



ADVICE TO ESMA

Guidelines on certain aspects of the MiFID compliance function requirements

I. Executive summary

The Stakeholder Group supports the adoption of guidelines related to MiFID and the overall approach of ESMA with respect to the Guidelines on compliance reporting requirements. This issue is of high importance to ensure that rules designed to protect investors are effectively applied and do not remain « law on the books ». Therefore the adoption of the Guidelines should contribute effectively to enhance consumer protection, which is one of the ESMA's objectives.

While strongly supporting both the timing and the content of the Guidelines, the Group would like to call the attention of ESMA to a number of specific elements. In addition, the Group strongly supports the proportionality principle, which is included in Article 6 of the MiFID Implementing Directive, and even thinks that it should be strengthened.

In general, because of the high costs involved with compliance function requirements, the Group feels that ESMA should be mindful of the costs resulting from the proposed requirements. Therefore, some requirements included in the Guidelines, such as reports, staff-training and expertise, should be adapted in order not to prevent investment firms, and especially subject small and medium-sized ones, to enter in the market and to compete with larger firms.

The Group also feels that ESMA should allow more flexibility for small and medium-sized investment firms.

However, the Stakeholder Group would like to insist that irrespective of the size of the firm, the compliance function has to be performed adequately. The size of the firm is no excuse for poor compliance performance and outsourcing should be required when a firm does not have the internal resources to perform it internally.

As to the criteria used in the Guidelines, the Group feels that compliance is only a function of the nature of activities and instruments. Therefore, staff headcount should not be used as a justification for not having an adequate compliance function.

II. Explanatory remarks

1. On December 22, 2011 ESMA published a consultation paper relating to proposed Guidelines regarding the implementation of certain requirements of the Markets in Financial Instruments Di-

rective (MiFID)¹ The purpose of the Guidelines is to enhance clarity and foster convergence in the implementation of certain aspects of the MiFID requirements.

2. The second set of Guidelines deals with the issue of compliance function requirements (ESMA/2011/446). Article 13 of MiFID and Article 6 of the MiFID Implementing Directive set out the regulatory provisions for the compliance function of investment firms. As mentioned in the Consultation Paper, “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.”² Therefore, the purpose of these 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.
3. The adoption of Guidelines by ESMA is subject to Article 16 of the ESMA Regulation³ which provides that ESMA “shall, with a view to establishing consistent, efficient and effective supervisory practices within the ESFS (European System of Financial Supervisors), and to ensuring the common, uniform and consistent application of Union law, issue Guidelines and recommendations addressed to competent authorities or financial market participants”. Both Guidelines are addressed to competent authorities which are subject to the “comply or explain” approach imposed by Article 16(3) of the Regulation. The Guidelines are also addressed to financial market participants. However, participants are not under a duty report, “in a clear and detailed way, whether they comply with that Guideline...”⁴
4. These Guidelines constitute new developments at the EU level. They do not duplicate previous work by the Committee of European Securities Regulators (CESR). However, they build on existing requirements developed by national regulators. The Guidelines are divided between General Guidelines and Supporting Guidelines.

III. General comments of the Group on Guidelines on certain aspects of the MiFID compliance function requirements

III.I. Reporting obligations of the compliance function

5. The Group considers that there is no need to provide compliance function reports to competent authorities on a regular or periodic basis. Such reports can be always submitted to the supervisory authority on request or in the course of an on-site inspection. Such reports if submitted to the supervisory authority, taking into consideration all other types of regulated information that investment firms file with the regulator in the course of their activity, could put a stress on the capacity of the regulator to process and assess the information supplied and to employ a risk-based strategy of

¹ Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments.

² Compliance Draft Guidelines, p. 5.

³ 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.

⁴ Art. 16(3) of the ESMA Regulation raises the possibility for this reporting requirement to apply.

identifying firms violating the legal requirements applicable to their activity and the protection of clients.

III.II. Advisory obligations of the compliance function

Paragraph 26 (Staff training)

6. As mentioned in the Guidelines, investment firms need to ensure that their staff are adequately trained.
7. However, this being said, the core essence of the compliance function is to monitor, assess on regular basis, advise and assist the relevant persons responsible for carrying out investment services and activities to comply with the firm's obligations under Directive 2004/39/EC. As these are very heavy and responsible obligations by themselves there is a need to be very careful when imposing another major obligation such as extensive staff training in order to prevent the effective compliance function from diluting and diverting its core essence.
8. The Group also feels that it could be expedient if competent authorities were charged with the function of providing training to compliance officers from the investment firms based on their supervisory experience and monitoring practices allowing them to gather information about typical and recurring violations of the relevant legislation. Business and trade associations could also be given role in that aspect provided they have the necessary resources and/or expertise to organize and conduct training courses for compliance staff. A certificate could even be issued by the competent authority. Otherwise, it could authorise private sector actors to deliver the certificate.

III.III. Effectiveness of the compliance function

9. The very large majority of the Group thinks that all compliance staff should be subject to the same high level standards so as to their level of education, in order to ensure that the compliance function is performed appropriately. Compliance officers not directly engaged in the management of units should be subject to the same stringent formal rules in respect to their education, than heads of units. Irrespective of level, every employee of an investment firm involved in compliance needs to have an adequate and sufficient understanding of risks, behaviour and situations to be able to perform their respective tasks. Employees should not just rely on their superior.
10. However, some members of the Group think that the requirements applicable to the expertise of the compliance staff and officers should be structured in a graduated manner such as to allow officers from the compliance staff who are not directly engaged in the management of units of the compliance office or the office itself to be subject to less stringent formal rules (as to e.g. education, work experience) than those applying to heads of units or the office itself.

III.IV. Exemptions

11. The Group supports the proportionality principle which is included in Article 6 of the MiFID Implementing Directive.⁵ The principle of proportionality implies that “where an investment firm con-

⁵ 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.

siders 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”.⁶ Regarding the possibility to have exemptions from certain requirements based on this principle, the Group would like first to remind that a proportionate response to the compliance role function does not mean no compliance. Having said that, the Group would like to point some issues regarding exemptions.

Paragraph 46 (Staff headcount)

12. The Guidelines mention that, when deciding on measures that are best suited to the firm’s particular nature and circumstances, the staff headcount should be taken into account. Some members of the Group feel that too much importance should not be given to this criterion. The compliance is only a function of the nature of activities and instruments, and staff headcount should not be used as a justification for not having an adequate compliance function.

Paragraph 49 (Exemption from appointment of a separate compliance officer)

13. This principle of proportionality leads the Guidelines to allow a “smaller investment firm with a very narrow field of activities and/or limited human resources” not to appoint a separate compliance officer. As mentioned, this exemption to appoint a separate compliance officer does not constitute an exemption to apply the compliance requirements themselves. The Group considers this exemption to be justified in order not to prevent small and medium-sized investment firms from entering into existence and to promote competition in the financial sector. Nevertheless, small and medium-sized investment firms with no separate compliance officers present also higher compliance risks, be it only for the reason that the individual assuming the function of compliance officer might simply not be well trained in the area of law. Therefore, the Group considers that when such exemption is accepted, these firms should be subject to increased scrutiny and specific attention by the Competent Authority.

III.V. Combining the compliance function with other functions

Paragraphs 52-55

14. The Group takes as the starting point that whoever is in charge of compliance should receive the same training and take the same exam, if there is one, as if she was full time. The fact that an individual is the CEO or CFO or CIO of a small firm is not sufficient to assume that she knows all the rules regarding compliance.
15. However, consistent with the principle of proportionality, the Group feels that in the case of small and medium-sized investment firms more freedom should be given to them to structure their compliance function with regard to organization and staff in order for them to minimize costs. The same approach should apply to the overlapping of functions. ESMA might consider that, for small and medium-sized investment firms, the overlapping of functions **could** become the rule rather than the exception. In order to promote this approach, Competent Authorities could also be allowed to issue Guidelines setting standards for categorization of investment firms based on the size and volume of their operations.

⁶ Compliance Draft Guidelines (ESMA/2011/446), p. 13.

16. The Group also thinks that irrespective of the size of the firm, the compliance function has to be performed adequately. Therefore, smaller firms, which as a matter of fact need a certain flexibility, could be required to outsource their compliance function, when they do not have the internal resources to perform it internally.

This advice will be published on the Securities and Markets Stakeholder Group section of ESMA's website.

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