

ESMA CONSULTATION
Guidelines on certain aspects
of the MiFID II compliance function
requirements
-
AMAFI answer

ABOUT AMAFI

Association Française des Marchés Financiers (AMAFI) is the legal trade organisation representing financial market participants in France. AMAFI members are investment firms and credit institutions (French, European and global firms), operating in and/or from France (corporate and investment banks (CIBs), brokers-dealers, market infrastructures, exchanges and private banks). AMAFI has been extremely active on MiFID II issues. We are involved in all regulatory matters that concern commercialization of financial instruments. As far as financial products are concerned, we mostly represent all issuers/manufacturers of products (CIBs) but, through our private bank members, distributors as well. AMAFI has more than 140 members operating in equities and fixed-income and interest rate products, as well as commodities, derivatives and structured products for both professional and retail clients.

EXECUTIVE SUMMARY

AMAFI considers that compliance function is a key function within firms and crucial for ensuring firms compliance with regulatory requirements and more generally for improving investor protection and market integrity. In that respect, we very much welcome ESMA initiative to enhance clarity and foster convergence in the implementation of the new MiFID II compliance function requirements. We generally support all the general guidelines in the Consultation Paper and **particularly share ESMA views on fostering compliance culture within firms, the role of senior management and the necessary attributes to the compliance function as developed in the guidelines** (see our answers to Q10 to Q16).

However, AMAFI wish to insist on the **importance of the proportionality** principle that **could be even better taken into account in all of its aspects**: the nature of the services and activities, the nature of the financial instruments as well as the nature or the category of the clients; notably as regards to product governance arrangements (see our answers to Q1, Q6 and Q7). It is also important to avoid any **unnecessary over prescriptive guideline and leave some flexibility to the firms to decide the most relevant organisation and scope for the compliance function** (see our answers to Q2, Q4, Q5, Q17 and Q18).

AMAFI would like to outline that **compliance function goes beyond the sole MiFID II scope** and generally includes supervision of other regulations such as Market Abuse Regulation for example or depending on the different organisations, Anti Money Laundering as well. In that context, we do not believe compliance function should be split according to different regulations applicable since that could be detrimental to its efficiency or even lead to inconsistencies.

Finally, we would like to outline that **compliance function should not undertake any operational task that is incompatible with its role as a second level of supervision as well as its independence and an efficient use of its resources** (see our answers to Q6).

RESPONSES TO ESMA QUESTIONS

- **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.

AMAFI fully agrees with the Guideline 1 especially regarding the necessity to conduct a risk assessment and implement a risk-based approach to determine the actions that should be done by the compliance function (monitoring, advisory and assistance). Nevertheless, AMAFI would like to add that the risk assessment exercise is not limited to the compliance function but concerns as well other controls functions such as operational risks, etc.

We particularly support the content of the supporting guideline (§ 19) that provides that the findings of the compliance risk assessment should be used to set out the work programme of the compliance function and to allocate the functions resources efficiently.

Nevertheless, to better take into account proportionality principle (that aims at taking into account the nature of the services provided, the types of financial instruments as well as the nature or category of the clients' firm); AMAFI proposes the following amendments.

Proposed amendments

19. The findings of the compliance risk assessment should be used to set the work programme of the compliance function and **other controls function** to allocate the functions resources efficiently. The compliance risk assessment should be **regularly reviewed and** updated, **when necessary**, to ensure that the objectives, focus and the scope of compliance monitoring and advisory activities remain valid.
20. In identifying the level of compliance risk the firm faces, the compliance function should take into account (in addition to the investment services, activities and ancillary services provided by the firm as required by Article 22(2), second paragraph, of the MiFID II Delegated Regulation) the types of financial instruments traded and distributed **as well as the nature and categories of the clients' firm**.
22. The identified risks should be reviewed on a regular basis and when necessary **(for any unexpected material changes)** also on an ad-hoc-basis to ensure that any emerging risks are taken into consideration (for example, resulting from new business fields, other **significant** changes in the firm's structure or relevant changes in the regulatory framework).

- **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.

AMAFI agrees with the approach developed in this Guideline as it seems important to use a risk-based approach to implement the monitoring activity of the compliance function. We would just suggest replacing the term of "internal guidelines" by "internal policies and procedures".

For a sake of clarity, it is necessary, in our view, to clearly define the notion of "firm" especially in **paragraph 24** by making a reference to the notion of "investment firm" within MiFID II meaning (*i.e.* head office and its subsidiaries but not its branches).

We particularly agree with **paragraph 28** that recognize the possibility to rely on the first level of controls to be performed by the operative units, whereas compliance function performs second level of controls. We believe that such organisation is indeed efficient and should be promoted by ESMA towards all National Competent Authorities. That is why we would suggest including that point in the wording of the General Guideline 2.

We also support the **paragraph 30** that usefully clarifies that compliance function is not required to have a role in determining the outcome of complaints. However, we disagree with the wording that compliance function should have a role in overseeing the operation of the complaints process. We also disagree with the last sentence of the same paragraph. That is why we suggest the following amendments.

Proposed amendments

23. The aim of the risk based monitoring programme should be to evaluate whether the firm's business is conducted in compliance with its obligations under MiFID II, its related delegated acts and/or any national implementing provisions thereof and whether its internal guidelines policies and procedures, organisation and control measures remain effective and appropriate. **To that end, monitoring activities should take into account the first level of controls in the firm's business areas (i.e. controls by the operative units, as opposed to second level controls performed by compliance).**

24. Where an investment firm (as defined in Article 4.1.1 of MiFID II) is part of a group, responsibility for the compliance function rests with each firm in that group. A firm should therefore ensure that its compliance function remains responsible for monitoring its own compliance risk. This includes where a firm outsources compliance tasks to another firm within the group. The compliance function within each firm should, however, take into account the group of which it is a part - for example, by working closely with audit, legal, regulatory and compliance staff in other parts of the group.

30. The compliance function should have a role in ~~overseeing~~ **monitoring as a second level of controls** the operation of the complaints process and it should consider complaints as a source of relevant information in the context of its general monitoring responsibilities. This does not require compliance functions to have a role in determining the outcome of complaints **or managing the complaints' operation**. ~~In this regard, firms should grant the compliance function access to all customer complaints received by the firm.~~

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

No, AMAFI believes that guideline 2 is enough.

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

No, AMAFI disagrees with this paragraph.

Firstly, AMAFI considers that only the reports mentioned in Articles 22.2.c and 22.3.c must be done by the compliance function. The other reports mentioned in Article 25 ("risk management" and "internal audit") must be managed by other departments, so they should not be quoted in those Guidelines dedicated to the compliance function.

Secondly, the additional tools developed in this paragraph (even if they are only presented as examples) are not implementable especially the tools developed in point (b) and (c):

- As mentioned in this Guideline, compliance function must annually report to the management body (*MiFID II DR, Art. 25.2.c*) and, where relevant, on an ad-hoc basis (*MiFID II DR, Art. 25.3.c*). It does not seem possible to do more as the ad-hoc reports already cover situations mentioned in point (b);

- The compliance function is not supposed to interact with clients (except in some situations). It seems inappropriate, particularly from a commercial point of view but also considering the independence of the function, to carry out interviews with clients to ensure that the investment firm complies with its obligations.

Proposed amendments

AMAFI proposes to **delete** the paragraph 26 or, if not possible, to make at least the following amendments:

26. Suitable tools and methodologies for monitoring activities are, inter alia, the mandatory compliance reports according to articles 22(2)(c), 22(3)(c), ~~and 25(2) and (3)~~ of the MiFID II Delegated Regulation which should be used to warrant the necessary management attention. Additional tools that could be used by the compliance function include (but are not limited to):
- (a) the use of aggregated risk measurements (for example, risk indicators);
 - ~~(b) the use of (additional) reports warranting management attention documenting material deviations between actual occurrences and expectations (exceptions report) or situations requiring resolution (issues log);~~
 - (c) targeted trade surveillance, observation of procedures, desk ~~reviews and/or interviewing relevant staff as well as the firm's clients.~~

- **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.

Yes, AMAFI agrees with the paragraph and most of the content of the compliance function report as described in paragraph 32.

We may wonder however if the guideline is not over prescriptive in (b) where it requires to include in the compliance function reports summary of on-site inspections or desk-based reviews performed by the compliance function as well as of the planned monitoring activities for the subsequent review. Indeed, depending on firms' organisations, such tasks are performed by the audit function and not necessarily by the compliance function.

Same remark about the (c), 3rd bullet point, where it requires to include the "number of complaints" whereas it is not the role of the compliance function like said above in answer to Question 2.

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.

AMAFI disagrees with the suggested content regarding product governance arrangements.

Indeed, in AMAFI's view, some ESMA's suggestions are disproportionate and are against the principle that compliance function is not supposed to perform operational task but rather undertake a second level of supervision of the firm's requirements:

- The (exact) number of products manufactured as well as all the target markets of all the product manufactured or distributed: AMAFI does not understand why the report should contain a such granular information whereas target markets should be approved by a special committee. Furthermore, for simpler financial instruments that are widely distributed, like ordinary shares, the number of each individual share does not make much sense for product governance overseeing purposes and seems overburdensome to identify by firms.

- The name of (all) distributors: this information seems disproportionate to be included in the report. It would be more efficient to communicate the “top list” of the distributors or distributors for which compliance issues have been identified.
- The fact that some products are distributed outside their positive target market: to be consistent with ESMA’s Guidelines on product governance, the communication should be limited to sales outside the positive target market for purposes other than diversification or hedging. Moreover, on a risk-based approach, it seems consistent to report to the senior management only the products for which there is a significant number of sales outside the positive target market (for purpose other than diversification or hedging) or alternatively, the number of sales within the negative target market.

Additionally, the way the paragraph is written seems over prescriptive (“*systematically*”, “*at least*”...) for a Level 3 Guideline and should include in our view, at the very beginning of the paragraph, an explicit reference to the proportionality principle (“*where relevant and subject to proportionality principle*”).

Finally, this paragraph 33 is not in line with the principle that compliance function is responsible to oversee firm’s compliance with requirements and in accordance with compliance risk assessment. Elements described in paragraph 33 are actually within first level of controls that shall fall into the scope of “*operative units, as opposed to second level controls performed by compliance*”.

For all those reasons, AMAFI disagrees with suggested paragraph 33 and propose the following amendments:

Proposed amendments

33. In the section of the report covering the firm’s product governance arrangements, the compliance function should also address, where relevant to the situation of the firm (e.g. taking into account its role as product manufacturer and/or distributor) and without limitation:

- (a) the compliance function’s role in the elaboration, monitoring and review of the firm’s product governance requirements;
- (b) all topics required under Art. 22(2) Delegated Regulation 2017/565, as stated above under paragraph 32, regarding the monitoring of the firm’s product governance by the compliance-function (for example, the compliance function’s findings relating to the firm’s product governance policies and procedures, breaches and deficiencies, actions taken or to be taken to remedy the latter).
- (c) ~~systematically~~, information about the financial instruments manufactured/distributed by the firm, including information on the distribution strategy according to Art. 9 (6) and Art. 10 (8) of the Delegated Directive EU 2017/593, namely ~~at least:~~ **all relevant information that relate to the compliance risk assessment and aim assessing the compliance of the firm with its product governance requirements (i.e., compliance function opinions and/or warning , results of controls performed, etc...)**
 - ~~the number and nature of the products manufactured or distributed (as applicable) including their respective target markets and other information from the respective product approval process necessary to assess the product’s compliance-risk (e.g. complexity of the product, product related conflicts of interests, particularly relevant data from the scenario analysis, the cost-return ratio, etc.)~~
 - ~~(in case of manufacturers) as part of the information on the respective distribution strategy: the respective distributors;~~
 - ~~whether the products are distributed outside their (positive) target market and to which extent,~~

[...]

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.

Yes, **AMAFI very much agrees with the proportionality principle.**

Yes, we believe that **additional criteria should be taken into account such as the category of the clients as well as the nature of investment services provided by the firm.**

Indeed, a firm would not have the same product governance arrangements where it only deals with eligible counterparties or professional clients (as end-clients). Likewise, a distributor that only provides execution services on simple financial instruments would have less in-depth process than the one that provides investment advice on complex/risky products.

That is why AMAFI would like to suggest adding those criteria within the wording of the Guidelines about the proportionality principle:

Proposed amendments

33. [...] The compliance report is subject to the proportionality principle in accordance with Article 22(1) of the MiFID II Delegated Regulation. Therefore, when reporting, for example, on the firm's product governance arrangements, the information for simpler, more common products may be less in-depth, whereas products characterised by complexity/risk features or by other relevant features (such as, for example, illiquidity and innovation) should be described in more detail. **Likewise, the firm shall take into account the nature of the service provided and the category of its clients when reporting on product governance arrangements.**

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?

No, AMAFI does not believe that further guidance is needed.

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

No, AMAFI does not believe that other topics of MiFID II should be included in the report.

- **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.

Yes, **AMAFI generally agrees with Guideline 4. Nevertheless, we would have expected that such guideline would have been the first guideline of this document since “advisory” is the very essence of compliance function even before “risk assessment” and “monitoring”.**

AMAFI also agrees with the new examples and the clarification on the **key role to be played by senior management**. That is why we believe that advisory responsibilities of the compliance function are as well for senior management. Lastly, we fully support the paragraph 46 that says that firms should ensure that the compliance function is involved in all material correspondence with competent authorities.

However, we wish to clarify the three following points:

- (i) The **compliance function should, first and for most, define the compliance principles** under which businesses should operate. In any case it cannot be the only function responsible for establishing all policies and procedures within the firm. We believe the guidelines could be amended to clarify that.
- (ii) The purpose of compliance culture is indeed the principle of improving investor protection but **also the integrity of markets**.
- (iii) On staff training, we disagree with the assumption that training is “*performed*” by compliance function. We consider that compliance function should rather monitor that such training is being made accordingly. In addition, since the present Guidelines are limited to MiFID II scope, the wording should clarify that “training” here is related to MiFID II.

Accordingly, we would like to suggest the following amendments to guideline 4.

Proposed amendments

General guideline 4

37. Firms should ensure that the compliance function fulfils its advisory responsibilities including: providing support for staff **and management** training; providing day-to-day assistance for staff **and management** ~~and participating in the establishment of policies and procedures within the firm~~ **and should define the compliance principles under which businesses should operate** (e.g. the firm’s remuneration policy or the firm’s product governance policies and procedures).

Supporting guidelines

38. Firms should promote and enhance a ‘compliance culture’ throughout the firm, which should be supported by the senior management. 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~~ **as well as integrity of markets**.

39. The firm needs to ensure that its staff is adequately trained (see Guidelines for the assessment of knowledge and competence; ESMA71-1154262120-153 EN (rev)). The compliance function should ~~support~~ **monitor** that business units in the area of investment services and activities (i.e. all staff involved directly or indirectly in the provision of investment services and activities) ~~in performing any training~~ **related to MiFID II**.

41. Training should be **kept up-to-date** ~~developed on an on-going basis~~ so that it takes into account all relevant changes (for example, new legislation, standards or guidelines issued by ESMA and competent authorities, and changes in the firm’s business model).

- **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.

No, AMAFI totally agrees with Guideline 5.

It should be very clear indeed that sufficient human and IT resources should be allocated to the compliance function.

- **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.

Yes, AMAFI agrees with the creation of this guideline and its content.

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

Yes, AMAFI agrees with the additions to Guideline 6 and fully share ESMA belief that it is important to emphasise and insist on skills, knowledge, expertise and authority of the compliance function.

- **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.

No, AMAFI agrees with guideline 7.

- **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.

No, AMAFI agrees with guideline 8.

- **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.

AMAFI agrees with the Guideline 9 but would like to outline that in some jurisdiction Compliance Officers have a personal liability attached to the function therefore it is necessary to leave them enough flexibility to decide the most efficient organisation.

- **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.

No, AMAFI disagrees with this proposal. Indeed, MiFID II treats various topics which require different knowledge and expertise (the skills needed to understand systematic internaliser requirements are not the same than the ones needed to understand the product governance requirements). In the same time, other regulations (such as PRIIPs for example) treats topics closely linked to MiFID II. So, even in large investment firms, it does not seem appropriate to require that some people are only focused on MiFID II even though investment firms are also impacted by other regulations.

In any case, it seems over prescriptive to impose such requirement. It should be left to the decision of the firm how to organise within the compliance function supervision of specific regulations.

Proposed amendments:

AMAFI proposes to **delete** the paragraph 78.

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

As mentioned in Q17, AMAFI proposes to delete the paragraph 78.

- **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.

Yes, AMAFI agrees with the amendments made to Guideline 11.

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

No, AMAFI generally agrees with the Guideline 11 but would to suggest clarifying that due diligence assessment should only be made when outsourcing to a service provider outside of the group.

Proposed amendments:

92. The firm should perform a due diligence assessment before choosing a service provider (***i.e. meaning an external entity and not an entity of the same group***) in order to ensure that the criteria set out in Articles 22 and 31 of the MiFID II Delegated Regulation are met. The 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. The extent of the due diligence assessment is dependent on the nature, scale, complexity and risk of the tasks and processes that are outsourced.

- **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.

Yes, AMAFI agrees with the amendments made to Guideline 12.

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

Yes, AMAFI suggests to amend the paragraph 92 to add that such questionnaire could be used – when it contains all the required information as it is the case in France – to fulfil the reporting requirements of the compliance function stated in Article 22.2.c of MiFID II DR and developed in Guideline 3.

Proposed amendments

92. Some Member States require the compliance officer to fulfil an annual questionnaire in order to gather information on compliance of the firm. The questionnaire is an evaluation grid on how the applicant's business is going to be conducted and monitored by the firm. [...] The questionnaire could be used to monitor the firm and to require the firm to adopt an action plan to remediate to the issues, to determinate the priorities of the supervision of the competent authority and to calibrate its risk-based approach. **This annual questionnaire, when it contains all the information required, can also be used to fulfil the reporting obligation to the senior management laid down in Art. 22 (2) point (c) and developed in Guideline 3.**

