

Response of the Association of Luxembourg Compliance Officers (“ALCO”) to the ESMA Consultation paper on “Guidelines on certain aspects of the MiFID compliance function requirements”.

ALCO is the Association of Luxembourg Compliance Officers whose objective is to bring together Compliance Officers – and in general people with compliance responsibilities – from the financial and insurance sectors in Luxembourg. It endeavours to promote communication and the exchange of ideas between its members through regular meetings, through their participation in internal or external working groups, and by organising conferences and debates on professional ethics and compliance issues within the financial sector in the Grand-Duchy of Luxembourg. Its aims also to establish contacts with foreign associations which have similar objective.

The association is operating since 2000 and is composed of more than 600 members across the financial sector in Luxembourg.

As an introduction, the ALCO strongly welcomes the ESMA initiative to set guidelines supporting and structuring the Compliance function in investments firms (as per the MiFID definition). This paper is seen as a positive contribution with two general comments :

- the fact that the Compliance function is not limited to investor protection but also encompasses other objectives such as anti-money laundering, data protection, market abuses and also sometimes antifraud etc should be taken into account. It should be checked that the present principles do not interfere or conflict with other possible principles related to the above matters although from a Luxembourg point of view, it is not seen as such.
- the necessity to consider / balance the proportionality principle as mentioned in principle 5 of the C/P.

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 believe that a risk-based approach is indeed an efficient way of organising and using compliance resources. However the necessity for Compliance to be kept informed of business changes should be underlined in order to be informed without any delay of new emerging risks. Supporting the systematic involvement of Compliance in any new business developments would mitigate the risk.

The formalisation of the risk assessment should not be regulated and it should be considered that regular Compliance reporting might adequately meet the requirement.

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

In our view, the proposals are adequate and we fully recognize the monitoring dimension of Compliance.

Regarding principle 13 we agree that each investment firm remains responsible for monitoring its own compliance risks. However, to avoid conflicting views within a Group, this monitoring should be in line with the Group policies & principles and local legal & regulatory prescriptions. The existing wording might call for an unwished and unnecessary independence towards the Group the investment firm belongs to.

Regarding principle 14, we do support the idea of on site reviews but for efficiency purposes, this should be considered in connection with principle 17 and in coordination / reliance on other internal controls, in the concept of delegated tasks.

Regarding principle 17, we think it could be slightly mitigated as for small-size institutions, resources may be limited. In such case, and taking into consideration the proportionality principle Compliance should be given the possibility to rely on reports / monitoring produced by internal audit or risk management, rather than reperforming all the controls itself.

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

We agree with all aspects of this guideline.

With regards to principle 20, progress of the remedial measures, when known, should also be an item of the regular reporting.

With regards to principle 24, we support the transparency towards the competent authorities. However, to avoid creating an additional administrative burden we would promote that reports transmitted to the investment firm supervisory function could also be forwarded, as it, to the Authorities. We do not share the view of one authority who requested an annotated version of the reporting.

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

Although we fully support the idea of Compliance being responsible for training staff on Compliance matters, we would like to stress the following points:

With regards to principle 27, training should be based on the employee's risk exposure: indeed, staff that is not exposed to MiFID does not require regular training in this respect. However, highly exposed staff would need to be trained on a relatively frequent basis (for example at least once every two years).

With regards to principle 26, Compliance should not be responsible for training on all policies and procedures of the firm but only on matters falling under Compliance's responsibility. Other training is and should remain the responsibility of line management. The wording that Compliance should "arrange training" might not be appropriate to avoid an unwanted shift of administrative and logistic tasks to Compliance to organize training.

Regarding principle 29, we do not share the views that Compliance should assess whether staff hold the necessary awareness of the firms policies and procedures. The responsibility of Compliance is to periodically inform staff of the relevant policies and procedures and to promote a compliance culture within the Firm.

With regards to principle 32, we fully support and we would suggest an even clearer wording mentioning that no decision should be taken without a Compliance opinion / consultation and that an adverse decision should be reported to the Senior Management and the supervisory function.

With regards to principle 33, we would like to specify that there is some correspondence with competent authorities that is out of Compliance scope such as for example the periodic financial reporting. This requirement should be limited to matters falling under the scope of Compliance fields of responsibility.

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

We fully agree and support.

Regarding comments IV.1. specifying that *all compliance staff should have the necessary knowledge and experience for the task assigned to them*, we recommend to clarify that each Compliance staff should not necessarily be a specialist in each Compliance matters but that, overall, the Compliance department should have the necessary knowledge and experience to undertake its mission.

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 fully agree and support both points. However, some kind of proportionality should be taken into account especially when applied to smaller Investment Firms.

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.

This point is indeed crucial! The independence of the Compliance function is key to its effectiveness.

Not only when performing its monitoring or advisory tasks, but also when there is a need to report incidents or breaches to the relevant bodies, the Compliance function should not be censored. Although this consultation paper only looks at the Compliance function from a MiFID point of view, we would like to stress that the same principles should apply regarding other Compliance matters such as AML. For example, if Compliance is confronted with a suspicious transaction, it should be able to exercise its duties in an independent way.

With regards to the appointment or replacement of the compliance officer, it would be preferable that the decision is taken by the supervisory function and, if taken by the senior management, it should at least be ratified by the supervisory function.

The paper does not address the level of the position of the compliance officer within the Firm. We believe that the position should be high enough to guarantee its independence. We believe that a reporting line to the CEO or the president of the supervisory function would guarantee at best the independence.

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?

Same answer as question 7.

Q9: Please provide your comments (with reasons) on any or all aspects of this guideline on Article 6(3) exemptions.
Q10: Please provide your comments (with reasons) on any or all aspects of this guideline on combining the compliance function with other functions.

We agree and think that such assessment should take place in a dialogue with the firm's regulatory authority.

On principle 50, regarding the possible combination with Legal, it is generally proper not to combine. When there is a crisis, the compliance officer if combined with Legal might be in a difficult or conflicting position.

On principle 53, we take the view that compliance function and internal audit should definitely be distinguished. Internal Audit acts at the third level of control whereas Risk Management and Compliance act at the second level of control.

We strongly support the principle that the compliance function cannot be subordinated to other control functions like Risk Management, Internal Control or Legal if considered as such. However, some coordination could and should exist for efficiency purposes but, in all cases, it should remain clear that Compliance responsibility and independence is maintained and Compliance, when delegating tasks, is still supervising their proper execution.

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

We agree with the guidelines as set out in the paper as long as the delegation of compliance functions for large Firms remains within the Group.

For small investment firms where the compliance function is often held partially by a senior manager, the outsourcing solution might bring additional skills and more availability than the internal solution. It also enables a permanent solution and avoids back-up issues (absence, illness ...). However, it should not be a reason for not developing a sound and adequate Compliance culture throughout the firm. A clear Compliance responsibility should be maintained within the firm (stronger than simply appointing someone for supervising the outsourced function).

We also think that the delegation of the Compliance function should be kept within the condition of principle 62 (nature, size and scope of the activities) and the reasons for the delegation should be clearly articulated. Some guidance on the conditions under which the outsourcing might not be considered as acceptable might be helpful. Conflict of interests between the service provider and the outsourcing party must also be avoided.

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.

We agree, although we believe this review should be risk-based and of a "free format". By this, we mean that the authority can also base its assessment on the regular exchanges it may have with the Compliance function, be they written or oral.

We think that a regular communication between the Authority and the Compliance officer should be supported. It would also reinforce the position of the Compliance officer. We also take the views that it is part of a normal supervisory process that when a compliance officer is removed or resigns, an exit meeting is organised by the Authority.

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?

Although we agree that the authorities do have a role to play in this field, we would like to stress that the prime responsibility of assessing the adequacy of the firm's Compliance function lies with the firm itself, its Executive Committee and its supervisory function in particular.

To conclude, we would also like to mention that the crucial question of the “status” of the Compliance Officer -as well as the responsibility it entails- could also be considered. A first step has been taken in Belgium for instance by requiring at least that an insurance policy is subscribed by the investment firm to provide the Compliance Officer with a legal protection. This would be seen as a significant step to motivate qualified people joining the profession or remaining in the profession, thus maintaining a high level of expertise and confidence into the Compliance Officer status.