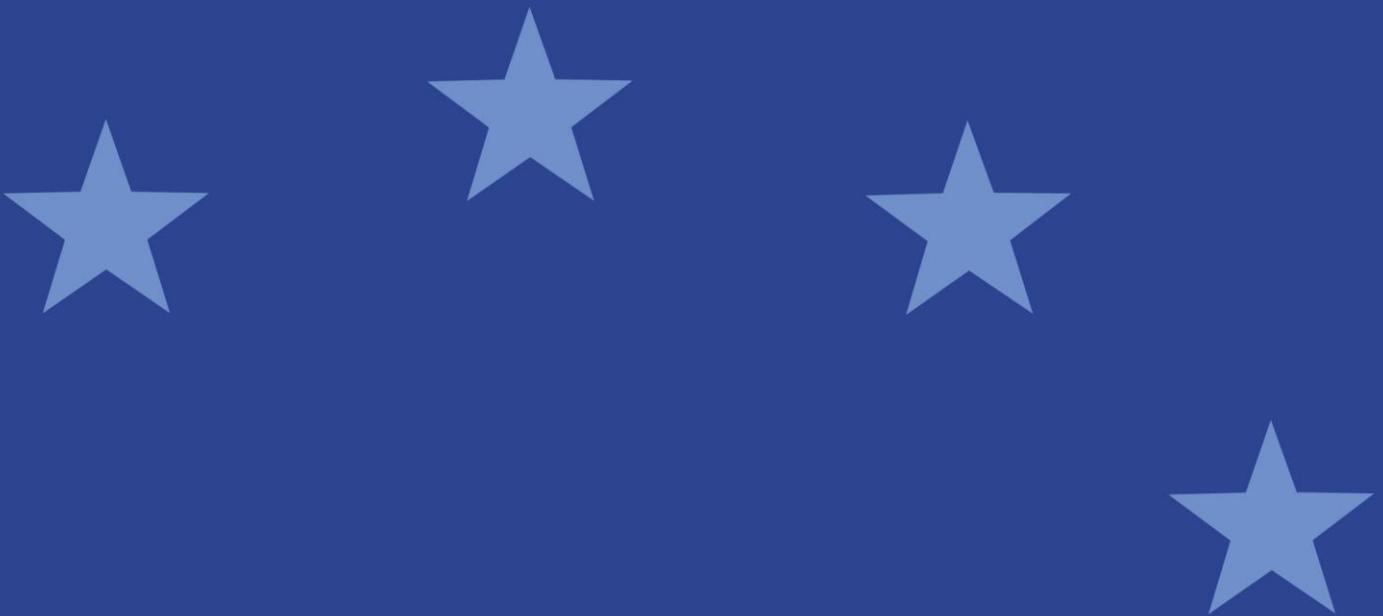




European Securities and  
Markets Authority

## Consultation paper

Guidelines on certain aspects of the MiFID compliance function requirements



## **Responding to this consultation paper**

ESMA invites comments on all matters set out in this consultation paper and, in particular, on the specific questions listed in Annex 1. Comments are most helpful if they:

- indicate the number of the question to which the comment relates;
- respond to the question stated;
- contain a clear rationale, also clearly stating the costs and benefits; and
- describe any alternatives ESMA should consider.

Comments should reach us by **24 February 2012**.

All contributions should be submitted online at [www.esma.europa.eu](http://www.esma.europa.eu) under the heading 'Consultations'.

### **Publication of responses**

All contributions received will be published following the end of the consultation period, unless otherwise requested. Please clearly and prominently indicate in your submission any part you do not wish to be publically disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure. A confidential response may be requested from us in accordance with ESMA's rules on access to documents. We may consult you if we receive such a request. Any decision we make is reviewable by ESMA's Board of Appeal and the European Ombudsman.

### **Data protection**

Information on data protection can be found at [www.esma.europa.eu](http://www.esma.europa.eu) under the heading 'Disclaimer'.

### **Who should read this paper?**

This paper is primarily of interest to competent authorities and firms that are subject to MiFID – in particular, investment firms, credit institutions and UCITS management companies when providing investment advice or discretionary portfolio management services. This paper may also be of interest to trade associations, investors and consumer groups because MiFID's compliance function requirements seeks to ensure that firms have in place effective compliance arrangements so that any risk of failure by firms to comply with its MiFID obligations (including MiFID's provisions to ensure investor protection) can be detected and minimised.

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## **Acronyms**

ESMA            European Securities and Markets Authority

MiFID           Markets in Financial Instruments Directive

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## **I. Executive summary**

### **Reasons for publication**

1. In accordance with Article 16(2) of the ESMA Regulation<sup>1</sup>, this paper sets out for consultation draft ESMA guidelines on certain aspects of the Markets in Financial Instruments Directive (MiFID)<sup>2</sup> compliance function requirements.
2. The financial crisis has highlighted the need for more clarification about the role of compliance, especially in view of the plethora of evolving legislation and increasing levels of scrutiny from both regulators and consumers. Also, compliance risk often takes second place to other areas of risk within a firm, and this can lead to the deficient implementation of appropriate compliance processes.
3. The purpose of these draft guidelines is to enhance clarity and foster convergence in the implementation of the MiFID organisational requirements relating to certain aspects of the compliance function. The guidelines are also aimed at reinforcing the importance of the compliance function.

### **Contents**

4. Section II explains the background to our proposals.
5. Section III sets out draft guidelines on the responsibilities of the compliance function for monitoring, reporting and advising.
6. Section IV sets out draft guidelines on the organisational requirements of the compliance function for the standards of effectiveness, permanence and independence. Separate guidelines are proposed for the arrangements an investment firm should apply in the following situations: the application of the exception set out in Article 6(3)(2) of the MiFID Implementing Directive, the extent of interaction of the compliance function with other functions, and the outsourcing of the tasks of the compliance function.
7. Section V is addressed to competent authorities and proposes approaches for reviewing the requirements of the compliance function.
8. Annex I lists all the questions set out in the consultation paper; Annex II contains the high-level cost-benefit analysis; and Annex III contains the full text of the draft guidelines.

### **Next steps**

9. ESMA will consider the responses it receives to this consultation paper in Q1 2012 and expects to publish a final report, and final guidelines, in Q2 2012.

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<sup>1</sup> Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC.

<sup>2</sup> Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments.

## **II. Background**

1. MiFID requires investment firms to implement a series of systems and controls (appropriate to the nature, scale and complexity of their business) aimed at securing a robust governance framework, with a clear organisational structure and lines of responsibility, and effective risk management and compliance processes. This includes policies and procedures to ensure regulatory compliance and the establishment of a compliance function.
2. The financial crisis has highlighted the need for better and tighter monitoring and managing of risk (including reputational risk) by investment firms, and for a more comprehensive and pro-active compliance strategy, especially in view of the plethora of evolving legislation and increasing levels of scrutiny from both regulators and investors.
3. Also, compliance risk often takes second place to other risk areas within an investment firm, and this can lead to the deficient implementation of appropriate compliance processes. The compliance function should therefore have a more prominent role within investment firms.
4. Article 13 of MiFID and Article 6 of the MiFID Implementing Directive set out the regulatory provisions for the compliance function of investment firms. The proposals for guidelines in this area are aimed at helping investment firms to increase the effectiveness of the compliance function, so are focused on the responsibilities of the compliance function.
5. These guidelines should be read together with the proportionality principle as set out in Article 6(1) of the MiFID Implementing Directive. Therefore, these guidelines apply to investment firms taking into account the nature, scale and complexity of their respective businesses, and the nature and range of investment services and activities undertaken in the course of their business.
6. The explanatory text in support of several guidelines contains descriptions of specific practices of competent authorities concerning the compliance function of investment firms. These descriptions aim to provide the reader with additional information on differing approaches of competent authorities without setting up additional requirements for investment firms or competent authorities (and thereby triggering the obligation under Article 16(3) of the ESMA Regulation to comply or explain).
7. These guidelines are focused on providing further clarification on the regulatory provisions in Article 6 of the MiFID Implementing Directive and the compliance function's scope as set out in MiFID. These guidelines do not aim to cover generally what constitutes an effective compliance function (like the compliance function guidance issued by other international bodies).

## **III. Guidelines on responsibilities of the compliance function**

8. The responsibilities of the compliance function are set out in Article 6(2) and 9(2) of the MiFID Implementing Directive. They include requirements for monitoring and assessment of the level of the compliance risk the investment firm faces, reporting on material compliance matters, and advising and assisting investment firm staff. This section III sets out guidelines for the effective fulfilment of these responsibilities.
9. The compliance function's responsibilities set out in these guidelines encompass all areas of investment services, activities and ancillary services provided by investment firms.

### III.I. Compliance risk assessment

**While ensuring the comprehensive scope of the compliance function, investment firms should ensure that the function takes a risk-based approach in order to allocate the function's resources efficiently. Risk assessment should be used to determine the focus of the monitoring and advisory activities of the compliance function. The assessment should be performed regularly to ensure that the focus and the scope of compliance monitoring and advisory activities remain valid.**

10. MiFID requires investment firms to establish, implement and maintain adequate policies and procedures designed to detect any risk of failure by the investment firm to comply with its obligations under MiFID. As part of this, the compliance function should identify the level of compliance risk the investment firm faces, taking into account the investment services, activities and ancillary services provided by the investment firm, as well as the scope of financial instruments traded and distributed.
11. The compliance function's objectives and work program should be developed and set up on the basis of this assessment. The identified risks should be reviewed on a regular basis to ensure that any emerging risks (for example, resulting from new business fields or other changes in the investment firm's structure) are taken into consideration.

**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.**

### III.II. Monitoring obligations of the compliance function

**Investment firms should ensure that the compliance function establishes a monitoring program that covers all relevant areas of the investment firm's investment services, activities and ancillary services in order to ensure that compliance risk is comprehensively monitored.**

12. The aim of a monitoring program should be to evaluate whether the investment firm's business is conducted in compliance with its obligations under MiFID and whether the internal guidelines, organisation and control measures the investment firm has put in place remain effective and appropriate.
13. Where an investment firm is part of a group (national or international), responsibility for the compliance function rests with each investment firm in that group. While the compliance function within each investment firm should take the group of which it is a part into account - for example, by working closely with audit, legal, regulatory and compliance staff in other parts of the group - it should nevertheless ensure that the investment firm (as distinct from the group) remains responsible for monitoring its own compliance risk.
14. The risk-based approach to compliance should form the basis for determining the appropriate tools and methodologies, as well as the extent of the monitoring program and the frequency of monitoring activities (which may be recurring, ad-hoc and/or continuous). The compliance function should also ensure that its monitoring activities are not only desk-based, but that it also verifies - for example, through on-site inspections at the operative business units - how policies and procedures are imple-

mented in practice. The compliance function should also consider the scope of reviews to be performed.

15. Suitable tools and methodologies for monitoring activities that could be used by the compliance function (or indeed by other functions) could include (but are not limited to):
  - (a) the use of aggregated risk measurements (for example, risk indicators) and the checking of calculations;
  - (b) the use of reports warranting management attention, documenting material deviations between actual occurrences and expectations (an exceptions report) or situations requiring resolution (an issues log);
  - (c) targeted trade surveillance, observation of procedures, desk reviews and/or interviewing of relevant staff.
16. The monitoring program should also reflect changes to the investment firm's risk profile, which may arise, for example, from significant events such as acquisitions, IT system changes, or re-organisation. It should also extend to the implementation and effectiveness of any remedial measures taken by the investment firm in response to breaches of MiFID.
17. The monitoring activities performed by the compliance function should also take into account the first level controls in the investment firm's business areas (i.e. controls by the operative units, as opposed to second level controls performed by compliance) and reviews by the risk management and internal audit functions. Reviews by the internal audit function should be co-ordinated with the monitoring activities performed by the compliance function.
18. While the compliance function should not have a role in determining the outcome of complaints, it should have a role in overseeing the operation of the complaints process. In this regard, investment firms should grant the compliance function access to customer complaints received by the firm, and the complaints process should ensure that the compliance function can access any complaint.

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

### III.III. Reporting obligations of the compliance function

**Investment firms should ensure that regular written compliance reports are sent to senior management. Investment firms should ensure that the content of those compliance reports contains a description of the implementation and effectiveness of the firm's compliance program. Reports should be prepared at least annually. Where the compliance function makes significant findings, the compliance officer should, in addition, report these promptly to senior management. The supervisory function, if any, should also receive the reports.**

19. The written report to senior management should cover all business units providing investment services, activities and ancillary services. Where the report does not cover all of these activities of the investment firm, the compliance function should clearly state the reasons for it not doing so.
20. The following matters should be addressed in these written reports, where relevant:

- (a) implementation of the compliance program and outcome of the review of the policies and procedures as well as the outcome of on-site inspections or desk-based reviews including breaches and deficiencies in the investment firm's organisation and compliance processes that have been discovered and the appropriate remedial measures taken;
  - (b) relevant changes in regulation as well as the applicable standards and guidelines set out by ESMA and competent authorities on these provisions over the period covered by the report and the measures taken and to be taken to ensure compliance with the changed requirements (where senior management has not previously been made aware of these through other channels);
  - (c) future relevant regulatory changes which are likely to have a significant impact on the business;
  - (d) other significant compliance issues that have occurred since the last report; and
  - (e) major correspondence with competent authorities (where senior management has not previously been made aware of these through other channels).
21. In addition, the compliance function should report to senior management, in a timely manner, on an ad-hoc basis when significant compliance matters such as major breaches of MiFID and the respective national laws have been discovered. The report should also provide suggestions for the necessary remedial steps.
  22. The reports provided to senior management should also be provided to the supervisory function, if any.
  23. The compliance function could consider additional reporting lines to a group compliance function where the investment firm is part of a group.
  24. Some competent authorities require investment firms to provide them with compliance function reports. This practice provides competent authorities with first-hand insight into an investment firm's compliance activities, as well as any breaches of regulatory provisions. One competent authority also requires senior management to provide it with an annotated version of the report containing explanations of the compliance function's findings.

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

III.IV. Advisory obligations of the compliance function

**Investment firms should ensure that the compliance function fulfils its advisory responsibilities including training for staff, day-to-day assistance for staff and participation in the establishment of new policies and procedures within the investment firm.**

25. It is important that investment firms, apart from any corporate culture, promote and enhance a 'compliance culture' throughout the firm. The purpose of the compliance culture is not only to establish the overall environment in which compliance matters are treated, but also to engage staff with the principle of improving investor protection.

26. The investment firm needs to ensure that its staff are adequately trained. For this, the compliance function should arrange training and/or other support for staff. Where training is performed by other units, the compliance function should support these units in performing any training. Training and/or other support should focus particularly, but not exclusively, on:
  - (a) the internal policies and procedures of the investment firm and its organisational structure; and
  - (b) MiFID, the relevant national laws, the applicable standards and guidelines set out by ESMA and competent authorities, and other supervisory and regulatory requirements that may be relevant, as well as any changes to these.
27. Training should be performed on a regular basis, and need-based training should be performed where necessary. Training should be delivered as appropriate – for example, to the investment firm’s entire staff as a whole, or to specific business units, or even to a particular individual.
28. Training should be developed on an on-going basis so that it takes into account all relevant changes (for example, new legislation or standards or guidelines set out by ESMA and competent authorities, changes in the investment firm’s business model).
29. The compliance function should periodically assess whether staff hold the necessary level of awareness and correctly apply the investment firm’s policies and procedures.
30. Compliance staff should also provide assistance to staff from the operative units in their day-to-day business and be available to answer questions arising out of daily business activity.
31. The compliance function should be involved in the development of the relevant policies and procedures within the investment firm in the area of investment services, activities and ancillary services. In this context, the compliance function should be enabled, for example, to provide compliance expertise and advice to business units about strategic decisions or new business models, or at the launch of a new advertising strategy.
32. Furthermore, the compliance function should be involved in all significant modifications of the organisation of the investment firm in the area of investment services, activities and ancillary services. This includes the decision-making process when new business lines or new financial products are being approved. In this context, the compliance function should be given the right to participate in the approval process for all financial instruments to be taken up in the distribution process. Senior management should therefore encourage business units to consult with the compliance function regarding their operations.
33. The compliance function should regularly be involved in all relevant correspondence with competent authorities.

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

#### IV. Guidelines on organisational requirements of the compliance function

34. Article 6(2) of the MiFID Implementing Directive requires investment firms to establish and maintain a permanent, effective and independent compliance function; and Article 6(3)(a) requires the compliance function to have the necessary authority, resources and expertise, as well as access to all relevant information. This section sets out draft guidelines for organisational arrangements in order to assist investment firms in complying with these provisions. It also sets out draft guidelines for organisational requirements regarding the application of the exception provided for in Article 6(3), the combining of the compliance function with other control functions, as well as for outsourcing matters.

##### IV.I. Effectiveness of the compliance function

**Investment firms should ensure that appropriate human and other resources are allocated to the compliance function taking into account the scale and types of investment services, activities and ancillary services undertaken by the investment firm. They should also provide compliance staff with the authority necessary to exercise their duties effectively, as well as access to all information concerning the investment services and activities as well as ancillary services undertaken.**

**Investment firms should also ensure that all compliance staff have the necessary knowledge and experience for the tasks assigned to them. The compliance officer should have sufficiently broad knowledge and experience and a sufficiently high level of expertise so as to be able to assume responsibility for the compliance function as a whole and ensure that it is effective.**

35. The number of staff required for the tasks of the compliance function depends to a large extent on the nature of the investment services, activities and ancillary services and other services provided by the investment firm. Where an investment firm's business unit activities are significantly extended, the investment firm should ensure that the compliance function is similarly extended. Whether the number of staff is still adequate for the fulfillment of the duties of the compliance function should be monitored regularly by the investment firm.
36. In addition to human resources, sufficient IT resources should be allocated to the compliance function.
37. Adequate resources also include the allocation of an appropriate budget for the compliance function. The compliance officer should be consulted before the budget is determined. All decisions for significant cuts in the budget should be documented in writing and contain detailed explanations.
38. Compliance staff should at all times have access to the relevant information for their tasks including all relevant databases. In order to have a permanent overview of the areas of the investment firm where sensitive or relevant information might arise, the compliance officer should have access to all information systems within the investment firm as well as any internal or external audit reports or other reporting to senior management or the supervisory board, if any. Where relevant, the compliance officer should also be granted right of attendance for meetings of senior management or the supervisory function. Where this right is not granted, this should be documented and explained in writing. For this, the compliance officer should have in-depth knowledge of the investment firm's organisation, corporate culture and decision-making processes in order to be able to identify for which meetings his or her attendance is important.

39. In order to ensure that compliance staff have the authority required for their duties, the senior management of the investment firm should support them in the exercise of these duties. Authority also implies possessing adequate expertise and relevant personal skills, and may be enhanced by the investment firm's compliance policy (or 'charter') explicitly acknowledging the specific authority of the compliance staff.
40. The necessary expertise of all compliance staff requires knowledge of MiFID and the respective national laws as well as the applicable standards and guidelines set out by ESMA and competent authorities on these provisions, as far as these are relevant for the provision of their tasks. A higher level of expertise is necessary for the designated compliance officer.
41. The compliance officer should demonstrate sufficient professional experience where this is necessary to be able to assess the (potential) compliance risks and conflicts of interest inherent in the investment firm's business activities. The required professional experience may have, amongst others, been acquired in operational positions, in other control functions or in regulatory functions. Additionally, the compliance officer should have specific knowledge of the different business activities provided by the investment firm. The relevant expertise required may differ from one investment firm to another, as the nature of the main compliance risks that firms face will differ. In respect of Article 5(1)(d) of the MiFID Implementing Directive, a newly employed compliance officer may therefore have the need for specialised knowledge focused on the specific business model of the investment firm even though this person has been previously appointed as compliance officer for another investment firm if the business model and inherent risks between the investment firms differ widely.

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

IV.II. Permanence of the compliance function

**Investment firms are required to ensure that the compliance function performs its tasks and responsibilities on an ongoing, permanent, basis. In order to ensure this, investment firms should provide adequate stand-in arrangements for the responsibilities of the compliance officer which apply when the compliance officer is absent, and arrangements to ensure that the responsibilities of the compliance function are performed on an ongoing basis. These arrangements should be in writing.**

42. The investment firm should ensure that the responsibilities of the compliance function are fulfilled adequately by other persons during any absence of the compliance officer. This ought to be ensured for foreseeable (for example, annual leave) or any unforeseeable (for example, illness) absence of the compliance officer. Compliance staff should be sufficiently qualified to perform the compliance officer's duties in his absence.
43. The responsibilities and competences as well as the authority of the compliance staff should be set out in a 'compliance charter' or other general policies or internal rules. This should include information on the work plan and the reporting duties of the compliance function as well as information on the compliance function's risk-based approach to monitoring activities. Relevant amendments to regulatory provisions should be reflected promptly by adapting these policies/rules.
44. Furthermore, the compliance function should perform its activities on a permanent basis and not only in specific circumstances. This requires regular monitoring on the basis of a monitoring schedule. The

monitoring activities should regularly cover all key areas of investment services and activities, taking into account the risk content associated with the business areas. The compliance function should be able to respond rapidly to unforeseen events, thereby changing the focus of its activities within a short timeframe if necessary.

**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.**

#### IV.III. Independence of the compliance function

**Investment firms should ensure that the compliance function holds a position in the organisational structure that ensures that the compliance officer and other compliance staff act independently when performing their tasks, and that the compliance officer is appointed and replaced by senior management or the supervisory function.**

45. While senior management is responsible for establishing an appropriate compliance organisation and for monitoring the effectiveness of the organisation that has been implemented, the tasks performed by the compliance function in the day-to-day business should be carried out independently from senior management and other units of the investment firm. In particular, the investment firm's organisation should ensure that other business units may not issue instructions or otherwise influence compliance staff and their activities. Senior management's instructions to compliance staff should be general and should not interfere with the compliance function's day-to-day activities. The investment firm should ensure that the decision on the appointment and replacement of the compliance officer may only be taken by senior management or the supervisory function.

**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 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?**

#### IV.IV. Exemptions

**Where an investment firm considers that it may not be proportionate for it to comply with the requirements set out in Article 6(3) of the MiFID Implementing Directive, it should assess whether the effectiveness of the compliance function is com-**

**promised by the proposed arrangements. This assessment should be reviewed regularly.**

46. Investment firms should decide on measures that are best suited to the firm's particular nature and circumstances. In deciding this, investment firms should take the following criteria (inter alia) into account:
- (a) The types of investment services, activities and ancillary services and other business activities provided by the investment firm (including those not related to investment services, activities and ancillary services), interaction between the investment services and activities and ancillary services and other business activities carried out by the investment firm.
  - (b) The scope and volume of the investment services, activities and ancillary services carried out (absolute and relative to other business activities), balance sheet total and income of the investment firm from commissions and fees and other income in the context of the provision of investment services, activities and ancillary services.
  - (c) The types of financial instruments offered to clients.
  - (d) The types of customers targeted by the investment firm (professional, retail, eligible counterparties).
  - (e) Staff headcount.
  - (f) Whether the investment firm is part of an economic group under Article 1 of the Seventh Council Directive of 13 June 1983 on consolidated accounts (Directive 83/349/EC).
  - (g) Services provided through a commercial network, i.e. tied agents, or branches.
  - (h) Cross-border activities provided by the investment firm.
  - (i) Organisation and sophistication of the IT systems.
47. Competent authorities may also find these criteria useful in determining which types of investment firms may benefit from the exemptions under Article 6(3) of the MiFID Implementing Directive.
48. An investment firm may fall under the exemption if the performance of the necessary compliance tasks – including where appropriate combined with other control functions – does not require a full-time position due to the nature, scale and complexity of the firm's business, and the nature and range of the investment services, activities and ancillary services offered.
49. It may be disproportionate for a smaller investment firm with a very narrow field of activities and/or limited human resources to appoint a separate compliance officer. Where an investment firm makes use of the exemption, conflicts of interest between the tasks performed by the relevant persons should be minimised as much as possible.
50. The compliance function should generally not be combined with the legal unit, or be subordinate to internal control functions, where this could undermine the compliance function's independence.

51. Where an investment firm makes use of the exemption, it should document how this is justified, taking into account the principle of proportionality so that the competent authority is able to assess this.

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

IV.V. Combining the compliance function with other functions

**With the exception of the internal audit function, the independence of the compliance function is not necessarily compromised by compliance staff overlapping with other control functions. The overlap of the compliance function with other control functions should be documented, including the reasons for any overlap.**

52. Compliance staff should generally not be involved in the activities they monitor. However, overlap of the compliance function with other control units at the same level (such as money laundering prevention or risk management) may be acceptable if this does not generate conflicts of interests or compromise the effectiveness of the compliance function.
53. Combining the compliance function with the internal audit function should generally be avoided as this is likely to undermine the independence of the compliance function because the internal audit function is charged with the oversight of the compliance function.
54. Any overlap of the compliance function with other control functions should be documented by investment firms so that competent authorities are able to assess whether the combination of functions is adequate. Whether staff from other control functions also perform compliance tasks, should also be a relevant consideration in the determination of the relevant number of staff necessary for the compliance function.
55. Regardless of any overlap, the compliance function should in any case coordinate its activities with the control activities performed by other units.

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

IV.VI. Outsourcing of the compliance function

**Investment firms should ensure that all applicable compliance function requirements are fulfilled where any or all of the compliance function is outsourced.**

56. The MiFID outsourcing requirements for critical or important functions apply in full to the outsourcing of the compliance function. All the conditions for outsourcing set out in Article 14 of the MiFID Implementing Directive must be met if an investment firm outsources the compliance function.
57. The requirements that apply to the compliance function are the same whether or not the compliance function is outsourced. This means that all the requirements in Article 6 of the MiFID Implementing Directive must be met if the compliance function is fully or partially outsourced to a service provider.
58. The investment firm should perform a due diligence assessment before choosing a service provider in order to ensure that the criteria set out in Articles 6 and 14 of the MiFID Implementing Directive are

met. The investment firm should ensure that the service provider has the necessary authority, resources, expertise and access to all relevant information in order to perform the outsourced compliance function tasks effectively.

59. Investment firms should also ensure that when outsourced, the compliance function remains permanent in nature, i.e. that the service provider can perform the function on an ongoing basis and not only in specific circumstances.
60. Investment firms should monitor whether the service provider performs its duties adequately, which includes monitoring the quality and the quantity of the services provided. The investment firm ought to appoint a person to be responsible for supervising and monitoring the outsourced function on an ongoing basis, and this person should have the necessary resources and expertise to be able to fulfil this responsibility.
61. Investment firms should be aware that outsourcing of the compliance function within a group does not lead to a lower level of responsibility for the senior management of the individual investment firms within the group. However, a centralised group compliance function may, in some cases, provide the compliance officer with better access to information, and lead to greater efficiency of the function, especially if the entities share the same premises.
62. If an investment firm, due to the nature, size and scope of its business activities, is unable to employ compliance staff independent of the performance of services they monitor, then outsourcing of the compliance function is likely to be an appropriate approach to take.

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

## **V. Guideline on competent authority review of the compliance function**

### V.I. Review of the compliance function by competent authorities

**Competent authorities should review how investment firms implement and maintain the MiFID compliance function requirements. This should apply in the context of the authorisation process, as well as in the course of on-going supervision.**

63. Article 7 of MiFID states that a competent authority shall not grant authorisation to an investment firm unless and until such time as it is fully satisfied that the applicant complies with all requirements under the provisions adopted pursuant to MiFID. Accordingly, the competent authority should assess whether a firm's compliance function is adequately resourced and organised and whether adequate reporting lines have been established. It should require that any necessary amendments are made to the compliance function as a condition for authorisation.
64. Additionally, as part of the ongoing supervisory process, a competent authority should assess whether the measures implemented by the investment firm for the compliance function are adequate, and whether the compliance function fulfils its responsibilities appropriately. Competent authorities should also assess whether amendments to the resources and organisation of the compliance function are required due to changes in the business model of the investment firm, and where such amendments are necessary, monitor whether these amendments have been implemented (having provided a reasonable timeframe for the firm to do so).

65. Some competent authorities license or approve the nominated compliance officer following an assessment of the qualifications of the compliance officer. This assessment may include an analysis of the compliance officer's curriculum vitae, as well as an interview with the designated person. This sort of licensing process may help to strengthen the position of the compliance function within the investment firm and in relation to third parties.
66. Other regulatory approaches impose the responsibility for the assessment of the compliance officer's qualification solely on the senior management of the investment firm. Senior management assesses the prospective compliance officer's qualifications before appointment. Whether the investment firm properly complies with this requirement is then assessed within the general review of the firm's compliance with the relevant MiFID requirements.
67. Some Member States require investment firms to notify the competent authorities of the appointment and replacement of the compliance officer. In some jurisdictions, this notification must also be accompanied by a detailed statement on the grounds for the replacement. This can help competent authorities gain insight into possible tensions between the compliance officer and senior management which could be an indication of deficiencies in the compliance function's independence.
68. The above practices could be helpful to other competent authorities.

**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.**

**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?**

## Annex I

### List of questions

- 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.
- Q2: Please provide your comments (with reasons) on any or all aspects of this guideline on the monitoring obligations of the compliance function.
- Q3: Please provide your comments (with reasons) on any or all aspects of this guideline on reporting obligations of the compliance function.
- Q4: Please provide your comments (with reasons) on any or all aspects of this guideline on the advisory obligations of the compliance function.
- Q5: Please provide your comments (with reasons) on any or all aspects of this guideline on the effectiveness of the compliance function.
- 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.
- 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 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?
- 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.
- Q11: Please provide your comments (with reasons) on any or all aspects of this guideline on outsourcing of the compliance function.

- 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.
- 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?

## **Annex II**

### **Cost-benefit analysis**

1. Article 16 of the ESMA Regulation requires ESMA, where appropriate, to analyse the potential costs and benefits relating to proposed guidelines. It also states that cost-benefit analyses must be proportionate in relation to the scope, nature and impact of the proposed guidelines.
2. The purpose of the draft guidelines is to enhance clarity by emphasising a number of important issues, and to foster convergence in the implementation of the MiFID organisational requirements relating to the compliance function. The aim is to help investment firms to improve their implementation of these requirements and thereby enhance existing standards. The draft guidelines do not reflect any regulatory changes; neither do they purport to provide substantially new guidance relating to the applicable MiFID requirements.
3. For investment firms, a more effective compliance function, and a clearer strategy for implementing compliance processes, should ensure that the compliance function will add value to the investment firm. Greater convergence leads to improved investor protection (consumer outcomes), which is a key ESMA objective.
4. Given the limited scope, nature and impact of the proposed guidelines, ESMA considers that a full cost-benefit analysis is therefore not required.

## Annex III

### Draft guidelines on certain aspects of the MiFID compliance function requirements

#### I. Scope

1. These guidelines apply to investment firms (including credit institutions or UCITS management companies when providing investment services) and competent authorities.
2. These guidelines apply from [30] days after publication.

#### II. Definitions

3. Unless otherwise specified, terms used in the Markets in Financial Instruments Directive and the MiFID Implementing Directive have the same meaning in these guidelines. In addition, the following definitions apply:

<i>Markets in Financial Instruments Directive</i>	Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments.
<i>MiFID Implementing Directive</i>	Directive 2006/73/EC of 10 August 2006 implementing Directive 2004/39/EC of the European Parliament and the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive.
<i>compliance function</i>	The function within an investment firm responsible for identifying, assessing, advising, monitoring and reporting on the investment firm's compliance risk.
<i>compliance officer</i>	The person appointed by the investment firm responsible for the compliance function (see Article 6(3)(b) of the MiFID Implementing Directive).
<i>compliance risk</i>	The risk of regulatory sanctions an investment firm may suffer as a result of its failure to comply with its obligations under MiFID and the respective national laws, as well as the applicable standards and guidelines set out by ESMA and competent authorities on these provisions.
<i>compliance staff</i>	All persons performing activities for the compliance function.
<i>senior management</i>	The person or persons who effectively direct the business of the investment firm (see Article 2(9) of the MiFID Implementing Directive).
<i>supervisory function</i>	The person or persons (the function) within an investment firm responsible for the supervision of its senior management (see Article 9(4) of the MiFID Implementing Directive).



### **III. Purpose**

4. The purpose of these guidelines is to ensure common, uniform and consistent application of the compliance function provisions in Article 13 of the Markets in Financial Instruments Directive (MiFID) and Article 6 of the MiFID Implementing Directive. Together, these articles set out the regulatory provisions for the compliance function of investment firms.

### **IV. Compliance and reporting obligations**

#### **Status of the guidelines**

5. This document contains guidelines issued under Article 16 of the ESMA Regulation.<sup>3</sup> In accordance with Article 16(3) of the ESMA Regulation competent authorities and financial market participants must make every effort to comply with guidelines.
6. Competent authorities to whom these guidelines apply should comply by incorporating them into their supervisory practices, including where particular guidelines are directed primarily at financial market participants.

#### **Reporting requirements**

7. Competent authorities to which these guidelines apply must notify ESMA whether they comply or intend to comply with the guidelines, with reasons for non-compliance, by **[date]** to **[email address]**. A template for notifications is available from the ESMA website.
8. Financial market participants are not required to report whether they comply with these guidelines.

### **V. Guidelines on certain aspects of the MiFID compliance function requirements**

#### **V.I. Guidelines on responsibilities of the compliance function**

##### **Compliance risk assessment**

###### *General guideline*

9. While ensuring the comprehensive scope of the compliance function, investment firms should ensure that the function takes a risk-based approach in order to allocate the function's resources efficiently. Risk assessment should be used to determine the focus of the monitoring and advisory activities of the compliance function. The assessment should be performed regularly to ensure that the focus and the scope of compliance monitoring and advisory activities remain valid.

###### *Supporting guidelines*

10. MiFID requires investment firms to establish, implement and maintain adequate policies and procedures designed to detect any risk of failure by the investment firm to comply with its obligations under

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<sup>3</sup> Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC.

MiFID. As part of this, the compliance function should identify the level of compliance risk the investment firm faces, taking into account the investment services, activities and ancillary services provided by the investment firm, as well as the scope of financial instruments traded and distributed.

11. The compliance function's objectives and work program should be developed and set up on the basis of this assessment. The identified risks should be reviewed on a regular basis to ensure that any emerging risks (for example, resulting from new business fields or other changes in the investment firm's structure) are taken into consideration.

### **Monitoring obligations of the compliance function**

#### *General guideline*

12. Investment firms should ensure that the compliance function establishes a monitoring program that covers all relevant areas of the investment firm's investment services, activities and ancillary services in order to ensure that compliance risk is comprehensively monitored.

#### *Supporting guidelines*

13. The aim of a monitoring program should be to evaluate whether the investment firm's business is conducted in compliance with its obligations under MiFID and whether the internal guidelines, organisation and control measures the investment firm has put in place remain effective and appropriate.
14. Where an investment firm is part of a group (national or international), responsibility for the compliance function rests with each investment firm in that group. While the compliance function within each investment firm should take the group of which it is a part into account - for example, by working closely with audit, legal, regulatory and compliance staff in other parts of the group - it should nevertheless ensure that the investment firm (as distinct from the group) remains responsible for monitoring its own compliance risk.
15. The risk-based approach to compliance should form the basis for determining the appropriate tools and methodologies, as well as the extent of the monitoring program and the frequency of monitoring activities (which may be recurring, ad-hoc and/or continuous). The compliance function should also ensure that its monitoring activities are not only desk-based, but that it also verifies - for example, through on-site inspections at the operative business units - how policies and procedures are implemented in practice. The compliance function should also consider the scope of reviews to be performed.
16. Suitable tools and methodologies for monitoring activities that could be used by the compliance function (or indeed by other functions) could include (but are not limited to):
  - (a) the use of aggregated risk measurements (for example, risk indicators) and the checking of calculations;
  - (b) the use of reports warranting management attention, documenting material deviations between actual occurrences and expectations (an exceptions report) or situations requiring resolution (an issues log);

- (c) targeted trade surveillance, observation of procedures, desk reviews and/or interviewing of relevant staff.
- 17. The monitoring program should also reflect changes to the investment firm's risk profile, which may arise, for example, from significant events such as acquisitions, IT system changes, or re-organisation. It should also extend to the implementation and effectiveness of any remedial measures taken by the investment firm in response to breaches of MiFID.
- 18. The monitoring activities performed by the compliance function should also take into account the first level controls in the investment firm's business areas (i.e. controls by the operative units, as opposed to second level controls performed by compliance) and reviews by the risk management and internal audit functions. Reviews by the internal audit function should be co-ordinated with the monitoring activities performed by the compliance function.
- 19. While the compliance function should not to have a role in determining the outcome of complaints, it should have a role in overseeing the operation of the complaints process. In this regard, investment firms should grant the compliance function access to customer complaints received by the firm, and the complaints process should ensure that the compliance function can access any complaint.

## **Reporting obligations of the compliance function**

### *General guideline*

- 20. Investment firms should ensure that regular written compliance reports are sent to senior management. Investment firms should ensure that the content of those compliance reports contains a description of the implementation and effectiveness of the firm's compliance program. Reports should be prepared at least annually. Where the compliance function makes significant findings, the compliance officer should, in addition, report these promptly to senior management. The supervisory function, if any, should also receive the reports.

### *Supporting guidelines*

- 21. The written report to senior management should cover all business units providing investment services, activities and ancillary services. Where the report does not cover all of these activities of the investment firm, the compliance function should clearly state the reasons for it not doing so.
- 22. The following matters should be addressed in these written reports, where relevant:
  - (a) implementation of the compliance program and outcome of the review of the policies and procedures as well as the outcome of on-site inspections or desk-based reviews including breaches and deficiencies in the investment firm's organisation and compliance processes that have been discovered and the appropriate remedial measures taken;
  - (b) relevant changes in regulation as well as the applicable standards and guidelines set out by ESMA and competent authorities on these provisions over the period covered by the report and the measures taken and to be taken to ensure compliance with the changed requirements (where senior management has not previously been made aware of these through other channels);
  - (c) future relevant regulatory changes which are likely to have a significant impact on the business;

- (d) other significant compliance issues that have occurred since the last report; and
  - (e) major correspondence with competent authorities (where senior management has not previously been made aware of these through other channels).
23. In addition, the compliance function should report to senior management, in a timely manner, on an ad-hoc basis when significant compliance matters such as major breaches of MiFID and the respective national laws have been discovered. The report should also provide suggestions for the necessary remedial steps.
24. The reports provided to senior management should also be provided to the supervisory function, if any.
25. The compliance function could consider additional reporting lines to a group compliance function where the investment firm is part of a group.
26. Some competent authorities require investment firms to provide them with compliance function reports. This practice provides competent authorities with first-hand insight into an investment firm's compliance activities, as well as any breaches of regulatory provisions. One competent authority also requires senior management to provide it with an annotated version of the report containing explanations of the compliance function's findings.

### **Advisory obligations of the compliance function**

#### *General guideline*

27. Investment firms should ensure that the compliance function fulfils its advisory responsibilities including training for staff, day-to-day assistance for staff and participation in the establishment of new policies and procedures within the investment firm.

#### *Supporting guidelines*

28. It is important that investment firms, apart from any corporate culture, promote and enhance a 'compliance culture' throughout the firm. The purpose of the compliance culture is not only to establish the overall environment in which compliance matters are treated, but also to engage staff with the principle of improving investor protection.
29. The investment firm needs to ensure that its staff are adequately trained. For this, the compliance function should arrange training and/or other support for staff. Where training is performed by other units, the compliance function should support these units in performing any training. Training and/or other support should focus particularly, but not exclusively, on:
- (a) the internal policies and procedures of the investment firm and its organisational structure; and
  - (b) MiFID, the relevant national laws, the applicable standards and guidelines set out by ESMA and competent authorities, and other supervisory and regulatory requirements that may be relevant, as well as any changes to these.

30. Training should be performed on a regular basis, and need-based training should be performed where necessary. Training should be delivered as appropriate – for example, to the investment firm’s entire staff as a whole, or to specific business units, or even to a particular individual.
31. Training should be developed on an on-going basis so that it takes into account all relevant changes (for example, new legislation or standards or guidelines set out by ESMA and competent authorities, changes in the investment firm’s business model).
32. The compliance function should periodically assess whether staff hold the necessary level of awareness and correctly apply the investment firm’s policies and procedures.
33. Compliance staff should also provide assistance to staff from the operative units in their day-to-day business and be available to answer questions arising out of daily business activity.
34. The compliance function should be involved in the development of the relevant policies and procedures within the investment firm in the area of investment services, activities and ancillary services. In this context, the compliance function should be enabled, for example, to provide compliance expertise and advice to business units about strategic decisions or new business models, or at the launch of a new advertising strategy.
35. Furthermore, the compliance function should be involved in all significant modifications of the organisation of the investment firm in the area of investment services, activities and ancillary services. This includes the decision-making process when new business lines or new financial products are being approved. In this context, the compliance function should be given the right to participate in the approval process for all financial instruments to be taken up in the distribution process. Senior management should therefore encourage business units to consult with the compliance function regarding their operations.
36. The compliance function should regularly be involved in all relevant correspondence with competent authorities.

## **V.II. Guidelines on organisational requirements of the compliance function**

### **Effectiveness of the compliance function**

#### *General guidelines*

37. Investment firms should ensure that appropriate human and other resources are allocated to the compliance function taking into account the scale and types of investment services, activities and ancillary services undertaken by the investment firm. They should also provide compliance staff with the authority necessary to exercise their duties effectively, as well as access to all information concerning the investment services and activities as well as ancillary services undertaken.
38. Investment firms should also ensure that all compliance staff have the necessary knowledge and experience for the tasks assigned to them. The compliance officer should have sufficiently broad knowledge and experience and a sufficiently high level of expertise so as to be able to assume responsibility for the compliance function as a whole and ensure that it is effective.

#### *Supporting guidelines*

39. The number of staff required for the tasks of the compliance function depends to a large extent on the nature of the investment services, activities and ancillary services and other services provided by the investment firm. Where an investment firm's business unit activities are significantly extended, the investment firm should ensure that the compliance function is similarly extended. Whether the number of staff is still adequate for the fulfilment of the duties of the compliance function should be monitored regularly by the investment firm.
40. In addition to human resources, sufficient IT resources should be allocated to the compliance function.
41. Adequate resources also include the allocation of an appropriate budget for the compliance function. The compliance officer should be consulted before the budget is determined. All decisions for significant cuts in the budget should be documented in writing and contain detailed explanations.
42. Compliance staff should at all times have access to the relevant information for their tasks including all relevant databases. In order to have a permanent overview of the areas of the investment firm where sensitive or relevant information might arise, the compliance officer should have access to all information systems within the investment firm as well as any internal or external audit reports or other reporting to senior management or the supervisory board, if any. Where relevant, the compliance officer should also be granted right of attendance for meetings of senior management or the supervisory function. Where this right is not granted, this should be documented and explained in writing. For this, the compliance officer should have in-depth knowledge of the investment firm's organisation, corporate culture and decision-making processes in order to be able to identify for which meetings his or her attendance is important.
43. In order to ensure that compliance staff have the authority required for their duties, the senior management of the investment firm should support them in the exercise of these duties. Authority also implies possessing adequate expertise and relevant personal skills, and may be enhanced by the investment firm's compliance policy (or 'charter') explicitly acknowledging the specific authority of the compliance staff.
44. The necessary expertise of all compliance staff requires knowledge of MiFID and the respective national laws as well as the applicable standards and guidelines set out by ESMA and competent authorities on these provisions, as far as these are relevant for the provision of their tasks. A higher level of expertise is necessary for the designated compliance officer.
45. The compliance officer should demonstrate sufficient professional experience where this is necessary to be able to assess the (potential) compliance risks and conflicts of interest inherent in the investment firm's business activities. The required professional experience may have, amongst others, been acquired in operational positions, in other control functions or in regulatory functions. Additionally, the compliance officer should have specific knowledge of the different business activities provided by the investment firm. The relevant expertise required may differ from one investment firm to another, as the nature of the main compliance risks that firms face will differ. In respect of Article 5(1)(d) of the MiFID Implementing Directive, a newly employed compliance officer may therefore have the need for specialised knowledge focused on the specific business model of the investment firm even though this person has been previously appointed as compliance officer for another investment firm if the business model and inherent risks between the investment firms differ widely.

### **Permanence of the compliance function**

### *General guideline*

46. Investment firms are required to ensure that the compliance function performs its tasks and responsibilities on an ongoing, permanent, basis. In order to ensure this, investment firms should provide adequate stand-in arrangements for the responsibilities of the compliance officer which apply when the compliance officer is absent, and arrangements to ensure that the responsibilities of the compliance function are performed on an ongoing basis. These arrangements should be in writing.

### *Supporting guidelines*

47. The investment firm should ensure that the responsibilities of the compliance function are fulfilled adequately by other persons during any absence of the compliance officer. This ought to be ensured for foreseeable (for example, annual leave) or any unforeseeable (for example, illness) absence of the compliance officer. Compliance staff should be sufficiently qualified to perform the compliance officer's duties in his absence.
48. The responsibilities and competences as well as the authority of the compliance staff should be set out in a 'compliance charter' or other general policies or internal rules. This should include information on the work plan and the reporting duties of the compliance function as well as information on the compliance function's risk-based approach to monitoring activities. Relevant amendments to regulatory provisions should be reflected promptly by adapting these policies/rules.
49. Furthermore, the compliance function should perform its activities on a permanent basis and not only in specific circumstances. This requires regular monitoring on the basis of a monitoring schedule. The monitoring activities should regularly cover all key areas of investment services and activities, taking into account the risk content associated with the business areas. The compliance function should be able to respond rapidly to unforeseen events, thereby changing the focus of its activities within a short timeframe if necessary.

## **Independence of the compliance function**

### *General guideline*

50. Investment firms should ensure that the compliance function holds a position in the organisational structure that ensures that the compliance officer and other compliance staff act independently when performing their tasks, and that the compliance officer is appointed and replaced by senior management or the supervisory function.

### *Supporting guidelines*

51. While senior management is responsible for establishing an appropriate compliance organisation and for monitoring the effectiveness of the organisation that has been implemented, the tasks performed by the compliance function in the day-to-day business should be carried out independently from senior management and other units of the investment firm. In particular, the investment firm's organisation should ensure that other business units may not issue instructions or otherwise influence compliance staff and their activities. Senior management's instructions to compliance staff should be general and should not interfere with the compliance function's day-to-day activities. The investment firm should ensure that the decision on the appointment and replacement of the compliance officer may only be taken by senior management or the supervisory function.

## Exemptions

### *General guideline*

52. Where an investment firm considers that it may not be proportionate for it to comply with the requirements set out in Article 6(3) of the MiFID Implementing Directive, it should assess whether the effectiveness of the compliance function is compromised by the proposed arrangements. This assessment should be reviewed regularly.

### *Supporting guidelines*

53. Investment firms should decide on measures that are best suited to the firm's particular nature and circumstances. In deciding this, investment firms should take the following criteria (inter alia) into account:
- (a) The types of investment services, activities and ancillary services and other business activities provided by the investment firm (including those not related to investment services, activities and ancillary services), interaction between the investment services and activities and ancillary services and other business activities carried out by the investment firm.
  - (b) The scope and volume of the investment services, activities and ancillary services carried out (absolute and relative to other business activities), balance sheet total and income of the investment firm from commissions and fees and other income in the context of the provision of investment services, activities and ancillary services.
  - (c) The types of financial instruments offered to clients.
  - (d) The types of customers targeted by the investment firm (professional, retail, eligible counterparties).
  - (e) Staff headcount.
  - (f) Whether the investment firm is part of an economic group under Article 1 of the Seventh Council Directive of 13 June 1983 on consolidated accounts (Directive 83/349/EC).
  - (g) Services provided through a commercial network, i.e. tied agents, or branches.
  - (h) Cross-border activities provided by the investment firm.
  - (i) Organisation and sophistication of the IT systems.
54. Competent authorities may also find these criteria useful in determining which types of investment firms may benefit from the exemptions under Article 6(3) of the MiFID Implementing Directive.
55. An investment firm may fall under the exemption if the performance of the necessary compliance tasks – including where appropriate combined with other control functions – does not require a full-time position due to the nature, scale and complexity of the firm's business, and the nature and range of the investment services, activities and ancillary services offered.

56. It may be disproportionate for a smaller investment firm with a very narrow field of activities and/or limited human resources to appoint a separate compliance officer. Where an investment firm makes use of the exemption, conflicts of interest between the tasks performed by the relevant persons should be minimised as much as possible.
57. The compliance function should generally not be combined with the legal unit, or be subordinate to internal control functions, where this could undermine the compliance function's independence.
58. Where an investment firm makes use of the exemption, it should document how this is justified, taking into account the principle of proportionality so that the competent authority is able to assess this.

### **Combining the compliance function with other functions**

#### *General guideline*

59. With the exception of the internal audit function, the independence of the compliance function is not necessarily compromised by compliance staff overlapping with other control functions. The overlap of the compliance function with other control functions should be documented, including the reasons for any overlap.

#### *Supporting guidelines*

60. Compliance staff should generally not be involved in the activities they monitor. However, overlap of the compliance function with other control units at the same level (such as money laundering prevention or risk management) may be acceptable if this does not generate conflicts of interests or compromise the effectiveness of the compliance function.
61. Combining the compliance function with the internal audit function should generally be avoided as this is likely to undermine the independence of the compliance function because the internal audit function is charged with the oversight of the compliance function.
62. Any overlap of the compliance function with other control functions should be documented by investment firms so that competent authorities are able to assess whether the combination of functions is adequate. Whether staff from other control functions also perform compliance tasks, should also be a relevant consideration in the determination of the relevant number of staff necessary for the compliance function.
63. Regardless of any overlap, the compliance function should in any case coordinate its activities with the control activities performed by other units.

### **Outsourcing of the compliance function**

#### *General guideline*

64. Investment firms should ensure that all applicable compliance function requirements are fulfilled where any or all of the compliance function is outsourced.

#### *Supporting guidelines*

65. The MiFID outsourcing requirements for critical or important functions apply in full to the outsourcing of the compliance function. All the conditions for outsourcing set out in Article 14 of the MiFID Implementing Directive must be met if an investment firm outsources the compliance function.
66. The requirements that apply to the compliance function are the same whether or not the compliance function is outsourced. This means that all the requirements in Article 6 of the MiFID Implementing Directive must be met if the compliance function is fully or partially outsourced to a service provider.
67. The investment firm should perform a due diligence assessment before choosing a service provider in order to ensure that the criteria set out in Articles 6 and 14 of the MiFID Implementing Directive are met. The investment firm should ensure that the service provider has the necessary authority, resources, expertise and access to all relevant information in order to perform the outsourced compliance function tasks effectively.
68. Investment firms should also ensure that when outsourced, the compliance function remains permanent in nature, i.e. that the service provider can perform the function on an ongoing basis and not only in specific circumstances.
69. Investment firms should monitor whether the service provider performs its duties adequately, which includes monitoring the quality and the quantity of the services provided. The investment firm ought to appoint a person to be responsible for supervising and monitoring the outsourced function on an ongoing basis, and this person should have the necessary resources and expertise to be able to fulfil this responsibility.
70. Investment firms should be aware that outsourcing of the compliance function within a group does not lead to a lower level of responsibility for the senior management of the individual investment firms within the group. However, a centralised group compliance function may, in some cases, provide the compliance officer with better access to information, and lead to greater efficiency of the function, especially if the entities share the same premises.
71. If an investment firm, due to the nature, size and scope of its business activities, is unable to employ compliance staff independent of the performance of services they monitor, then outsourcing of the compliance function is likely to be an appropriate approach to take.

### V.III. **Guideline on competent authority review of the compliance function**

#### **Review of the compliance function by competent authorities**

##### *General guideline*

72. Competent authorities should review how investment firms implement and maintain the MiFID compliance function requirements. This should apply in the context of the authorisation process, as well as in the course of on-going supervision.

##### *Supporting guidelines*

73. Article 7 of MiFID states that a competent authority shall not grant authorisation to an investment firm unless and until such time as it is fully satisfied that the applicant complies with all requirements under the provisions adopted pursuant to MiFID. Accordingly, the competent authority should assess whether a firm's compliance function is adequately resourced and organised and whether adequate

reporting lines have been established. It should require that any necessary amendments are made to the compliance function as a condition for authorisation.

74. Additionally, as part of the ongoing supervisory process, a competent authority should assess whether the measures implemented by the investment firm for the compliance function are adequate, and whether the compliance function fulfils its responsibilities appropriately. Competent authorities should also assess whether amendments to the resources and organisation of the compliance function are required due to changes in the business model of the investment firm, and where such amendments are necessary, monitor whether these amendments have been implemented (having provided a reasonable timeframe for the firm to do so).
75. Some competent authorities license or approve the nominated compliance officer following an assessment of the qualifications of the compliance officer. This assessment may include an analysis of the compliance officer's curriculum vitae, as well as an interview with the designated person. This sort of licensing process may help to strengthen the position of the compliance function within the investment firm and in relation to third parties.
76. Other regulatory approaches impose the responsibility for the assessment of the compliance officer's qualification solely on the senior management of the investment firm. Senior management assesses the prospective compliance officer's qualifications before appointment. Whether the investment firm properly complies with this requirement is then assessed within the general review of the firm's compliance with the relevant MiFID requirements.
77. Some Member States require investment firms to notify the competent authorities of the appointment and replacement of the compliance officer. In some jurisdictions, this notification must also be accompanied by a detailed statement on the grounds for the replacement. This can help competent authorities gain insight into possible tensions between the compliance officer and senior management which could be an indication of deficiencies in the compliance function's independence.
78. The above practices could be helpful to other competent authorities.