

**AFME Response to ESMA Consultation Paper: Guidelines on certain aspects of the MiFID Compliance Function requirements.**

To: ESMA (submitted online to [www.esma.europa.eu](http://www.esma.europa.eu))

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**Summary:**

AFME welcomes the opportunity to comment on ESMA's draft Guidelines.

Our member firms are supportive of the high-level principles expressed in the Guidelines and ESMA's desire to enhance clarity and foster convergence in the implementation of the MiFID organisational requirements relating to aspects of the compliance function.

We believe that the Guidelines will be helpful in reinforcing the importance of the compliance function, although we are not currently aware of specific material problems relating to the implementation of the MiFID 1 compliance requirements and, as far as our Members are concerned at least, do not agree with ESMA's assertion that "compliance risk often takes second place to other areas of risk within a firm". AFME firms are supporters of a strong compliance culture and authoritative and independent compliance functions.

There are a number of specific points, however, that we have highlighted in our detailed response in order to ensure that the Guidelines will work well in practice and can be applied proportionately and pragmatically across the EEA. Where appropriate, we have also provided concrete drafting suggestions.

We note that ESMA states that the guidelines shall apply 30 days after publication. This would appear an unrealistically short implementation timescale. We would therefore strongly suggest that ESMA should allow 3-6 months to allow firms and regulators to either implement the new guidelines or verify that their existing policies and procedures are aligned with the guidelines.

We would be happy to provide further detail on any of our comments if ESMA would find this helpful.

Yours faithfully

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## **AFME Response to ESMA Consultation Paper: Guidelines on certain aspects of the MiFID Compliance Function requirements**

### **General remarks:**

- As previously stated we are supportive of the Guidelines and consider them to provide in many cases helpful clarification of existing requirements. However, we note that the Guidelines also contain narrative content on *current* supervisory practices. Examples of this would include Guideline 24 which refers to one competent authority which requires senior management to provide annotated findings of the compliance report or Guidelines 65 to 68 which summarise current practices e.g. for the assessment and appointment of the compliance officer. Given that supervisory practices may change and the Guidelines are designed for long term validity, we wonder if some of this narrative could be removed or possibly be included in an appendix on current supervisory practices.
- We note that there is a lack of linguistic consistency regarding some of the terms utilised in the Guidelines. For example, Guideline 40 refers to “designated compliance officer”, Guideline 41 refers to the “compliance officer” and Guideline 65 refers to “nominated compliance officer”. As we believe these references relate to the same individual we would suggest that the terminology should be aligned as far as possible.
- As there are slight discrepancies in the numbering between the main consultation paper text and ANNEX 3 of the consultation paper, references to Guideline numbers shall refer to the main body of the consultation paper. Guidelines to which we have provided concrete drafting amendments in Annex 1 have been flagged \*.

### **Detailed Consultation Response:**

#### **Compliance Risk Assessment**

**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.**

Yes we agree in principle. The proposal would appear in line with practice in most firms and we welcome the focus on a risk-based approach. To ensure the sufficient use of resources it will be important to apply guidelines proportionally and efficiently and in way that is relevant to the firm’s risk profile, customer base and product range with the main emphasis being on areas where compliance risk is most significant.

#### **Monitoring Obligations of the compliance function**

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

The proposal would appear in line with practice in many firms and we welcome the articulation of the “three lines of defence model”.

The Guideline\* could be enhanced by making specific reference to the need for effective recording, escalation and resolution of the findings from monitoring work. Whilst this is implicit, the current Guidelines do not currently state this and we believe the text should be make specific reference to these important elements of monitoring expressively.

Guideline 12\* states that firms should “evaluate whether the investment firm’s business is conducted in compliance with its obligations under MiFID”. We would suggest that many firms will wish to take a holistic view of compliance with regulatory obligations as a whole. A firm may not have implemented a specific MiFID compliance monitoring programme but will still assess all relevant provisions as part of different programmes. (For example a firm could assess the implementation of MiFID suitability requirements as part of its TCF implementation programme and/or review conflicts of interest as part of its wider conflicts management programme).

The wording in Guideline 13\*, which states, that each investment firm should “take the group of which it is part into account” when discharging its compliance responsibilities, is rather vague. In practice some firms may wish to make significant use of central resources e.g. a central monitoring function in order to discharge relevant compliance responsibilities and allocate resources most efficiently. Whilst we agree that the relevant nominated compliance officer will remain responsible for the authorised entity there should be scope for central functions to perform some significant activities. We note that ESMA acknowledges the potential value of a centralised compliance function in its comments on outsourcing in Guideline 61.

Given the importance of Compliance and internal audit performing their functions independently, we would suggest that the requirement in Guideline 17\* to “coordinate” internal audit reviews and compliance monitoring activities is too strong although of course both functions need to be cognizant of the work they perform respectively.

Whilst we agree that overall responsibility for complaints handling should rest with business units, we would reject the suggestion in Guideline 18\* that the compliance function “should not have a role in determining the outcome of complaints” as much will depend on the specific nature of the complaint and there may be situations where more intensive Compliance engagement could be appropriate.

## **Reporting Obligation of the Compliance Function**

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

The Guidelines would appear in line with practice in many firms and we support the proposal for adequate written reports to senior management.

ESMA states that where the compliance function makes significant ad-hoc findings, these should be reported promptly to senior management as well as the supervisory function. We would suggest that firms should be able to exercise a degree of discretion. Whilst a compliance matter may be of relevance to the relevant member of senior management, it would not always necessarily warrant escalation to the supervisory function. Only reports highlighting material risks in the opinion of senior compliance management should require referral to a compliance/risk/internal audit committee of the Board (whichever would receive the annual compliance assessment report). The reference to “the supervisory function, if any” is also not very clear and further clarification on what this relates to is required. It could be a reference to the management body (Board) or it could be a reference to the function which is supervising the senior management of the business unit in question. The Guidelines should be more specific but allow for the element of discretion outlined previously.

We would suggest that the Guidelines should also include a new provision about investment firms being required to put in place appropriate escalation processes where Compliance is denied access to relevant people and information.

The description of the contents of the compliance report in Guideline 20\* seems rather prescriptive. For example a large firm is likely to receive hundreds of items of correspondence with competent authorities (a number of which would only be material in the local context) and the benefit of circulating copious amounts of correspondence is questionable although we would of course agree that key matters arising from such correspondence should be brought to the attention of relevant senior management. However, we believe that the written reports should include a description of any obstacles and impediments to achieving compliance e.g. resourcing constraints as well as refusal of access to people and information.

### **Advisory obligations of the compliance function**

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

The Guidelines appear acceptable subject to being applied on a proportionate basis with due consideration to effectiveness and efficiency.

We fully support measures to promote and enhance a compliance culture throughout a firm. However, we believe Guideline 25 is worded too narrowly by describing the purpose of compliance culture as “engaging staff with the principle of improving investor protection”. Whilst investor protection is clearly very important, compliance culture encompasses a wide range of behaviours and attitudes with a view to complying with the spirit as well as the rules of the wider regulatory environment.

Guideline 29 suggests that the compliance function should “periodically assess whether staff hold the necessary level of awareness and correctly apply the firm’s policies and procedures”. It is important that this Guideline is applied flexibly and pragmatically and recognises the role business unit management play in supervising and assessing staff.

Guideline 31\* should recognise that compliance should provide expertise and advice to business units regarding both *existing* and new business models.

Guideline 32\* suggests that the compliance function “should be involved in all significant modifications of the organisation of the investment firm”. Whilst it is desirable that Compliance will be involved, Compliance should be allowed to determine any involvement on the basis of a risk-based approach (see our response to Question 1) and there may be certain projects or transactions where direct Compliance involvement is not absolutely necessary.

### **Effectiveness of the compliance function**

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

Overall we support the Guideline. However, given the risk-based approach supported by ESMA, extending a firm’s business unit activities will not necessarily result in a proportionate extension of the compliance function as implied by Guideline 35\*. The appropriate compliance resource will depend on the inherent risks of the new business activity, with “riskier” activities requiring proportionally a larger number of additional compliance staff.

Guideline 39\* states that “authority also implies possessing adequate expertise and relevant personal skills” and goes on to say that this authority may be enhanced by a specific compliance charter acknowledging the authority of compliance.

We believe the Guidelines are unclear regarding the link between authority and expertise and it is not apparent how a compliance charter would demonstrate or enhance compliance expertise or skills. (See also our comments on a compliance charter in Question 6). However, we do believe that a formal recognition of the authority of Compliance could be helpful.

Guideline 40 seems to suggest that *all* compliance staff need to demonstrate knowledge of MiFID. However, although general awareness of MiFID is desirable for most compliance staff, especially in larger firms, specialised compliance staff may be allocated to non-MiFID related activities requiring no or minimal knowledge of specific MiFID provisions. We believe therefore the reference to “as far as relevant for the provision of their task” is very important and in certain instances some compliance staff may not require any MiFID experience. However, investment firms should require and support compliance staff to be appropriately qualified and staff should be supported in their ongoing training and development. We would suggest that the guidelines could reference this as Guideline 26 seems to focus on the training requirements for staff other than compliance.

### **Permanence of the Compliance Function**

**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.**

Overall we support the Guidelines which appear in line with practice in many firms. We agree that there is a need for a permanent compliance function and appropriate stand-in/contingency arrangements to cover the compliance function. However, there should be no specific requirement as suggested by Guideline 43, for newly creating a specific “compliance charter” provided appropriate rules, policies or procedures are in place.

### **Independence of the compliance function**

**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.**

**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?**

Whilst we welcome Guidelines on the independence of the compliance function, Guideline 45\* should not prevent Compliance from receiving instructions or suggestions from business units (e.g. a business could propose that compliance should undertake monitoring for an area in which ‘first line’ business has identified a potential issue) but prohibit engagement which is likely to conflict with the

independent assessment and judgement of the compliance function. Especially in smaller firms, close interaction between business and compliance may be appropriate subject to appropriate safeguards, such as direct access to senior management, being put in place.

A frequent and interactive dialogue and collaborative approach with senior management and business functions are also important in allowing Compliance to exercise its role effectively and to avoid operating in a silo.

Additionally whilst we acknowledge that the compliance function should be independent and should not be reporting into any business function, ESMA should also recognise that in certain organisations, Compliance may report into other control or advisory functions such as Legal/General Counsel or Risk and therefore will not operate on a wholly stand-alone basis. It would be helpful if ESMA could provide further clarity on the nature of its concerns.

We agree that the compliance officer should be appointed and replaced by senior management.

## **Exemptions**

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

We welcome appropriate exemptions and a proportionate application of the Guidelines. However, we would object to the suggestion in Guideline 50\* that Compliance should “generally” not be combined with the legal unit, where this could carry a potential risk of undermining the independence of Compliance. An appropriate combination of suitable control functions such as Risk, Anti-money laundering or Legal may create significant organisational efficiencies and synergies and should be acceptable as long as the independence of the compliance function is ensured and any potential conflicts of interest are managed appropriately. Guideline 52 does appear to acknowledge this. See also our response to Question 10.

## **Combining the compliance function with other functions**

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

See our comments to Question 9. We appreciate the regulatory concern that there should be a clear delineation of roles and responsibilities and would support requirements for clear job descriptions and articulation of reporting lines. However, the requirement in Guideline 54 to document any overlap of the compliance function with other control functions could lead to onerous “tick-box type” obligations to document specific functions and activities with little demonstrable benefit to firms or their regulators. Given the dynamic nature of business and the fact that the interaction with other functions may vary on a project by project or product by product basis, this Guideline would need to be applied flexibly, if it is required at all.

## **Outsourcing of the compliance function**

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

We welcome ESMA’s confirmation that it is appropriate for firms to outsource some or all of their compliance activities.

### **Review of the compliance function by competent authorities**

**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 your answer.**

**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?**

We are supportive of appropriate regulatory oversight of the compliance function as outlined in the Guidelines and acknowledge the legitimate interests of regulators in making judgements about the compliance function and its staffing. As noted in our general remarks on page 2, we would, however, query the rationale for the inclusion of Guidelines 65-68.



## **Annex I: Drafting suggestions**

### **III.II Monitoring obligations of the compliance function.**

*Investment firms should ensure that the independent compliance function establishes and performs a monitoring program that covers all relevant areas of the investment firm's investment services, activities and ancillary services in order to ensure that compliance risk is comprehensively monitored, material concerns are escalated and findings reported and resolved promptly.*

#### **Drafting suggestion Guideline 12:**

*The aim of the monitoring programme should be to evaluate whether the investment firm's business is conducted in compliance with its regulatory obligations including MiFID...*

#### **Drafting suggestion Guideline 13:**

*While the compliance function within each investment firm may wish to work closely with audit, legal, regulatory and compliance staff in other parts of the group and outsource some of its activities within the group, it should nevertheless ensure that the investment firm (as distinct from the group) remains responsible for monitoring its own compliance risk.*

#### **Drafting suggestion Guideline 17:**

*Reviews by the internal audit function should take into account the monitoring activities performed by the compliance function.*

#### **Drafting suggestion Guideline 18:**

*While the primary responsibility for determining the outcome of complaints should rest with the business units, compliance should have a role in overseeing the operation of the complaints process.*

#### **Drafting suggestion Guideline 20: additional text to be added:**

*f) A description of the obstacles and impediments to achieving compliance such as resourcing constraints as well as refusal of access to people and information.*

#### **Drafting suggestion Guideline 22:**

*If this appropriate and relevant, the reports provided to senior management should also be provided to the supervisory function, if any.*

#### **Drafting suggestion Guideline 31:**

*In this context, the compliance function should be enabled, for example, to provide compliance expertise and advice to business units about strategic decisions regarding existing or new business models or issues [...]*



**Drafting suggestion Guideline 32:**

*Furthermore, based on a risk assessment and where appropriate, the compliance function should be involved in all significant modifications of the organisation of the investment firm....*

**Drafting suggestion Guideline 35:**

*Where an investment firm's business unit activities are significantly extended, the investment firm should ensure that the compliance function is [...] extended in line with the new risk profile of the firm.*

**Drafting suggestion Guideline 39:**

*The authority of the compliance function [...] may be enhanced by the investment firm's compliance policy (or procedures) explicitly acknowledging the specific authority of the compliance staff.*

**Drafting suggestion Guideline 45:**

*In particular, the investment firm's organisation should ensure that other business units may not [...] unduly influence compliance staff and their activities in a way that could compromise the independence of the compliance function.*

**Drafting suggestion Guideline 50:**

*An investment firm may combine its compliance function with the legal unit or another control function such as risk, as long as this does not undermine the compliance function's independence, generate conflicts of interest or compromise the effectiveness of the compliance function.*