understanding the risks involved (the "qualitative test");
- (2) in relation to *MiFID or equivalent third country business* in the course of that assessment, at least two of the following criteria are satisfied:
 - (a) the client has carried out transactions, in significant size, on the relevant market at an average frequency of 10 per quarter over the previous four quarters;
 - (b) the size of the client's financial instrument portfolio, defined as including cash deposits and financial instruments, exceeds EUR 500,000;
 - (c) the client works or has worked in the financial sector for at least one year in a professional position, which requires knowledge of the transactions or services envisaged;
 (the "quantitative test"); and
- (3) the following procedure is followed:
 - (a) the client must state in writing to the firm that it wishes to be treated as a professional client either generally or in respect of a particular service or transaction or type of transaction or product;
 - (b) the firm must give the client a clear written warning of the protections and investor compensation rights the client may lose; and
 - (c) the client must state in writing, in a separate document from the contract, that it is aware of the consequences of losing such protections.

[Note: first, second, third and fifth paragraphs of section II.1 and first paragraph of section II.2 of annex II to *MiFID*]

3.5.3A G (1) As a result of ■ COBS 3.5.3BR and ■ COBS 3.5.3ER a firm should always assess a local public authority or municipality against a "quantitative test" to treat it as an *elective professional client*, regardless of whether the firm intends to conduct business involving *MiFID or equivalent third country business* or other regulated activities subject to ■ COBS 3.

- 3.5.3B** **R**
- (2) The “quantitative test” that a *firm* should use depends on the application of ■ COBS 3.5.3BR (which applies for *UK clients*) and ■ COBS 3.5.3ER (which applies for non-*UK clients*).
- (1) A *firm* may treat a *UK* local public authority or municipality as an *elective professional client* if it complies with ■ COBS 3.5.3R(1) and ■ COBS 3.5.3R(3) and, in addition, paragraph (2) of this *rule*.
- (2) In the course of the assessment under ■ COBS 3.5.3R(1) the criterion in (a) below is satisfied as well as one of the criteria in (b) below (the “quantitative test”):
- (a) the size of the *client’s financial instrument* portfolio defined as including cash deposits and *financial instruments*, exceeds £10,000,000; and
- (b) either:
- (i) the *client* has carried out transactions, in significant size, on the relevant market at an average frequency of ten per quarter over the previous four quarters; or
- (ii) the *person* authorised to carry out transactions on behalf of the *client* works or has worked in the financial sector for at least one year in a professional position, which requires knowledge of the provision of services envisaged; or
- (iii) the *client* is an ‘administering authority’ of the Local Government Pension Scheme within the meaning of the version of Schedule 3 of The Local Government Pension Scheme Regulations 2013 or, (in relation to Scotland) within the meaning of the version of Schedule 3 of The Local Government Pension Scheme (Scotland) Regulations 2014 in force at 1 January 2018, and is acting in that capacity.
- 3.5.3C** **R**
- (1) This *rule* applies where a *firm* is subjecting a *UK* local public authority or municipality to the tests and is following the procedure required as a result of ■ COBS 3.5.3BR in respect of the *firm’s* business carried on in relation to that *person’s*:
- (a) business in the course of or connected to its administration of a *pension scheme*; and
- (b) other business as a local public authority or municipality.
- (2) A *firm* must apply the qualitative and quantitative tests required as a result of ■ COBS 3.5.3BR separately and independently in relation to the *client’s* business under (1)(a) and (1)(b).
- (3) A *firm* must follow the procedure in ■ COBS 3.5.3R(3) required as a result of ■ COBS 3.5.3BR separately and independently in relation to the *client’s* business under (1)(a) and (1)(b).
- 3.5.3D** **G**
- As a result of ■ COBS 3.5.2BR and ■ COBS 3.5.3CR, and depending on the outcome of the qualitative and quantitative tests required as a result of ■ COBS 3.5.3BR, a *firm* may be required to categorise a *UK* local public authority or municipality differently in relation to the two sorts of business described at ■ COBS 3.5.3CR(1)(a) and (b).

- 3.5.3E** **R** (1) A *firm* may treat a non-UK local public authority or municipality as an *elective professional client* if it complies with **■** COBS 3.5.3R(1) and **■** COBS 3.5.3R(3) and, in addition, applies the relevant “quantitative test” under paragraph (2).
- (2) The relevant “quantitative test” under this *rule* is either:
- (a) where the local public authority or municipality is established in an *EEA State* and the *EEA State* has adopted alternative or additional criteria to those listed in the fifth paragraph to section II.1 of annex II to *MiFID*, those criteria as set out in the law or measures of that *EEA State*; or
- (b) in any other case the same “quantitative test” that is applied in relation to *MiFID* or *equivalent third country business* under **■** COBS 3.5.3R(2).
- 3.5.4** **R** If the *client* is an entity, the qualitative test should be performed in relation to the *person* authorised to carry out transactions on its behalf.
[Note: fourth paragraph of section II.1 of annex II to *MiFID*]
- 3.5.5** **G** The fitness test applied to managers and directors of entities licensed under directives in the financial field is an example of the assessment of expertise and knowledge involved in the qualitative test.
[Note: fourth paragraph of section II.1 of annex II to *MiFID*]
- 3.5.6** **R** Before deciding to accept a request for re-categorisation as an *elective professional client* a *firm* must take all reasonable steps to ensure that the *client* requesting to be treated as an *elective professional client* satisfies the qualitative test and, where applicable, the relevant quantitative test.
[Note: second paragraph of section II.2 of annex II to *MiFID*]
- 3.5.7** **G** An *elective professional client* should not be presumed to possess market knowledge and experience comparable to a *per se professional client*
[Note: second paragraph of section II.1 of annex II to *MiFID*]
- 3.5.8** **G** *Professional clients* are responsible for keeping the *firm* informed about any change that could affect their current categorisation.
[Note: fourth paragraph of section II.2 of annex II to *MiFID*]
- 3.5.9** **R** (1) If a *firm* becomes aware that a *client* no longer fulfils the initial conditions that made it eligible for categorisation as an *elective professional client*, the *firm* must take the appropriate action.
- (2) Where the appropriate action involves re-categorising that *client* as a *retail client*, the *firm* must notify that *client* of its new categorisation.
[Note: fourth paragraph of section II.2 of annex II to *MiFID*]