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12-02-24

Comments on ESMA's Consultation paper "Guidelines on certain aspects of the MiFID compliance function requirements"
Your reference: ESMA/2011/446

Dear Sir or Madam,

the German Banking Industry Committee (GBIC) is grateful for the opportunity to respond to ESMA regarding its Consultation paper "Guidelines on certain aspects of the MiFID compliance function requirements" published on 22 December 2011.

Please find enclosed our comments on this Consultation paper.

Yours faithfully,
on behalf of the German Banking Industry Committee
National Association of German Cooperative Banks

by proxy

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Comments

on the European Securities and Markets Authority (ESMA) Consultation paper

"Guidelines on certain aspects of the MiFID compliance function requirements" (22 December 2011 | ESMA/2011/446)

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Berlin, 12-02-24

The **German Banking Industry Committee** is the joint committee Operated by the central associations of the German banking industry. These associations are the Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR), for the cooperative banks, the Bundesverband deutscher Banken (BdB), for the private commercial banks, the Bundesverband Öffentlicher Banken Deutschlands (VÖB), for the public-sector banks, the Deutscher Sparkassen- und Giroverband (DSGV), for the savings banks finance group, and the Verband deutscher Pfandbriefbanken (vdp), for the Pfandbrief banks. Collectively, they represent more than 2,200 banks.

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GBIC Comments on ESMA-Consultation paper "Guidelines on certain aspects oft he MiFID compliance function requirements"

A. General

The German Banking Industry Committee (GBIC) is grateful for the opportunity to respond to ESMA regarding its Consultation Paper "Guidelines on certain aspects of the MiFID compliance function requirements" published on 22 December 2011.

Basically, the GCBI welcomes ESMA's approach. This holds true especially for the statement made under II. 5, pursuant to which the Guidelines shall go hand in hand with the principle of proportionality which is enshrined under the MiFID Implementing Directive (Article 6(1)). This statement is of such fundamental importance, that it should be included in the final version of the Guidelines. However, to date, this statement is still absent from the Draft Guidelines in Annex III. We propose an according addition in the final version of the Guidelines.

On a similar note, section II. No. 6 sets out that the explanatory text in support of the Guidelines shall and must not set up any additional requirements for investment firms or competent authorities. We feel that this is appropriate since there may be significant differences in the nature, scale and complexity of the investment firms' business as well as in the nature and the range of the investment services and activities provided by investment firms. We also suggest including this statement under the final version of the Guidelines.

We have concerns over the fact that the Draft Guidelines do not explicitly mention the business units' responsibility for MiFID compliance. At most, there is an indirect reference in the context of the differentiation between first level controls of the operational units and the second level controls of the compliance function. In our view, there should be a clarification of the fact that the primary responsibility for compliance with the requirements shall be incumbent upon the operational units.

Please find our more specific answers to the Consultation Paper's individual questions below. The basis for our commentary is III. to V. of the Consultation Paper. The brackets following the first reference also specify the corresponding reference in Annex III. We would be grateful if our present comments, both above and below, were to be taken into account in the final version of the Guidelines.

B. Specific comments

Q1: Do you agree that investment firms should ensure that, where the compliance function takes a risk-based approach, any comprehensive risk assessment is performed to determine the focus and the scope of the monitoring, reporting and advisory activities of the compliance function? Please also state the reasons for your answers.

We agree with this general statement. It is reasonable to support and acknowledge the investment firm and its compliance officer in finding the necessary balance between resources and risks and towards other functions.
We would simply like to point out that, at the same time - whilst the aforementioned Guideline or the aforementioned explanatory text remains silent on this matter - the question refers to "reporting activities" incumbent upon the compliance function.

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Q2: Please provide your comments (with reasons) on any or all aspects of this guideline on the monitoring obligations of the compliance function.

No. 13 Sentence 2 (No. 14, Sentence 2) states that "the compliance function within each investment firm should take the group of which it is part into account […] it should nevertheless remain responsible for monitoring its own compliance risk." While conceptually we understand the point it could potentially create perverse results by arguably requiring separate compliance functions for each legal entity. That is certainly not what is contemplated. We therefore would suggest the removal of this paragraph from the paper or at least clarification that this is not intended. Additionally, the geographical scope should be clarified. No. 13 should not apply to branches of investment firms outside the European Union.

We would also note that the on-site inspections requirement contained in **No. 14 (No. 15)** potentially has serious implications in terms of additional costs to compliance functions in both headcount and travel and that this should be considered as part of the cost benefit exercise.

No. 18 (No. 19) states that "the compliance function should have a role in overseeing the operation of the complaints process" which is a mere reiteration of the monitoring program mentioned in the Guideline under III.II. (No. 12). This does not add clarity but might create the misunderstanding that there should be increased monitoring of the handling of customer complaints.

Q3: Please provide your comments (with reasons) on any or all aspects of this guideline on reporting obligations of the compliance function.

Pursuant to **Sentence 2 of the Guideline under III.III. (No. 20)** the compliance report shall contain "a description of the implementation and effectiveness of the firm's compliance program". This sentence could be misunderstood as meaning that the compliance function would have to provide a self-assessment of its own task; in effect, this would be inappropriate. Rather, what is probably meant is that the compliance report shall include an assessment concerning the adequacy and effectiveness of the organisational measures and procedures that have been adopted within the investment firm in order to ensure MiFID compliance. We therefore suggest the following amendment to Sentence 2 of the Guideline under III.III:

> "…~~Investment firms should ensure that t~~The content of those compliance reports should contain~~s~~ a description of the adequacy ~~implementation~~ and effectiveness of the firm's measures and procedures put in place to comply with its obligations under MiFID~~compliance programm~~. …"

According to the current proposals under **No. 20(c) (No. 22 (c))**, future regulatory changes which are likely to have a significant impact on the business shall be addressed already in the compliance report. In our view, such a requirement would be excessive. According to Article 9(2) in conjunction with Article 6 of the MiFID Implementing Directive, the compliance report merely has to address matters that are relevant to compliance tasks. This involves monitoring and assessing the adequacy and effectiveness of the organisational measures and procedures put in place to ensure compliance with the requirements pertaining to

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the field of securities supervision as well as advice and assistance in order to help the operational units to meet these requirements (cf. Article 6(2) of the MiFID implementing Directive). Hence, forecasts concerning prospective *future* regulatory changes are not warranted by the existing mandate. We therefore propose the following amendment to No. 20(c):

> "20. (c) ~~future~~ relevant regulatory changes which ~~are likely to~~ have a significant impact on the business;"

Similarly, we have certain reservations over **No. 21, 2nd sentence (No. 23, 2nd sentence)** pursuant to which the compliance report shall also include suggestions concerning remedial steps needed in order to address certain shortcomings. In our view, generally speaking, suggesting necessary remedial steps does not form part of the compliance function's responsibilities. This task is incumbent upon the operational unit in which the shortcoming has been discovered. Otherwise, the compliance function would have to assess the adequacy and effectiveness of its own proposals. However, this would be incompatible with the requested independence of the compliance function. We therefore suggest deleting the sentence 2 under No. 21:

> "21. In addition, the compliance function should report to senior management, in a timely manner, on an ad-hoc basis when significant compliance matters such as major breaches of MiFID and the respective national laws have been discovered. ~~The report should also provide suggestions for the necessary remedial steps.~~"

We feel that the requirement proposed under **No. 22 (No. 24)** pursuant to which the compliance report would have to be made available to the supervisory function only makes sense when it comes to annual reports. As far as ad-hoc reports are concerned such an obligation should only arise in the case of events that will have material implications. Furthermore, in this context, it should be clarified that it is not necessarily part of the task of a compliance officer to make his or her report available to the supervisory function. Rather, the compliance report may also be made available by senior management.

No. 24 (No. 26) points out that "some competent authorities require investment firms to provide them with compliance function reports". This is not a standard market practice everywhere. Furthermore, in our view, the standard provision of internal compliance reports is inappropriate. Such a report should only have to be made available upon request of the competent authority. From our point of view, this is a sufficient guarantee for an effective and efficient supervisory activity. We propose an amendment to that effect.

Q4: Please provide your comments (with reasons) on any or all aspects of this guideline on the advisory obligations of the compliance function.

In our view, the focus of **No. 25, Sentence 2 (No. 28, Sentence 2)** is pointing in the wrong direction. The compliance function should offer protection to the investment firm and its staff. The fact that compliance with the provisions equally protects clients, is "merely" a kind of reflex of the task of the compliance function. This means that it is not the compliance function's task to improve investor protection. We therefore suggest deleting No. 25, Sentence 2:

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> „25. […] The purpose of the compliance culture is ~~not only~~ to establish the overall environment in which compliance matters are treated~~, but also to engage staff with the principle of improving investor protection~~."

In our view, **No. 26 (No. 29)** puts an excessive focus on the compliance function delivering training for the staff of the operational units. Here, too, the responsibility for training its staff is incumbent upon an operational unit itself. The role of the compliance function is limited to an advisory and supporting capacity. We therefore suggest that No. 26 should be amended as follows:

> "26. The investment firm needs to ensure that its staff are adequately trained. ~~For this, the compliance function should arrange training and/or other support for staff. Where training is performed by other units, t~~The compliance function should support the~~se~~ business units in performing any training for its staff. … "

No. 27 (No. 30) proposes that, in general, training shall be performed on a regular basis. We regard this as an overly formalistic approach and too far reaching. Whether training will be necessary on a regular or on an *ad-hoc* basis is going to depend on the specific circumstances of the individual case at hand. We therefore suggest the following amendment to No. 27:

> "27. Training should be performed on a regular basis~~,~~ and/or in specific cases ~~need-based training should be performed where~~ depending on what is necessary to impart the staff with the necessary knowledge. Training should be delivered as appropriate – for example, to the investment firm's entire staff as a whole, or to specific business units, or even to a particular individual."

Under **No. 32 (No. 35)** there should be a clarification that the decision on the involvement of the compliance officer into relevant information flows shall be incumbent upon the business units who will thus also be responsible for this. At this juncture we would appreciate a clarification.

Q5: Please provide your comments (with reasons) on any or all aspects of this guideline on the effectiveness of the compliance function.

According to the current proposal under **No. 35 (No. 39)**, a significant extension of the investment firm's business unit activities will incur the need for a "similar" extension of the compliance function. We have strong reservations over this proposal since it seems to be slightly ambiguous, to say the least. Any potential need for an extension of the compliance function will depend on the specific scenario at hand. Any requirement to the effect that an extension of the business activities shall automatically trigger the need for a corresponding extension of the compliance function would be inappropriate. We therefore suggest an amendment of No. 35 to the following effect:

> "35. The number of staff required for the tasks of the compliance function depends to a large extent on the nature of the investment services, activities and ancillary services and other services provided by the investment firm. ~~Where an investment firm's business unit activities~~

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~~are significantly extended, the investment firm should ensure that the compliance function is similarly extended.~~ Whether the number of staff is still adequate for the fulfilment of the duties of the compliance function should be monitored regularly by the investment firm and without delay when the investment firm significantly extends its business unit activities; when and as far as necessary the personal equipment of the compliance function must be adapted without delay."

Besides, we also have reservations over the requirement proposed under **No. 37 (No. 41)**, i.e. that a budget shall be mandatory for the compliance function. Budget allocation is not common practice in investment firms (be it in the operational units or in compliance); whilst not limited to, this especially applies to small and medium sized investment firms. In our view, mandatory budgets cannot be legislated top-down, at least not in cases where an investment firm anyway refrains from allocating specific budgets to other units. The key priority is that investment firms (i.e. senior management as the party responsible for this) provide the compliance function with appropriate resources in terms of human and material resources. We therefore suggest amending No. 37 as follows:

"37. When the investment firm provides a budget for the compliance function, this budget should be ~~A~~adequate ~~resources also include the allocation of an~~ appropriate ~~budget for the compliance function~~. The compliance officer should be consulted before the budget is determined. All decisions for significant cuts in the budget should be documented in writing and contain detailed explanations."

Pursuant to **No. 38 (No. 42)**, the compliance officer shall be granted the right of attendance for senior management and supervisory function meetings; in our view, this proposal is incompatible with the responsibilities of senior management and/or of the supervisory board. We believe that the European legislator would have explicitly regulated such a right in the MiFID Implementing Directive, had it deemed such a right necessary. Yet, according to the MiFID Implementing Directive, the compliance officer is only obligated to report *in writing* to senior management. A similar rule applies with regard to the supervisory body (cf. Article 9(2) and (3) of the MiFID Implementing provision). Hence, sentences 3 to 5 of No. 38 should be deleted:

"38. Compliance staff should at all times have access to the relevant information for their tasks including all relevant databases. In order to have a permanent overview to the areas of the investment firm where sensitive or relevant information might arise, the compliance officer should have access to all information systems within the investment firm as well as any internal or external audit reports or other reporting to senior management or the supervisory board, if any. ~~Where relevant, the compliance officer should also be granted right of attendance for meetings of senior management or the supervisory function. Where this right is not granted, this should be documented and explained in writing. For this, the compliance officer should have in-depth knowledge of the investment firm's organisation, corporate culture and decision-making processes in order to be able to identify for which meetings his or her attendance is important.~~"

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Q6: Do you agree that, in order to ensure that the compliance function performs its tasks and responsibilities on an ongoing permanent basis, investment firms should provide

(i) adequate stand-in arrangements for the responsibilities of the compliance officer which apply when the compliance officer is absent; and

(ii) arrangements to ensure that the responsibilities of the compliance function are performed on an ongoing basis?

Please also state the reasons for your answers.

We agree with the statement and both questions.

Q7: Do you agree that investment firms should ensure that the compliance function holds a position in the organisational structure that ensures that the compliance officer and other compliance function staff are independent when performing their tasks?
Please also state the reasons for your answer.

We agree with this statement too.

Q8: Do you agree that investment firms should ensure that the organisation of the compliance function guarantees that the compliance officer's daily decisions are taken independently from any influence of the business units and that the compliance officer is appointed and replaced by senior management only?

Basically, our answer to this is "Yes". However, this begs the question: Which shape and form should said "guarantee" take so that that it lends itself to verification on the part of the supervisor? It would appear more appropriate for an investment firm to "ensure" the corresponding independence.

However, **No. 45 (No. 51)** suggests that the compliance function shall perform day-to-day business independently from senior management. In our view, this would be incompatible with the fact that senior management is the party ultimately responsible for compliance. We are of the opinion that this statement fails to reflect the fact that senior management also bears responsibility for the compliance function. Hence, any restriction of senior management's right to direct the compliance function is not feasible, not even in terms of day-to-day business. We therefore suggest the following amendment to No. 45:

"45. ~~While~~ The senior management is responsible for establishing an appropriate compliance organisation and for monitoring the effectiveness of the organisation that has been implemented. The compliance officer is within his~~, the~~ task~~s~~ fulfilment only bound by instructions from the senior management. ~~performed by the compliance function in the day-to-day business should be carried out independently from senior management and other units of the investment firm. In particular, t~~The investment firm's organisation should ensure that other business units may not issue instructions or otherwise influence compliance staff

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> and their activities. ~~Senior management's instructions to compliance staff should be general and should not interfere with the compliance function's day-to-day activities.~~ The investment firm should ensure that the decision on the appointment and replacement of the compliance officer may only be taken by senior management or the supervisory function."

At most, a policy would be conceivable pursuant to which the compliance officer would have to record (and potentially also present in the compliance report) if the senior management deviates from crucial recommendations or assessments issued by him.

Q9: Please provide your comments (with reasons) on any or all aspects of this guideline on Article 6(3) exemptions.

While this section should generally not apply to larger institutions as it deals with exemptions for smaller firms it does contain language which could be potentially prejudicial. Specifically, **No. 50 (No. 57)** states that "The compliance function should generally not be combined with the legal unit, or be subordinate to internal control functions, where this could undermine the compliance function's independence." We would suggest deleting the reference to legal as it is inconsistent with what appears in No. 52 and 54 (No. 60 and 62) which specifically permits combing the compliance function with other control units besides internal audit. In addition, we would note that the more important part of the requirement is that there should not be a combination or subordination if it could undermine the compliance function's independence. Such a combination with legal would not *ipso facto* impact compliance's independence and in fact such combinations often create various synergies in terms of expertise and cost savings. As such, we suggest the deletion of the reference to legal.

Q10: Please provide your comments (with reasons) on any or all aspects of this guideline on combining the compliance function with other functions.

No. 54 (No. 62) states that "Any overlap of the compliance function [with other control functions] should be documented ... so that competent authorities are able to assess whether the combination of functions is adequate." We would question the value in doing such an exercise and therefore ask to delete this requirement.

Q11: Please provide your comments (with reasons) on any or all aspects of this guideline on outsourcing of the compliance function.

Assessing an external service provider's suitability, existing know-how etc. is already in the outsourcing bank's own interest. However, **No. 58 (No. 67)** should clarify that the intensity of the required due diligence assessment shall depend on the nature, scale, complexity and risk of the tasks and processes that are going to be outsourced.

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"58. The investment firm should perform a due diligence assessment before choosing a service provider in order to ensure that the criteria set out in Articles 6 and 14 of the MiFID Implementing Directive are met. The intensity of this assessment depends on nature, scale, complexity and risk of the outsourced tasks and processes.

Q12: Do you agree that competent authorities should also review, as part of the ongoing supervisory process, whether measures implemented by investment firms for the compliance function are adequate, and whether the compliance function fulfils its responsibilities appropriately? Please also state the reasons for you answer.

No comment.

Q13: Do you agree that competent authorities should also assess whether amendments to the organisation of the compliance function are required due to changes in the scope of the business model of the investment firm, and where such amendments are necessary, monitor whether these amendments have been implemented?

Cf. our earlier response under Question 5, concerning No. 35 (No. 39) ESMA Consultation Paper.