

EFAMA RESPONSE TO THE ESMA CONSULTATION PAPER ON GUIDELINES ON CERTAIN ASPECTS OF THE MiFID II COMPLIANCE FUNCTION REQUIREMENTS

Brussels, 14 October 2019

EFAMA, the voice of the European investment management industry, welcomes the opportunity to provide its feedback to ESMA on its Guidelines on certain aspects of the MiFID II compliance function requirements.

EFAMA represents through its 28 member associations, 62 corporate members and 25 associate members more than EUR 25 trillion in assets under management of which EUR 15.6 trillion managed by 60,174 investment funds at end 2017. Close to 32,000 of these funds were UCITS (Undertakings for Collective Investments in Transferable Securities) funds, with the remaining 28,300 funds composed of AIFs (Alternative Investment Funds). Asset management companies in Europe provide services to collective investment undertakings and are covered by their sector-specific regulation, i.e. UCITS Directive¹ and AIFMD².

A. General Remarks

The compliance function is a crucial function with the asset management companies, which is responsible for identifying, assessing, monitoring and reporting on the firm's compliance risk, among others also in relation to its obligations under MiFID II.

EFAMA considers that the existing 2012 Guidelines bring clarity with respect to the MiFID compliance requirements. We also welcome the review process of the Guidelines as this can foster further convergence in the implementation of certain aspects of the new MiFID II compliance function requirements.

A proportionate approach taking into consideration the firm's size and activities, along with recognizing the importance of the compliance function and the responsibility of the senior management is important to achieve

¹ Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS)

² Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010

the objectives of MiFID II in relation to compliance. With this in mind we are making a number of suggestions in relation to the draft Guidelines with the aim of ensuring the right organisation, expertise and approach is in place.

B. EFAMA response to the Questions of the Consultation

Guideline 1 – Compliance risk assessment

Q1: Do you believe that guideline 1 should be further amended and/or supplemented?

Please also state the reasons for your answer.

Risk assessment is an essential part of compliance when monitoring risk and it should be following developments in the activities of the firm and/or in the regulatory framework. We consider Guideline 1 is already comprehensive, hence we don't see the need to further amend or supplement it.

Guideline 2 – Monitoring obligations of the compliance function

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.

In relation to monitoring the obligations of the compliance function we believe a risk-based approach is the most appropriate to determine the key methodologies to be used and frequency of monitoring.

We also agree that compliance and relevant monitoring activities cannot be conceived as solely "desk-based" and should include on-site visits. At the same time a risk-based approach should identify the best way policies and procedures are to be implemented in practice and in different cases. With this in mind, we can agree with taking into consideration the potential support of any other "control or risk" function in the firm and "additional reports". However, some of the additional tools suggested in para 26 of the draft Guidelines to be used by the compliance function, e.g. interviewing firm's clients, are overly prescriptive and problematic. We would, therefore, suggest to remove these prescriptive references from the Guidelines.

Para 26 of the draft Guidelines makes reference to what should be used to "warrant the necessary management attention", but we would also see merits for a link to the capacity of the management body to inform the staff involved in the monitoring process about significant events.

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

Please see our comment to the previous question regarding the possibility for the management body to inform the staff involved in the monitoring process about significant events. Other than that, we don't see any further guidance as necessary.

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

One important clarification to add relates to risk indicators (under (a)). Risk management should explicitly refer to compliance-related risk management to distinguish from operational risk management functions.

Please see our comments in question 2 in relation to interviewing firm's clients, which we consider should be deleted. Compliance with regulation should be sufficiently demonstrated and recorded in documents rather than be based on an interview with a client.

Guideline 3 – Reporting obligations of the compliance function

Q5: Do you agree with the suggested general content of the compliance function reports (paragraph 32 of the guidelines)? Please also state the reasons for your answer.

We agree that the compliance reports addressed to the senior management should cover all business units involved or state the reasons for not doing so.

Regarding point (e) of para 26 we would consider appropriate to refer to "actions taken" by the senior management rather than "deviations". One reason is that in many cases the compliance function refers to the management body prior to the later taking a business decision.

Q6: Do you agree with the suggested content of the compliance function reports in relation to product governance arrangements (paragraph 33 of the guidelines)?

Please also state the reasons for your answer.

When it comes to product governance requirements the compliance function should only focus on reviewing and monitoring how the product governance internal arrangements are set up and applied in compliance with the applicable MiFID II rules. The compliance function cannot be assessing or elaborating these arrangements, as this can be in conflict with the independent role of the function. Applying the product governance requirements is primarily the responsibility of the product and distribution functions.

Based on that, we would suggest to delete the reference to "elaboration" from para 33 point a, as well as the product related information suggested in point c.

Moreover, for larger firms with dedicated product functions we would expect this to be an entirely proportionate approach in line with the proportionality principle ref. Article 22(1) of the MiFID II Delegated Regulation. It must be noted that the guidelines do refer to the proportionality principle but only in the context of the detail required within compliance function reporting (e.g. less detail on simpler/common products). The draft guidelines state that, in order to meet the obligation of par.33, the compliance function may take a critical look at any work, reports or methods from the firm's function or personnel working on product governance arrangements. They do not appear to allow the compliance function to refer/signpost to senior management reporting from the firm's product function for example, which would be logical if one applies the proportionality principle.

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.

We agree that the information included in the compliance function reports is proportional, as the reports need to include information that are meaningful based on the complexity and the levels of risk of the financial instruments manufactured and/or distributed by the firm.

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?

One possible way to address potential conflicts is to separate the complaints management function from the compliance function.

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

We believe this Guideline is comprehensive and no further topics/areas are to be included in the compliance function reports.

Guideline 4 – Advisory and assistance obligations of the compliance function

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.

We agree in general with the approach taken in the revised Guideline 4, with a few reservations. – see below.

It should be taken into consideration that compliance with financial regulation needs to meet the underlying objectives of the regulation, which include investor protection, but not only. The objectives of financial stability and market integrity are also key and we would therefore suggest to add them along investor protection in terms of engaging with staff and improving compliance culture within the firm.

Moreover, the assessment of the awareness and level of application of the staff in relation to the investment services and activities (mentioned in para 42) are a task for the human resources or the management team rather than the compliance function. The compliance function can take into consideration the outcome of this assessment, but cannot be tasked with carrying it.

Lastly, we understand the need for the compliance function to take into account the business models and strategic decisions of the firm. However, because the independence of the compliance function needs to be preserved, it should not be directly involved in such decisions and, hence, can't provide "expertise and advice to business units about all strategic decisions or new business models". We would therefore suggest removing this reference from para 44.

Guideline 5 – Effectiveness of the compliance function

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

We agree that the compliance function should have the appropriate human and other resources allocated to it, as well as the appropriate budget. For the later it would be useful to clarify in para 50 that the documentation related to decisions for significant cuts should be provided to the compliance function by the senior management. Moreover, it is important to ensure access to the right information.

Guideline 6 – Skills, knowledge, expertise and authority of the compliance function

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.

Ensuring the appropriate skills, knowledge and expertise is an integral part of the compliance function. For that reason, we consider that the content of this new Guideline should be linked to that of the previous Guideline, in particular with respect to the budget, human and other resources. It should also be stressed that given the important regulatory layers the compliance function is faced with and the new developments in IT and financial risks, education and training of the staff of the compliance function is of critical importance.

In relation to the compliance officer, it should be kept in mind that he/she cannot entail expertise on all regulatory fields and that it is the firm's responsibility to determine the appropriate organizational requirements for an effective compliance function that has the right skills not only at the compliance officer, but also at the team level.

Moreover, we consider the license or approval process of a compliance officer by a competent authority as problematic. The responsibility for the compliance function stays with the senior management, therefore the responsibility for assessing and appointing the compliance officer should also be with the senior management.

Further on, in cases of extensive responsibilities concentrated within the compliance function, it would be good to provide the compliance officer with an appropriate protection, e.g. via a specific insurance provision.

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

Please see our comments to the previous question.

Guideline 7 - Permanence of the compliance function

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

We have no further comments.

Guideline 8 – Independence of the compliance function

Q15: Do you believe that guideline 8 should be further amended and/or supplemented?

Please also state the reasons for your answer.

We agree with ensuring the independent status of the compliance officer and the staff of the compliance function. In that context, we believe it is important in cases of extensive responsibilities concentrated within the compliance function, to provide the compliance function with an appropriate protection, e.g. via a specific insurance provision.

Guideline 9 – Proportionality with regard to the effectiveness of the compliance function

Q16: Do you believe that guideline 9 should be further amended and/or supplemented?

Please also state the reasons for your answer.

We have no further comments.

Guideline 10 – Combining the compliance function with other internal control functions

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.

We believe that a proportionate approach would require every asset management company to organize itself in the most efficient way based on its size and activities.

With this in mind, we don't consider it proportional to establish a core team within the compliance function dealing solely with MiFID II compliance. Compliance with MiFID II can't be an isolated function as the main challenge with monitoring that relates to making the right links to the company's overall business. Therefore, MiFID compliance needs to be looked at together with monitoring compliance with other key regulatory frameworks (e.g. UCITS Directive, AIFMD, EMIR, MAR, AMLD, Benchmark Regulation). Important also to keep in mind that the UCITS Directive and AIFMD partially cover the same principles as MiFID.

It must be also underlined that the largest and most complex firms are those most likely to have created specialised, functional compliance structures to mirror the complexities of the firm. Costs/charges is an example where, in a large asset manager, compliance expertise at a European level must cover PRIIPS and UCITS alongside MiFID II. And it is more efficient for the same compliance person(s) to cover all aspects of costs/charges than to split the compliance (arbitrarily?) along regulatory lines.

For all the reasons mentioned above, we consider that the decision as to the organisation of the compliance function lies only within the company and no prescriptive rule as to the attribution of particular regulatory frameworks to dedicated teams should apply.

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

We have no further comments.

Guideline 11 – Outsourcing of the compliance function

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

We agree that firms should monitor whether the service provider performs its services adequately. We have no further comments.

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

We have no further comments.

Guideline 12 – Review of the compliance function by competent authorities

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

Please see our comments to question 12 in relation to the license or approval process of a compliance officer by a competent authority, which we consider problematic. The responsibility for assessing and appointing the compliance officer should be with the senior management.

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

We have no further comments.

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