

Comments

ESMA Consultation Paper Guidelines on certain aspects of the MiFID II compliance function requirements

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Comments on ESMA Consultation Paper Guidelines on certain aspects of the MiFID II compliance function requirements, 10 October 2019

General remarks

We welcome the opportunity to comment during the consultation on the guidelines on certain aspects of the MiFID II compliance function requirements and would like to make the following general remarks in advance:

Although the MiFID II¹ requirements contain little in the way of changes as regards the compliance function, the large amount of new, detailed guidance in the proposed ESMA guidelines is a source of irritation. Given the regulation already in place, no further detailed guidance by ESMA is necessary in our view.

Specific remarks

Q1: Do you believe that guideline 1 should be further amended and/or supplemented? Please also state the reasons for your answer.

Answer: No. The proposed amendments to guideline 1 raise some questions.

According to paragraph 6, the term "*shall*" is used by ESMA when describing a MiFID II requirement. In general guideline 1 (paragraph 18) the previously used term "*should*" has been replaced by "*shall*". Paragraph 18 does not, however, correspond to Article 22(2) of the MiFID II Delegated Regulation. For example, the open phrase "*amongst others*" that it now contains is nowhere to be found in the MiFID II Delegated Regulation. Furthermore, it remains unclear what the intention behind the addition of "*priorities*" (alongside "*focus*") is. Overall, the changes to the wording make general guideline 1 less comprehensible.

The same applies for the supporting guidelines. For example, it remains unclear particularly in paragraph 19 why changes were made to the wording (e.g. new term "*work programme*" – referred to so far in Article 22 of the MiFID II Delegated Regulation and the 2012 ESMA guidelines solely as "*monitoring programme*"; addition of "*objectives*" alongside "*focus*").

Q2: Do you agree with the suggested approach in relation to the compliance function's monitoring obligations? Please also state the reasons for your answer.

Answer: As regards our comments on paragraph 26, see our answer to Q4 below.

Q3: Do you believe that further guidance is needed to clarify the compliance function's monitoring obligations?

Answer: No.

¹ Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU, Art. 21 ff. Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive.

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Q4: Do you agree with the addition to paragraph 26?

Answer: Possible client reaction to process shortcomings are revealed in the course of complaints management. The proposed addition to point (c) (client interviews) is therefore unnecessary, as the compliance function is already required to consider clients' complaints as a source of relevant information in the context of its activity (see paragraph 30). Such client interviews by the compliance function are neither practicable nor helpful. Since the compliance function is involved in the complaints management process, they do not deliver any additional benefit. The proposed addition of client interviews should therefore be dropped.

Q5: Do you agree with the suggested general content of the compliance function reports (paragraph 32² of the guidelines)? Please also state the reasons for your answer.

Answer: We take a partly critical view of the amendments made to the reporting obligations. The presentation of the content of the compliance report under the chosen headings in paragraph 32 of guideline 3 creates the impression that a specific structure for the compliance report is being prescribed. It should therefore be made clear that this is not intended by the guidelines and that the structure of the compliance report is only a recommendation and that deviating from it is allowed.

It should also be particularly borne in mind that, while the reports are also sent to the supervisory function, supervisory functions should only be bothered with information that is essential for them to perform their supervisory tasks.

Specifically:

Point (a)

Third bullet point: we see no need for reporting on the qualifications of compliance function staff. It is sufficient to report on these only in the event of material breaches of the qualification criteria (as regards this requirement, see in general point (c), first bullet point).

There is no need to set out the reporting lines in the compliance report. These are prescribed under the securities supervisory regime, so that their inclusion in the compliance report would be unnecessary.

We therefore recommend deletion of the third bullet point.

Point (b):

This part of the compliance report (*Manner of monitoring and reviewing*) is unnecessarily expanded in our view. It is of secondary importance for senior management and particularly for the supervisory function.

First bullet point: how the first bullet point relates to the second is unclear. Compared with the second bullet point, it would require detailed information, which is why it would be going too far. We therefore recommend deletion.

² Internal remark: cited (correctly, in our view) on page 9 of the ESMA consultation paper, but not in the summary of questions on page 13.

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Third bullet point: as the basis for the monitoring programme is always the latest version of the risk analysis, a summary of the planned monitoring activities in the compliance report is not possible. We therefore recommend deletion.

All in all, we are thus against expanding the reporting obligations under point (b) compared with the 2012 guidelines.

Point (c):

Third bullet point: the number of complaints is already provided to the competent supervisory authority in line with Article 26(6) of the MiFID II Delegated Regulation. There is therefore no need for it to be included in the compliance report once again.

As regards the required reporting of findings, the third bullet point contradicts the first bullet point, according to which a "*summary of major findings*" is sufficient. This should also apply to findings based on clients' complaints, particularly as in practice findings on deficiencies are often obtained not only from a single source but from several different sources (e.g. clients' complaints and own monitoring activity).

We therefore recommend deletion of the third bullet point.

Point (d):

Not least with the above-mentioned compliance report addressees in mind, the proposed additions compared with the 2012 guidelines go too far. That applies specifically to the first and third bullet points.

First bullet point: as regards degree of detail, the first bullet point under point (d) contradicts the first bullet point under point (c), according to which "*a summary of major findings*" is sufficient. The same should also apply to information on "*actions taken*". Given the intended compliance report addressees, indication of the organisational units involved should be dispensed with, as this information does not deliver any additional benefit to either senior management or the supervisory function. We therefore recommend deletion of the first bullet point.

Third bullet point: the proposed new reporting obligation in the first sentence of the third bullet point would go beyond the existing obligation to report to the competent supervisory authority under Article 26(6) of the MiFID II Delegated Regulation. As regards the second sentence, we refer to our above remarks on the first bullet point (under point (d)) and on the third bullet point under point (c). We therefore recommend deletion of the third bullet point.

The qualification contained in the 2012 guidelines that inclusion in the compliance report is only necessary where senior management has not already been duly informed through other channels should be reincorporated and generally adopted.

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Q6: Do you agree with the suggested content of the compliance function reports in relation to product governance arrangements (paragraph 33³ of the guidelines)? Please also state the reasons for your answer.

Answer: We agree in general with what paragraph 33 says. Only the information requirement in paragraph 33, point (c) goes too far in our view.

Q7: Do you agree that the information that should be included in the compliance function reports should be proportional to the complexity and level of risks of the financial instruments manufactured and/or distributed by the firm? Do you believe that additional criteria should be taken into account? Please also state the reasons for your answer.

Answer: We welcome the proposed guidance that the scope of the reporting obligations set out in paragraph 33 should be subject to the proportionality principle. It should also be borne in mind in this respect that the compliance report is intended for senior management and the supervisory function. These should only be bothered with information that is essential for them to perform their tasks. No additional criteria should therefore be taken into account.

Q8: Do you believe that further guidance is needed to clarify how firms should address the potential conflicts arising from the combination of the complaints management function with the compliance function? What practical solution could be envisaged?

Answer: According to Article 26(3), sentence 2 of the MiFID II Delegated Regulation, the complaints management function can be carried out by the compliance function. The MiFID II Delegated Regulation does not suggest that this may lead to conflicts of interest. Such potential conflicts of interest are not discernible either in our view. It is therefore surprising that ESMA assumes such a conflict of interest in new paragraph 34.

In our view, it is vital that the complaints management function is overseen by the compliance function (see already paragraph 30). This is usually done through application of the 'four eyes' principle, i.e. by someone within the compliance function who does not exercise the complaints management function. We therefore recommend deleting paragraph 34.

Q9: Do you believe that further topics/areas should be included in the compliance function reports?

Answer: No. We additionally refer to our answers to Q5 to Q8.

³ Remark on footnote 1 applies here accordingly.

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Q10: Do you agree with the approach taken for the review of guideline 4? Do you believe that guideline 4 should be amended and/or supplemented further? Please also state the reasons for your answer.

Answer: As regards paragraphs 37 to 46, no further amendments or additions should be made.

Q11: Do you believe that guideline 5 should be amended and/or supplemented further? Please also state the reasons for your answer.

Answer: We take a critical view of the responsibility of the management as made in paragraph 48, last sentence. Such responsibility cannot be determined by way of interpretation, but only at level 1 or, if an authorisation is stipulated, at level 2. In addition, responsibility of the management for appropriate staffing of the compliance function and for the expertise of the compliance function's staff conflicts with the explicitly stipulated responsibility of the compliance officer for the compliance function (see Article 22(3), lit. b) MiFID II Delegated Regulation). We therefore recommend deleting of last sentence in paragraph 48.

Given that the compliance function has full access to all relevant information for its tasks, including all reports to senior management and the supervisory function (see in this respect paragraph 51), we see no need for new paragraph 52. We recommend deleting paragraph 52.

Q12: Do you agree with the creation of a new guideline solely focused on the skills, knowledge, expertise and authority of the compliance function? Please also state the reasons for your answer.

Answer: As regards general guideline 6 (paragraph 53), we take a critical view of the requirement in the final sentence to demonstrate "*high professional ethical standards and personal integrity*". These are not relevant criteria under the securities supervisory regime, which says that the compliance function is required to possess the necessary "*expertise*" (see Article 22(3)(a) of the MiFID II Delegated Regulation). As the definition of such criteria would be open to interpretation, their verifiable implementation in practice is likely to be impossible. We therefore recommend deleting the final sentence of paragraph 53.

Q13: Do you agree with the additions to guideline 6 (formerly part of guideline 5)?

Answer: See in this connection our answer to Q12.

Q14: Do you believe that guideline 7 should be further amended and/or supplemented? Please also state the reasons for your answer.

Answer: In our view, paragraphs 59 to 62 are appropriate. No further amendments or additions should therefore be made.

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Q15: Do you believe that guideline 8 should be further amended and/or supplemented? Please also state the reasons for your answer.

Answer: In our view, paragraphs 63 to 65 are appropriate. No further amendments or additions should therefore be made.

Q16: Do you believe that guideline 9 should be further amended and/or supplemented? Please also state the reasons for your answer.

Answer: In our view, paragraphs 66 to 72 are appropriate. No further amendments or additions should therefore be made.

Q17: Do you agree that, subject to the proportionality principle, a firm should consider establishing and maintaining a core team of compliance staff whose sole area of responsibility is MiFID II? Please also state the reasons for your answer.

Answer: The compliance requirements are subject to the proportionality principle (cf. Article 22(1), final sentence of the MiFID II Delegated Regulation). This applies also in regard to compliance function staffing. What is important in this respect is therefore the situation in each individual investment firm.

Paragraph 78, especially Q17, raises fears that particularly smaller institutions that do not currently have “a core team within the compliance function staff members whose sole area of responsibility is MiFID compliance” may in future come under pressure to justify this although their staffing arrangements are in line with the regulatory requirements for the compliance function. This would be inappropriate.

Another argument against this proposal is that ESMA wishes to further specify Article 22 of the MiFID II Delegated Regulation, i.e. the MiFID compliance function. But where the compliance function already exists and is engaged in performing the relevant securities compliance tasks, we fail to understand how a further core team can be set up within it with a different set of tasks. Like the (securities) compliance function itself, this core team would also only deal with MiFID II questions.

New paragraph 78 should therefore be deleted.

Q18: Do you believe that guideline 10 should be further amended and/or supplemented? Please also state the reasons for your answer.

Answer: We refer to our answer to Q17 that concerns paragraph 78. Otherwise (paragraphs 73 to 77), the ESMA guidance is appropriate in our view. No further amendments or additions are therefore necessary.

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Q19: Do you agree with the amendments made to guideline 11? Please also state the reasons for your answer.

Answer: In our view, the amendments in paragraph 81 are appropriate. They provide clarification, i.e. they are in line with how outsourcing is understood in Germany today. We therefore have no objections to these amendments.

Q20: Do you believe that guideline 11 should be further amended and/or supplemented? Please also state the reasons for your answer.

Answer: In our view, paragraphs 79 to 86 are appropriate. No further amendments or additions are therefore necessary.

Q21: Do you agree with the amendments made to guideline 12? Please also state the reasons for your answer.

Answer: We see no need – in Germany, at any rate – for the supervisory approach specified in paragraph 92, as conformity with the compliance function requirements and due performance of compliance function tasks are already checked comprehensively by particularly the internal and external audit functions.

Q22: Do you believe that guideline 12 should be further amended and/or supplemented? Please also state the reasons for your answer.

Answer: We refer to our answer to Q21 that concerns paragraph 92. Otherwise (paragraphs 87 to 93), we see no need for any further amendments or additions.