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FBF response to the ESMA consultation on the draft guidelines concerning the compliance functions under the MiFID directive

The French Banking Federation (hereinafter the “FBF”) is the industry body representing the interests of the banking sector in France. Its membership includes all credit institutions approved for banking activities and doing business in France, totalling over 450 commercial and cooperative banks. FBF member Banks have 40,000 permanent branches in France, 400,000 employees and 60 million customers.

The FBF wishes to thank ESMA for its consultation of the parties with an interest in the positioning of compliance functions and their role in the marketing of investment services.

We should like to make the following introductory remarks:

Compliance chains have existed in an institutional form in French financial institutions since 2005, supplementing the deontological functions previously in place for many years. Whatever the terms used, professional ethicists or compliance officers, these are individuals whose assigned task is the implementation of banking and financial regulations, professional and ethical standards and instructions issued by the executive body. The compliance function is charged with disseminating this culture of compliance within its institution by means of three levers: prevention, advice and verification.

Prevention is probably the function's key aspect and is aimed at disseminating a culture of compliance to ensure that individual act in their daily work in accordance with rules and procedures, through training, raising awareness and implementation of policies and procedures. It is also in the prevention context that compliance officers contribute to the creation of new products.

Compliance provides advice to operational units every day. This is a delicate task since it up to each entity to shoulder its responsibilities in the performance of its daily activities and to seek advice from compliance only in situations where particular difficulty has arisen.

Lastly, compliance also has a role in verifying due adherence to rules for conformity. Each institution is attentive to the need for proper coordination between permanent control and periodic control, while at the same time organising the separation and independence of controls at the first and second levels (permanent control) and the third level (periodic control). Anomalies detected by means of these controls are analysed in order, where appropriate, to provide input for prevention, modifying existing procedures or reinforcing actions to raise awareness or training.

In addition to this common core, each institution organises its compliance chain in accordance with the specific characteristics arising from its structure (mutual savings banks, centralised groups), its size, its business and the type of customers it has. While preserving the autonomy of the compliance function, certain institutions, most notably because of the international, full-service character of their business, have a more horizontal internal structure. Their compliance functions are in this case an integral part of each entity based around a common procedural core. That is why it is essential to allow a degree of flexibility for operational application, in particular where the details of line reporting are concerned.

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.

Risk mapping is undoubtedly a key management component in providing input for prevention measures and guiding control plans. We feel however that such mapping must be based both on official provisions, whether legislative or regulatory, and industry and ethical standards. Mapping can be based on risks identified from risks of non-compliance which have not been the subject of any satisfactory remediation process.

It is only on completion of this initial work, which could be described as “objective” and which does not at this point take into account the characteristics specific to the institution, that it is possible to look at the interface between the risk map and the risk-based approach. This is because it appears to be hazardous to set out an initial risk map with the inclusion of factors for moderation, even before any initial objective treatment. Once the basic map has been defined, the risk-based approach can be usefully deployed, notably in control plans.

A compliance risk map is a living document that continues to receive input in the form of information of various types gathered not only by the regulation watch department but also by compliance in connection with the advice it provides or the performance of its control activities.

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

The monitoring of non-compliance risks is an important function in the compliance chain which uses a full palette of tools in order to enhance the effectiveness of controls, notably relying on the possibilities offered by the development of new technologies. The reference at point 14 to on-site inspections is not completely clear. In our view, the decision to use remote verification tools and/or to carry out checks on site should be left to the judgement of each institution. Each institution should be free to organize desk-based or on-site inspections depending on its organization, without imposition of any specific mode of control.

The roles and responsibilities of the three levels of control (first and second level permanent control and third level periodic control) must be clearly defined and separated.

Cooperation between inspectors is also an important criterion in controlling risk. The compliance chain can of course make use of periodic control to verify given points relating to compliance. In order to ensure smooth coordination and cooperation some institutions have put a compliance charter in place to address the issue of how these different functions interface.

Lastly, with regard to the processing of complaints (point 18), the role of compliance is similar to that which it plays with respect to the other departments in the operational treatment of complaints, for which compliance checks that treatment procedures have been adhered to. Other than in special cases, it is not the role of compliance to process customer complaints directly. Conversely, compliance should have access to all complaints in order to prevent repetition of instances of dysfunction. Analysis of categories of complaint may lead compliance to update its risk map, change procedures or target controls.

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

Similarly to what has been said above on the processing of complaints at operative level, regulation watch is a department in its own right and it should be left to the judgment of individual institutions to decide whether it should report to compliance. Whatever the decision, compliance must verify that the procedures applied in order to monitor the regulatory situation are effective and properly implemented.

Compliance uses regulation watch information for the purposes, where appropriate, of foresight analysis of upcoming changes. This is so because compliance undoubtedly has a role to play in assisting change by anticipating likely regulatory developments and ensuring constant enhancement of the application of existing regulatory provisions.

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

The advisories issued by the compliance function, which may extend to issuance of a veto, are a key part of compliance's role. They enable guidance to be given to operational functions or functions in direct contact with customers in situations that are particularly complex or which have unusual features, with a view to ensuring that proper consideration is given to customers' interests. Such advice, which is imposed by institutions' internal rules in some cases, may if negative lead to revision of plans for a new product, a transaction or an activity. The weight given to advice from compliance which, in certain cases left to the judgement of individual institutions in light of their business, must be escalated to senior managerial level, should be reinforced in ESMA's proposals.

Where training is concerned, our comment is similar to that on complaints processing and regulation watch activities: it is not in principle part of compliance's remit to provide training for staff directly. The definition of training programmes, the choice of training materials and the roll-out of training are usually the responsibility of human resources management which is charged with dispensing training to staff in accordance with procedures validated by compliance. However, compliance may in some circumstances be led to provide certain training, either to give it particular importance or due to the size or organizational structure of the institution, but such cases are the exception.

In paragraph 29, ESMA states that compliance must periodically assess the level of awareness of staff and their correct application of rules and procedures. The FBF wishes to be enlightened on this point which in our view is dependent on periodic control whereas compliance is responsible for permanent control.

The FBF wishes to state with respect to point 31, that it would be hazardous to request advice from compliance on strategic decisions or new business models. This is because such choices fall within the remit of senior management and the role of compliance should rather be, in our view, to provide support for the decisions of senior management and to verify that their implementation accords with regulatory requirements, industry standards and professional ethics.

The principle that informs compliance's activities is the need to protect the institution against risks of judicial, administrative or disciplinary sanction and risks of financial loss or reputational damage.

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

The guidelines proposed by ESMA on the resources that should be available to the compliance function call for no particular comment. The FBF considers that those resources are very much in line with the description of the responsibilities in preceding paragraphs. The FBF does however wish to recall that ESMA's guidelines should not be excessively prescriptive and that it must be left to institutions' discretion to decide whether the person carrying out the duties of the compliance function with regard to MiFID also performs those duties with regard to banking regulations.

In France, the financial services compliance officer (*Responsable de la Conformité des Services Financiers* or RCSI) holds formal certification and has a privileged relationship with the supervisor validating his or her appointment and position in the institution. Uniform definition of this function at European level would make it possible to envision its becoming passportable across the European Union.

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.

The description contained in the ESMA guidelines of the permanence of the compliance function appears to us to be excessively formalized and too cumbersome for the smallest entities. Although it is indeed important to ensure that a person with responsibility is always available for these duties, most notably for advice and control, ESMA's proposal which, if we understand it correctly, is aimed at instituting a continuity plan specific to compliance similar to a business continuity plan, seems to us to be genuinely excessive. The overall continuity plan of the individual institution covering all operational departments will also include compliance functions.

The issue of the organizational rules for the compliance function can typically be addressed in an internal compliance charter.

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 organization 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?

The questions of the independence and position of compliance in institutions are relevant to the governance of the individual entities, each of which combines the autonomy of the function with the need for proximity to operational departments. The FBF supports ESMA's position regarding the fact that the autonomy of the compliance function is linked to the need for it to report to management at a sufficiently senior level.

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

The question of the connection between the legal unit and compliance functions described at point 50 should in our view be addressed with very considerable care. This is so because while it can be seen that there is a conflict of interests between compliance, charged with protecting the interests of the customer, and members of the legal affairs department in providing support for business activities, this is not true of the other functions of the legal unit in monitoring the legal situation or analysing statutory or regulatory instruments for example. In these latter cases, input from the legal unit will be essential to the individuals responsible for compliance. In small organizations, contact between these two functions is frequent and procedural rules will ensure proper handling of any conflicts of interests that may arise.

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

The FBF considers that a very effective way of regulating the links between compliance and other functions is to draw up an internal charter laying down general principles common to all the departments concerned, demarcating the limits of each function and, lastly, making provision for handling any conflicts of interest that may arise.

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

The FBF considers that ESMA guidelines regarding the outsourcing of the compliance function are completely in line with the requirements laid down by MiFID. Specifically, it acknowledges that investment firms must ensure that all compliance-related requirements imposed by MiFID are duly fulfilled where all or part of the compliance function has been outsourced.

In France, investment firms that outsource essential or important services or other operational tasks continue to bear full liability for the fulfilment of all the obligations incumbent upon them. It is also provided that the outsourcing of an activity must be made subject to a formalized policy for the control of external service providers defined by the investment firm. Appropriate steps must be taken if it becomes apparent that the service provider is at risk of failing to perform its tasks in manner that is effective or compliant with legislative or regulatory requirements¹.

¹ Article 37-2 of Regulation 97-02 of 21 February 1997, relating to internal control in credit institutions and investment firms.

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.

The FBF shares ESMA's view whereby the competent authorities should verify whether the compliance measures implemented by investment firms are adequate and that the compliance function is fulfilling its responsibilities appropriately.

In France, investment firms have an obligation to implement control of non-compliance risk². Such risk is defined as *"the risk of legal, administrative or disciplinary sanctions, of significant financial loss or of reputational damage arising from failure to adhere to provisions specific to banking or financial activities, whether those provisions are legislative or regulatory in character, and whether it is a matter of professional or ethics standards, or instructions given by the executive, most notably pursuant to policies determined by the governing body"*³.

The *Autorité de contrôle prudentiel* [prudential control authority] verifies adherence to these provisions.

Q13: Do you agree that competent authorities should also assess whether amendments to the organization 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?

The tasks of the firm's senior management, which is charged with defining its business model, should not be confused with those of the firm's compliance function, which is charged with ensuring that the application of the aforementioned business model abides by all the rules applicable to the firm. The decision to modify the scope of the business model falls therefore within the remit of the institution's management. Intervention by the supervisory authority should be limited to ensuring that the changes do not affect the financial stability of the institution, without pronouncing judgement on its internal organization, insofar as that organization adheres to the applicable rules.

The supervisory authority must in any event be informed of the appointment of the institution's compliance officer.

² Article 11 of the aforementioned regulation no. 97-02.

³ Article 4 p) of the aforementioned regulation no. 97-02.