Alternative Investment Management Association

ESMA
103 rue de Grenelle
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France

Submitted via email

27 February 2012

Dear Sir/Madam,

Guidelines on certain aspects of the MiFID compliance function requirements

The Alternative Investment Management Association (AIMA)[1] appreciates the opportunity to respond to the European Securities and Markets Authority (ESMA) consultation paper 'Guidelines on certain aspects of the MiFID compliance function requirements' (the Consultation Paper).

AIMA supports ESMA's clarification of the requirements which MiFID entails for the compliance function of an investment firm. We fully agree that the role of compliance is an essential element within a well-run firm and that proper management of risk is of fundamental importance in ensuring the effective implementation of regulations which seek to maintain the stability of the European financial system.

We believe that the draft Guidelines which ESMA puts forward in the Consultation Paper will help to develop and sustain a high level of investor protection, will play a role in maintaining systemic stability and, in consequence, will assist in increasing economic prosperity across the Union.

In particular, AIMA welcomes ESMA's recognition, at draft Guideline 9, that the compliance function should follow a risk-based approach. We would also urge ESMA to ensure that the final text makes clear that firms should adopt a proportionate approach when implementing the Guidelines – a point we refer to on several occasions in our comments below.

In our response below, we first set out our general comments and concerns and then address two specific questions (Q5 and Q9) which ESMA has posed in the Consultation Paper.

AIMA's general comments and concerns

1. Timescale of application of the final Guidelines

We have significant concern that ESMA's proposals currently provide only for a 30 day period following publication before the Guidelines would apply in full. Given the changes to systems and procedures which may be required within some firms as a result of the Guidelines' introduction, we would regard this timeframe as being unduly short and consider that it would place almost impossible pressures on some firms to restructure their compliance function in time. By way of example, funds in which the compliance function has, until now, reported to the legal department, or which have multi-functional individuals who combine legal and compliance roles, may well find themselves obliged to recruit new members of staff in order to comply with the Guidelines. Bearing in mind that such firms would need to undertake a recruitment process and, when a successful candidate has been

[1] AIMA is the trade body for the hedge fund industry globally; our membership represents all constituencies within the sector – including hedge fund managers, fund of hedge fund managers, prime brokers, fund administrators, accountants and lawyers. Our membership comprises over 1,100 corporate bodies in over 40 countries.

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identified, the typical notice period for that person may well be anything up to three months, we strongly believe that a six month transitional period would be more feasible and proportionate.

2. Proportionality

As mentioned above, we strongly support ESMA's view that a risk based approach should be taken by the compliance function.

However, we would argue that the issue of proportionality should be given greater emphasis in the final Guidelines. Since firms vary widely according to their size, structure and the nature and complexity of their business models, it is clear that there is no 'one size fits all' model which could be applied to all compliance functions. What is clearly suitable for a large firm may be entirely inappropriate for smaller firms (and vice versa). For example, a greater formal separation of compliance, legal, risk and audit functions (as is implicit within the Guidelines) could pose considerable challenges for smaller investment firms for which each function simply would not warrant a full time position.

By way of specific example:

- draft Guideline 10 – the requirement for a firm to 'maintain adequate policies' to detect a failure by the firm to comply with its obligations under MiFID is unclear in its scope, since this will depend on the interpretation of the word 'adequate'. We would prefer this Guideline to read 'maintain appropriate and proportionate policies', which would provide greater clarity to firms while giving effect to the intentions of this Guideline;

- draft Guideline 12 – this requires that a firm must ensure that compliance risk is 'comprehensively monitored'. The term 'comprehensive', which is also used within draft Guideline 9, is overly broad and could potentially require the compliance function of smaller firms to be tasked with unrealistic levels of supervision and/or of areas of the firm's business which may not be relevant in terms of compliance risk. A better form of wording would be 'appropriately monitored' in place of 'comprehensively monitored';

- draft Guidelines 27 and 29 – these, as drafted, would appear to impose responsibility on the compliance function for all training across the firm, including training which is not relevant to risk management. We assume that this was not ESMA's intention and would suggest that the wording be amended to make this point clearer;

- draft Guideline 32 – again, the requirement to assess 'whether staff hold the necessary level of awareness' and 'correctly apply the investment firm's policies and procedures' should be amended so that it is restricted to those areas which are relevant to the compliance function (rather than to every aspect of the firm's business). Furthermore, while we agree that compliance should be part (and an important part) of the overall process, it would be wrong if ESMA's final Guidelines gave the impression that compliance, rather than senior management, should have the ultimate responsibility in this context.

- draft Guideline 45 – we believe that the phrase "the compliance officer should have specific knowledge of the different business activities provided by the investment firm" is too onerous and would argue that the phrase 'specific knowledge' should be amended to 'appropriate understanding';

- draft Guideline 46 – this stipulates that the compliance function should be performed "on an ongoing and permanent basis". Whilst we fully concur with this as a basic premise, we assume that the concept of 'an ongoing and permanent basis' is not intended to mean that the compliance function should be operational 24 hours a day, seven days a week, regardless of the size of the firm. The concept of 'absence', therefore, requires some clarification. Draft Guideline 47 refers to absence on annual leave and also for illness. There is a vast difference, for example, between a compliance officer taking a fortnight's annual leave on the one hand and taking a Friday afternoon off on the other hand. Equally, there is a difference between a long term

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illness and, say, taking a morning off work as a result of a bad cold. We would suggest that the requirement set out in draft Guidelines 46 and 47 be amended to introduce an element of absence 'for a significant period', for which appropriate cover would be required.

3. Greater powers and responsibilities of compliance

Certain aspects of the Guidelines should be extended in order to provide greater authority and responsibility for the compliance function. For example:

- draft Guideline 36 states that "[t]he compliance function should regularly be involved in all relevant correspondence with competent authorities". We consider that the term 'involved' is ambiguous and could be construed in such a way as to limit compliance's rights of meaningful intervention. Instead, we would prefer the Guideline to require, at the least, that 'the compliance function should be provided with access to all relevant correspondence with competent authorities';

- draft Guideline 41 requires that the compliance officer be 'consulted' before the compliance budget is determined. 'Consultation', however, could be achieved without the compliance officer having any meaningful input into the assessment and determination as to what would be an appropriate budget. We believe that the compliance officer should be a part of the approval process and that the Guidelines should make this explicit.

Particular Issues

Q5. Effectiveness of the Compliance Function

Draft Guideline 42 of the Consultation Paper stipulates that any failure to grant a compliance officer the right to attend a meeting of the senior management or the supervisory function must be documented and explained in writing. AIMA believes that the organisational requirement contained within this proposal would be disproportionately onerous for investment firms. We fully agree that the compliance officer should be present whenever there are matters relevant to his or her function under discussion; on the other hand, it is clear that there will be occasions when management meetings concern matters which are of no relevance to the compliance officer and it would be neither necessary nor appropriate for him or her to attend these. We, therefore, believe that a greater degree of flexibility is necessary in the final Guidelines. At the very least, we would suggest that the Guidelines make clear that the firms may comply with this requirement by setting out a generic policy as to when compliance staff have, and when they do not have, the right of attendance at meetings of senior management, rather than to provide a record for each meeting.

Importantly, the right of attendance and documenting requirements proposed by draft Guideline 42 would appear to duplicate the requirements found within other Guidelines. For example, draft Guideline 35 (which deals with the compliance function's involvement in significant modifications of the firm's organisation in the area of investment services, activities and ancillary services) already requires the compliance function to be involved in all relevant policies and procedures and be given the right to participate in all decisions regarding instruments for distribution. The attendance and documenting provisions contained within draft Guideline 42 are, therefore, unnecessarily duplicative.

Q9. Article 6(3) Exemptions

AIMA agrees that independence of the compliance function should be maintained and that conflicts of interest should be managed in an appropriate and proportionate manner according to the nature, scale and complexity of the firm concerned. In particular, AIMA welcomes in this context draft Guideline 56's specific provision for smaller investment firms with limited human resources which may find it difficult to appoint a separate compliance officer. We would, however, suggest that where draft Guideline 56 states that conflicts of interest

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between the tasks performed by the relevant persons '… should be minimised as much as possible', this wording should be replaced with '…should be managed appropriately.'

AIMA would also advocate the removal of the requirement, found within draft Guideline 57, which recommends that the compliance function, should, generally, not be combined with the legal unit of an investment firm's control function. Such a blanket requirement would incur significant costs and burdens as it is often not operationally feasible for the compliance function to be entirely separate from the legal unit. A number of alternative models exist which better ensure that the compliance function operates independently, thus achieving the intention of the Guidelines.

We believe that it should be acceptable for a general counsel or legal department professional to manage compliance or be required to report on compliance to someone within the firm's legal department. Draft Guidelines 60 and 62, in particular, make it clear that ESMA recognises certain instances whereby the compliance function could overlap with other functions as long as such overlap does not threaten the efficacy or independence of the compliance function. This renders draft Guideline 57 unnecessary, overly prescriptive and inconsistent with ESMA's purposive intentions. AIMA believes that draft Guidelines 60 and 62 are sufficient to ensure the optimal independence of an investment firm's compliance function. Should draft Guideline 57 remain, however, extensive clarification of the terms 'combined with' and 'could undermine' would be required.

We would, of course, be happy to discuss any of the comments made in this response more fully with ESMA if thought helpful.

Yours faithfully,

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