

**INTER-ASSOCIATION GUIDELINES
CONCERNING RELATIONSHIPS BETWEEN THE
COMPLIANCE FUNCTION AND OTHER FUNCTIONS
INVOLVED IN DEFINING COMMERCIAL POLICIES
GOVERNING THE PROVISION OF INVESTMENT,
ANCILLARY AND FINANCIAL PRODUCT DISTRIBUTION
SERVICES**

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Introduction

Scenario

The Italian national legislative and regulatory framework, which was defined following the entry into force of MiFID, assigns the compliance function an absolutely central role within intermediaries, owing in part to the priority attributed to safeguarding clients' interests in the provision of investment, ancillary and financial product distribution services.

The responsibilities of the compliance function include verifying that there are mechanisms within all of an intermediary's operating segments ensuring compliance with the law, and especially with provisions governing relationships with clients and the protection of clients' interests.

The compliance function – defined as management protection against non-compliance risk – therefore assumes key importance in terms of safeguarding company value, as well as reinforcing and protecting the intermediary's reputation and public trust in its operational and managerial integrity.

It is therefore in the interest of intermediaries to implement a proper structure for company processes that govern, among other matters, the adoption of strategic business decisions in the field of investment services offered to clients, devoting particular attention to regulating interactions between the various company functions involved, while also taking account of remarks by authorities on the subject of relationships between compliance functions and company functions responsible for defining commercial policies.

The reasons for the initiative

On the basis of the foregoing scenario, ABI, ASSOSIM and FEDERCASSE have deemed it appropriate to set up this governance initiative aimed at defining the principles of best practices and, through these Guidelines, clarifying the role to be assigned to the compliance function in defining commercial policies relating to the provision of investment, ancillary and financial product distribution services.

Structure and goals of the initiative

In further detail, the Guidelines establish the principles – drawn from applicable first- and second-level legislation – that lay down the timetable and methods of interaction between the compliance function and other company functions involved in the intermediary's decision-making process aimed at defining its business model in the provision of investment, ancillary and financial product distribution services.

In this regard, three levels believed to comprise that decision-making process have been identified:

- i) company guidelines and/or company policies defining the principles and procedural criteria that give rise to the commercial strategies adopted at the subsequent level;
- ii) strategic choices concerning the business model, which take the form of internal company regulations¹;
- iii) procedures and systems for the provision of services finalizing the commercial choices set forth in the two previous levels.

¹ The list of documents comprising what are known as “company regulations,” presented in level two of these Guidelines, is intended as an example and does not entail any obligation for intermediaries to adopt all of the documents cited therein.

Accordingly, the above decision-making process has been adapted to the following six subjects, which are believed to comprise an intermediary's business model:

1. products, services and pricing;
2. variable part of compensation, incentive system and conflicts of interest;
3. distribution channels;
4. client profiling and segmentation;
5. budgeting;
6. inducements.

In order to ensure that the non-compliance risk associated with the choices made by individual intermediaries are properly assessed, in accordance with the principle of proportionality, the above Guidelines are of a procedural nature and aim to formalize the hand-offs and interactions between the compliance function and the other functions involved in defining commercial policies, as well as to ensure that the processes and the associated decisions are tracked in a manner suited to allowing the intermediary's entire decision-making process to be reconstructed on an ex-post basis.

These Guidelines are adopted by intermediaries with respect to the provision in Italy of investment, ancillary and financial product distribution services.

These Guidelines shall be implemented with a view towards gradual adoption and progressive adjustment by intermediaries according to the nature, characteristics and extent of their operations.

LEVEL 1 (Company guidelines and/or company policies for drafting commercial policies)

On the basis of each intermediary's size and organizational model, as well as the nature and complexity of the business conducted, the senior body promotes and adopts **company guidelines and/or company policies** aimed at drafting commercial policies suited to achieving, over time, company profitability in conjunction with the informed assumption of risks, and in a manner compatible with financial performance and financial position, as well as operational conduct shaped by principles of integrity and transparency to clients.

In further detail, company guidelines and/or company policies:

- are drafted in accordance with the principle of proportionality;
- may be consolidated (transversal) or diversified by specific subject matter; and
- may either constitute separate documents or be integrated into internal provisions already adopted by intermediaries.

Company guidelines and/or company policies contain the procedural criteria and the general principles (see below) that guide the preparation of all documents that contribute to planning and achieving the company's commercial objectives.

On the subject of procedural criteria, company guidelines and/or company policies identify: i) the functions to be involved (the "functions involved") and how those functions are to be involved; ii) the procedure for interaction between the functions involved and the timing of such interaction; iii) the functions that are to supervise compliance with the above procedure; and iv) the functions competent for updating and archiving the documentation provided for in the procedure set forth in point ii).

The following are some non-exhaustive examples of the general principles that may be established in company guidelines and/or company policies, broken down by thematic area.

On the subject of **products**², **services and pricing**, general principles may provide for:

1. criteria for the intermediary aimed at best serving the client's interests when providing services;
2. a definition of the scope of the financial products to which the advice extends and the conditions under which such advice is provided;
3. the adoption of measures and criteria for mapping financial products consistent with the legislation and the characteristics and needs of target clients;
4. the adoption of a pricing policy consistent with the provisions of the Inter-Association Guidelines Governing Illiquid Financial Products validated by CONSOB on 5 August 2009 that is suited to permitting objective pricing subject to reconstruction, while taking account of the complexity of the financial products distributed;
5. the consistency of the pricing criteria and mechanisms adopted on the primary and secondary markets;
6. a specific service agreement governing the pricing process, if this process is outsourced to a third intermediary;
7. a suitable disclosure to clients in order to guarantee the transparency of the pricing conditions applied;
8. the education of those involved in sales processes so that they can develop the skills and acquire the knowledge necessary for them to do their job properly (i.e. via training programs).

² Both when products in the catalogue are revised and when new products are added.

On the subject of the **variable part of compensation**³, the **incentive system**⁴ **and conflicts of interest**, general principles may provide for:

1. consistency with the intermediary's objectives, company culture and overall corporate and internal control structure, as well as with prudent risk management policies and long-term strategies;
2. an incentive system that provides for the definition of objectives related to the compliance of behaviour with qualitative requirements, such as customer satisfaction, or quantitative requirements;
3. the presence of deferred disbursement criteria tied to performance assessment, where required by the legislation, measured on the basis of long-term indicators in regards to profitability over time;
4. the assumption of risk levels consistent with those defined as the target by senior bodies;
5. the independence of the compensation of company functions and offices from results arising from the conduct of activity that constitutes a potential conflict of interest with a negative impact on clients' interests;
6. the adaptation: i) of the activities and responsibilities of the functions involved, in addition to those of the compliance function (hereinafter the "CF"), to the process of identifying and managing conflicts of interest relating to commercial policies, with particular regard to compensation and incentive systems for personnel, as well as to incentives other than the commissions or fees normally collected for providing investment, ancillary and financial product distribution services; and ii) of appropriate organizational measures for managing conflicts of interest and preventing them from having a negative impact on clients' interests.

³ In reference to financial advisors, the variable part of compensation is understood to include any sums paid in addition to basic compensation.

⁴ Where adopted.

On the subject of **distribution channels**, general principles may provide for the adoption of various types of schemes, or a combination of such schemes, according to the legal risks peculiar to each distribution channel.

On the subject of **client profiling and segmentation**, general principles may provide for a review not only of the propriety of client profiling criteria, but also of client segmentation criteria, where client segmentation results in an impact on the methods of provision of the intermediary's investment, ancillary and financial product distribution services, as well as on the proper application of rules of conduct in relation to clients.

In the area of **budgeting**, general principles may indicate the methods whereby the budgeting process takes account of the information obtained by the intermediary on the subject of clients' needs and characteristics (see below) in view of proportionality and gradualism.

In the area of **inducements** (non-monetary compensation, commissions and benefits), general principles may provide for the identification of specific safeguards aimed at ensuring that incentives are properly surveyed and managed.

Role of the compliance function

The CF – called upon to express its assessments of non-compliance risks arising from choices regarding commercial policies and the need, if any, to implement further, additional safeguards aimed at mitigating such risks – is to be involved, at this level, in the process of defining company guidelines and/or company policies for the issuance of a compliance opinion. In this context, the CF's opinion, for the purposes of the analyses within its purview, is based on the principles set forth in applicable provisions of laws and regulations, as well as any codes/rules independently adopted or adhered to by the intermediary.

LEVEL 2 (Strategic choices)

In the definition of commercial policies, intermediaries must take, with regard to their internal regulations, the decisions made at the previous level as a point of reference, so they can best serve their clients' interests.

Such internal regulations shall therefore govern the various aspects pertaining to commercial policies, some of which are as follows: commercial strategies regarding entry into new markets with services and/or products; the extension of the geographical areas of interest; a focus on specific client segments; the inclusion of new types of products in the catalogue; the signing of collaborative arrangements with third entities; offering own-brand products and/or third party products; the mapping of products by risk level and intended client type; the planning of service provision procedures; volume and earnings objectives, such as customer satisfaction; commercial initiatives, with or without incentives; the inducement policy; and the pricing policy.

Internal company regulations concerning the subjects listed above are divided into various documents that include, but are not limited to, those listed below (the influence of the CF in the drafting of these documents should be particularly emphasized):

1. **Strategic plan or long-term development plan/annual commercial plan:**

- on the understanding that the inclusion of new products in the company catalogue is governed by the internal procedures/provisions in use at the intermediary, the CF verifies that the procedures defined ensure the following for the **launch of new products (own-brand products or those of third parties)**: i) the completeness and conformity of the documents

that are to result as the output of the activities (e.g., internal product assessment sheets), including with regard to the other policies that comprise the system; ii) the efficacy and completeness of information streams between the various company departments that participate in analyzing and assessing products, each to the extent of its sphere of competency; iii) a reference to training plans, where deemed to be necessary; and iv) the participation by the CF in the process of launching new products (own or third-party) to the extent of its competency, as defined in the company guidelines and/or company policies set out in level 1;

- in the area of **distribution channels**, the CF verifies the following for each channel:
 - i) the consistency of the decisions made by the intermediary, highlighting the implementations required to ensure the compliance of those decisions with legislative requirements and the risks ensuing from failure to adopt such implementations (for example, if an intermediary using a single traditional distribution channel [network or branches] intends to pursue a development plan that also includes the adoption of a multi-channel strategy, the CF must identify the measures required to ensure that the new channels' operations are compliant with the law. Such measures may be: information technology procedures for checking appropriateness/suitability via remote channels; codes of conduct and internal circulars governing the operations of financial advisors; operating processes capable of ensuring compliance with the right to reconsider in out-of-branch dealing; control systems, including remote systems, for monitoring the operations of financial advisors and thereby mitigating the risk of non-compliant , etc.);

- ii) the identification of the risks associated with the various distribution channels (e.g., for the financial advisors channel, the prevalence of the risk of behaviour not compliant with the law, and for remote channels, the prevalence of the risk of non-compliant processes, etc.);
 - iii) the planning of adequate safeguards for mitigating non-compliance risk according to the selected distribution channels (e.g., the prevalence of information technology instruments for safeguarding remote channels; the combination of rule-based safeguards [such as governance codes and agency agreement clauses] and information-technology safeguards [such as anomaly indicators and mailing systems for the operations of financial advisors]);
 - iv) the planning of training programs for personnel differentiated according to the distribution channels selected;
- in the area of **incentive systems**, the CF verifies that:
 - i) the set of objectives assigned (see below) is consistent with the principles indicated in the company guidelines and/or company policies;
 - ii) there is an adequate presence of objectives consistent with the client's needs;
 - iii) the planned goals meet measurability requirements, at least with regards to the sales network;
 - iv) the targets assigned (for example, threshold values for access to the bonus system) are appropriate, with the aim of avoiding distorting the sales network's behaviour;
 - v) deferred disbursement principles, where present, are applied for the purposes of the quality/sustainability of services over time;
- in the area of **advisory service**, in verifying compliance with the primary legislative requirements, the CF checks that adequate

contractual and procedural safeguards are in place in order to ensure that:

- i) only personal recommendations are provided, according to each client's specific characteristics;
- ii) the recommendations provided are subject to advance suitability assessment conducted according to an objective, impartial method;
- iii) the advisory agreement specifies the obligations assumed by the intermediary towards the client, as well as the scope of the financial instruments with respect to which the intermediary undertakes to render advisory service;
- iv) the procedures used by the intermediary in rendering the service to the client provide for criteria for the proposal of alternative instruments;
- v) the information technology systems provide for restrictions that allow only suitable transactions to be recommended;

2. **Budgeting:** drafted by the competent functions and approved by the senior body. In this regard, the CF verifies that the budget drafting process: i) takes account of the need to manage conflicts of interest for the purpose of minimizing the risk of non-compliance with the law; ii) takes account of information concerning the characteristics of clients already available to the intermediary, supplemented, where appropriate, by evidence obtained from a market, marketing and customer satisfaction analysis; and iii) identifies the services/products compatible with clients' characteristics on the basis of the above analysis;

3. **Periodic/annual communications plan concerning commercial initiatives:** drafted by the marketing/communication function, in collaboration with the other competent functions and the product factories/product management units in the context of any ad-hoc committees on the basis of the principles indicated in company

guidelines and/or policies. In this context, the CF verifies that the proposals prepared in this regard comply with the principles set forth in company guidelines and/or company policies;

4. **Commercial agreements:** in order to offer clients a wide range of investment products/services, the marketing function, or another function charged with this task, periodically assesses the product range and the expediency of entering into commercial agreements with third companies on the basis of the strategic guidelines laid down by the senior body. In the case of the marketing of the products of third companies, that same function then asks those companies to provide the documentation concerning the financial products or services being marketed, so that it may be determined whether they are consistent with commercial policies, in addition to documentation for the purpose of defining service agreements governing distribution methods. The CF supports the marketing function or other assigned function, in matters within its purview, in conducting the aforementioned assessment, verifying the suitability of potential agreements in regards to legislative compliance in the area of inducements, conflicts of interest and, more generally, compliance with provisions of applicable laws and internal regulations governing the placing/distribution of products/services. After assessing the opportunities in terms of costs and benefits and the assumption of risks, in collaboration with the other assigned company functions, the marketing function, or other assigned function, illustrates aspects including, but not limited to, the following for the competent decision-making body with the aim of formalizing the agreement: i) strategic objectives in terms of economic return and increase in market share; ii) target clients; iii) the conditions and responsibilities of the parties, for example establishing which party is required to assess suitability/appropriateness, conduct client profiling, etc; iv) the risks to be monitored; and v) the organizational impacts;

5. **Annual incentive plan:** drafted with the contribution of the human resources function, in part on the basis of the needs expressed by the competent functions, and approved by the senior body. The CF verifies that the incentive plan complies with applicable legislation and internal regulations. For example, the CF verifies that the criteria for defining incentive systems:

- a) are directed at ensuring a relationship between bonuses and company results in the medium/long term;
- b) take account of risk-adjusted result indicators;
- c) take account of qualitative parameters.

In further detail, the competent function assesses the expediency of including among the objectives for sales functions or other assigned functions customer satisfaction indicators created on the basis of specific surveys addressed to clients, and/or parameters that reflect the achievement of results, such as:

- advisory orders as a percentage of the total;
- the percentage of information gathered from the client; and
- the number of complaints.

The CF verifies that the objectives of the incentive system:

- i) are consistent with the role and duties performed, as assigned;
- ii) include objectives or adjustments based on compliance indicators, where deemed appropriate.

In the case of a multi-channel bank, when verifying the incentive plan the CF considers the particular working arrangements established between the bank and financial advisor (typically agency arrangements) and the resulting forms of compensation (prevalence of the variable component);

6. **Segmentation/clustering documentation:** this document (where present or included in another document containing company regulations) establishes operating criteria for the definition of:
- i) client segmentation and clustering and the maintenance thereof;
 - ii) commercial measures (see below).

The CF performs a conformity check on this document or its contents present in other company regulation documents where it is believed that the established segmentation and commercial measures have an impact on the methods whereby the intermediary's investment, ancillary and financial product distribution services are provided, as well as on the proper application of rules of conduct towards clients;

7. **Training plan:** the CF verifies that there are suitable training initiatives aimed at ensuring that operators/advisors are aware of: i) the services and products offered; ii) applicable legal obligations; and iii) applicable internal regulations;
8. **Conflict policy:** in the context of the conflict of interest management policy provided for in applicable regulations, the CF contributes to the following in regards to specific issues attributable to commercial policies:
- i) identifying the criteria on the basis of which to identify material conflicts of interest that may arise in the provision of services and damage the client's interests;
 - ii) identifying the departments that are required to report such situations of conflict of interest, including with regard to group activities, present in individual operating activities. Such surveys are conducted on a priority basis within departments that render investment and/or ancillary services, the human resources function (where present) and the sales function (where present);

- iii) assessing situations of potential conflict deriving from the various departments and identifying the procedures to be followed, as well as the measures to be adopted for managing conflicts of interest;
- iv) defining the content of the notice to be given to the client if the measures adopted are not sufficient to manage the conflict of interest;
- v) updating the register of conflicts of interest.

Conflict policies also include definitions of the internal reporting procedures to be adopted for timely reporting to the CF by the competent functions of all possible situations giving rise to conflicts of interest. This is done so that the conflict policy can be updated and supplemented (for example, new distribution agreements, changes to the incentive/compensation systems adopted and new products/services that the intermediary intends to distribute);

9. **Pricing policy:** in order to ensure that its pricing methods are objective and subject to reconstruction, the CF conducts an advance assessment that such methods are consistent with the general principles set forth in the company guidelines and/or company policies, checking that:

- i) roles and responsibilities relating to the pricing process have been identified;
- ii) the methods, sources, parameters and mark-ups employed have been identified;
- iii) there is a provision requiring there to be compliance with the principle of the consistency of the proprietary portfolio, primary market and secondary market;
- iv) a monitoring process aimed at verifying the propriety of the methods identified has been defined;
- v) an updating and revision process has been defined;

10. **Inducement policy:** in this respect, the CF verifies that the following process of identifying and managing inducements (non-monetary compensation/commissions/benefits) has been defined:

- i) identification of the functions involved in the process of identifying and managing inducements characterizing investment, ancillary and financial product distribution services rendered, with the assignment of the associated responsibilities;
- ii) an analysis, in accordance with applicable laws, of the criteria for identifying the types of inducements that the intermediary pays/receives in connection with the provision of investment, ancillary and financial product distribution services relevant for incentive purposes;
- iii) mapping of inducements (surveying of those paid/received by the intermediary and allocation to the corresponding categories provided for in applicable legislation; and identification of the criteria on the basis of which eligibility for inducements received by parties other than clients can be justified);
- iv) the definition of the criteria according to which information is provided to investors in accordance with the options established by law.

Role of the compliance function

To sum up, in level 2:

- the competent functions first draft the aforementioned documents, in accordance with the principle of proportionality and in light of the criteria established in level 1, as well as formulate any ad-hoc proposals that

supplement the documents already adopted in the context of periodic revisions, involving the CF for the activities within its purview; and

- the CF conducts a consistency check with level 1 principles on the above documents and individual ad-hoc proposals before they are submitted to the competent decision-making body.

LEVEL 3 (Procedures and systems)

In order to verify the suitability and effectiveness of the organizational and procedural safeguards implemented, as well as consistency with the budgeting defined in previous levels, the CF:

- verifies the following in connection with the **launch of new products**: i) compliance with the internal rules of the procedure followed when defining launch initiatives; and ii) where required, the completeness of the internal product assessment sheet, which contains a summary of the characteristics of the product and the comments/assessments of the various company functions involved. The CF also participates in defining the template for sheets with regard to the assessments within its purview;
- verifies that for **commercial agreements**, with regards to aspects within its purview, the operating methods adopted are consistent with the agreements entered into and the internal implementation provisions that the organization function, or other assigned function, has imparted to the interested functions and/or the distribution network, through the communication channels in use at the intermediary (circulars, service orders, etc.);
- verifies the characteristics of **commercial measures** launched during the year and aimed at steering the network towards commercial objectives for the period, and in particular those objectives to which specific bonuses are tied, in order to detect any risk that commercial departments may be induced to distribute products that do not correspond to clients' characteristics and risk profiles.

Commercial measures are also subject to conformity reviews and are implemented throughout the network through the issuance of specific internal regulations and, in some cases, alignment meetings with the distribution chain.

Notice of the implementation of new commercial measures must be given to the CF for the activities within its purview;

- in connection with **advertisements**, verifies the principles and models for preparing standard advertisements identified within the context of company guidelines and/or company policies and may conduct a one-off review of the content of individual advertisements to verify that they are compliant.

If an advertisement contains something "new", i.e. something that differs from standard communication principles and models identified in the context of company guidelines and/or company policies, the CF must always intervene and issue a specific opinion;

- on the subject of **advisory service**, reviews operating safeguards and verifies that: i) operating procedures contain a full, detailed description of all of the various phases of the advisory process; ii) provision of the service is adequately governed by procedures; and iii) there are first-level control safeguards that ensure that the service to clients is always properly rendered;
- in connection with **conflicts of interest attributable to commercial policies** – with the periodicity deemed suitable and at least annually – assesses the suitability of the measures adopted for managing potential conflicts of interest, proposing any corrective measures deemed necessary to the senior body;
- with regard to monitoring activity for **pricing**, the CF, in collaboration with other functions, verifies that company procedures have been defined with the aim of ensuring the effective use of the pricing methods provided for in the pricing policy;
- with respect to the **inducement management policy/guidelines**, the CF periodically reviews and assesses the suitability of the procedures and

measures adopted. The CF also verifies the progress of the 'inducements collected/paid by the intermediary' review process, proposing, where necessary, organizational and procedural changes aimed at ensuring suitable mitigation of the identified risk of non-compliance.

Role of the compliance function

In general terms, at this level the CF (directly or through participation in any other collegial bodies) instigates an assessment of the commercial policy on the basis of the company guidelines and/or company policies (level 1) and internal regulations (level 2), conducting an overall assessment the results of which are submitted to the senior body. This must be done on an annual basis at the very least.

In further detail, as regards the frequency and methods whereby the CF submits the results of reviews, reference may be made to the customary reports to the senior body that the CF is required to draft at pre-determined intervals (for each intermediary, and at least on an annual basis).

The CF also conducts ongoing reviews of the proper application and effectiveness of procedures.