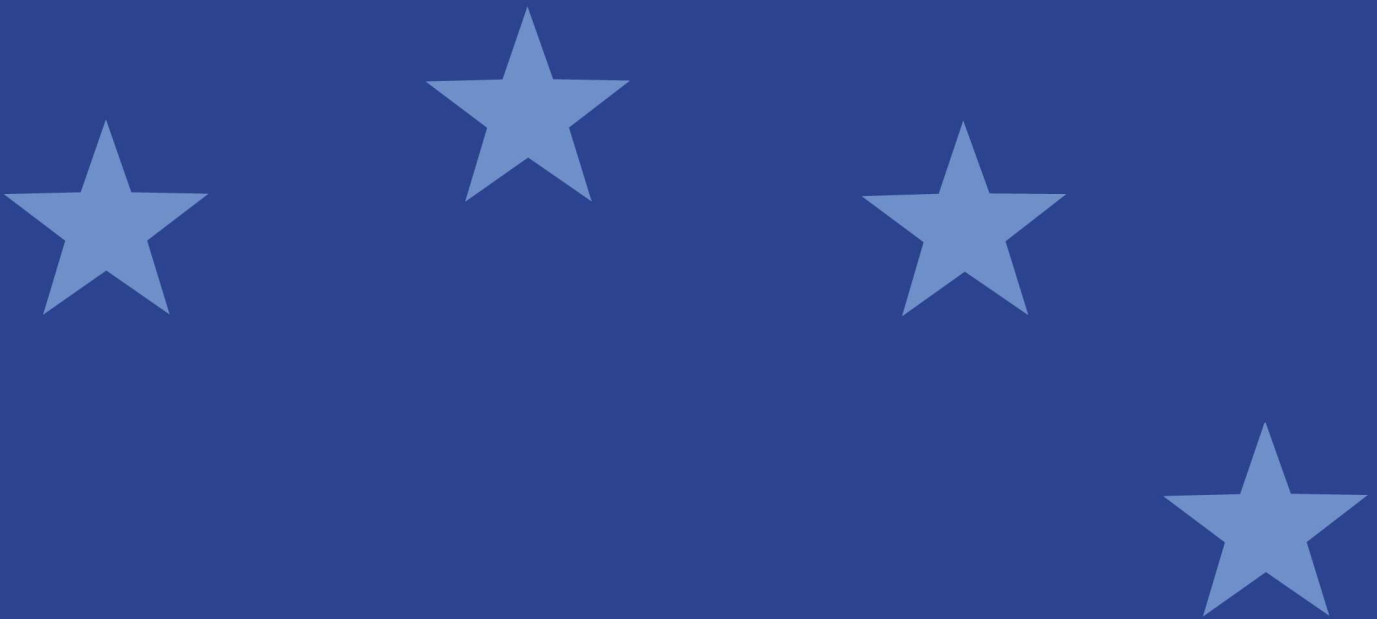




European Securities and  
Markets Authority

# Consultation Paper

**Guidelines on certain aspects of the MiFID II compliance function  
requirements**



## Responding to this paper

ESMA invites comments on this paper and in particular on the specific questions summarised in Annex I. Comments are most helpful if they:

- respond to the question stated;
- indicate the specific question to which the comment relates;
- contain a clear rationale; and
- describe any alternatives ESMA should consider.

ESMA will consider all comments received by **15 October 2019**.

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

### Publication of responses

All contributions received will be published following the close of the consultation, unless you request otherwise. Please clearly and prominently indicate in your submission any part you do not wish to be publicly 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 not to disclose the response 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 [Legal Notice](#).

### Who should read this paper

This paper is primarily of interest to competent authorities and firms that are subject to Directive 2014/65/EU of the European Parliament and of the Council (MiFID II). In particular, this paper is addressed to investment firms and credit institutions providing investment services and activities, investment firms and credit institutions selling or advising clients in relation to structured deposits, UCITS management companies and external Alternative Investment Fund



Managers (AIFMs) when providing investment services and activities in accordance with the UCITS Directive<sup>1</sup> and the AIFMD<sup>2</sup>.

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<sup>1</sup> 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).

<sup>2</sup> 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 Regulations (EC) No 1060/2009 and (EU) No 1095/2010.

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# 1. Executive Summary

## Reasons for publication

In accordance with Article 16(2) of the ESMA Regulation, this paper sets out for consultation draft ESMA guidelines on certain aspects of the MiFID II compliance function requirements.

The compliance function is a crucial function within firms, responsible for identifying, assessing, monitoring and reporting on the firm's compliance risk, i.e. the risk that a firm fails to comply with its obligations under MiFID II.

The purpose of these draft guidelines is to enhance clarity and foster convergence in the implementation of certain aspects of the new MiFID II compliance function requirements, replacing the existing ESMA guidelines on the same topic, issued in 2012<sup>3</sup>. This Consultation Paper builds on the text of the 2012 guidelines, which have been substantially confirmed (albeit clarified and refined where necessary). In addition, it takes into account new requirements under MiFID II and the results of supervisory activities conducted by national competent authorities (NCAs) on the application of the compliance function requirements.

By pursuing the objective of ensuring a consistent and harmonised application of the compliance function requirements, the proposed Guidelines will make sure that the objectives of MiFID II can be efficiently achieved. ESMA believes that the implementation of these guidelines should strengthen investor protection – a key objective for ESMA.

## Contents

Section 2 explains the background to the proposals.

Annex I lists all the questions set out in the consultation paper; Annex II contains the cost-benefit analysis; Annex III contains the full text of the draft guidelines; and Annex IV presents the correlation table between the proposed draft guidelines and the corresponding 2012 guidelines.

## Next Steps

ESMA will consider the responses it receives to this consultation paper in Q4 2019/Q1 2020 and expects to publish a final report, and final guidelines, in Q2 2020.

## 2. Background

### Overview

1. The compliance function is a crucial function within firms, responsible for identifying, assessing, monitoring and reporting on the firms' compliance risk.
2. MiFID II requires firms to implement a series of systems and controls (appropriate to the nature, scale and complexity of their business as well as the range of investment services and activities undertaken in the course of that 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 permanent, independent and effective compliance function.
3. The importance of the compliance function was already clear under MiFID I and has been confirmed in MiFID II. Strengthening the compliance function under MiFID II was key as a strong compliance function reduces compliance risk and facilitates competent authorities to exercise their powers effectively. While the objectives of the compliance function, as well as the key principles underpinning the regulatory requirements, have remained unchanged, the obligations have been further strengthened, broadened and detailed under MiFID II.
4. The MiFID II Level 2 provisions have been enhanced (Article 22 of the MiFID II Delegated Regulation<sup>4</sup>), compared to MiFID I (Article 6 of the MiFID I Implementing Directive<sup>5</sup>). Notably, they now include some of the recommendations set out in ESMA's 2012 guidelines.
5. In addition, MiFID II expanded the role of the compliance function in relation to certain specific topics, such as:
  - the compliance function is assigned new and specific responsibilities in relation to MiFID II's product governance requirements under Article 9(6) and (7) and Article 10(6) and (8) of the MiFID II Implementing Directive<sup>6</sup>;

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<sup>3</sup> ESMA/2012/388.

<sup>4</sup> Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive.

<sup>5</sup> Commission Directive 2006/73/EC of 10 August 2006 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive.

<sup>6</sup> Commission Delegated Directive (EU) 2017/593 of 7 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to safeguarding of financial instruments and funds belonging to clients, product governance obligations and the rules applicable to the provision or reception of fees, commissions or any monetary or non-monetary benefits.

- the compliance function may also operate as the complaints management function of the firm (Article 26(3) of the MiFID II Delegated Regulation);
  - the compliance function shall also advise the management body of the firm on the firm's remuneration policy (Article 27(3) of the MiFID II Delegated Regulation).
6. Article 16(2) of MiFID II and Article 22 of the MiFID II Delegated Regulation (mainly but other provisions apply) set out the regulatory provisions for the compliance function of firms. The proposals for guidelines in this area are aimed at helping firms to increase the effectiveness of the compliance function, so are focused on the responsibilities of the compliance function.
  7. These guidelines should be read together with the proportionality principle as set out in the second paragraph of Article 22(1) of the MiFID II Delegated Regulation. Therefore, these guidelines apply to 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.
  8. The need to enhance clarity and to foster convergence on some of the above-mentioned aspects has triggered the review and update of the existing guidelines on certain aspects of the MiFID compliance function requirements issued by ESMA in 2012 (from here on the "2012 guidelines").
  9. In addition, ESMA also aims to:
    - take into account the results of supervisory activities conducted by national competent authorities (NCAs) on the implementation of the compliance function requirements (including the implementation by firms of the 2012 guidelines); and
    - provide additional detail on some aspects that were already covered under the 2012 guidelines.

### **General approach followed for the review of the 2012 guidelines**

10. MiFID II has reinforced the existing MiFID I requirements relating to the compliance function, rather than introducing a completely different regime. For this reason, ESMA has chosen to build upon the text of the 2012 guidelines, which have been substantially confirmed (albeit clarified, refined and supplemented where necessary).
11. ESMA notes that, in order to avoid any unnecessary repetitions, it has deleted from the 2012 guidelines the ones that have been incorporated directly in the MiFID II Delegated Regulation (for example, general guidelines 2, 3 and 9, now incorporated within Article 22 of the MiFID II Delegated Regulation). ESMA however notes that the corresponding supporting guidelines have been generally confirmed, as they still provide a valuable contribution in terms of practical examples and clarification on how the requirements should be applied in practice.

12. Taking into considerations all the above, the guidelines have been partially reorganised and divided in the following main sections and sub-sections:
  - I. Responsibilities of the compliance function;
    - Compliance risk assessment;
    - Monitoring obligations of the compliance function;
    - Reporting obligations of the compliance function;
    - Advisory and assistance obligations of the compliance function;
  - II. Organisational requirements of the compliance function;
    - Effectiveness of the compliance function;
    - Skills, knowledge, expertise and authority of the compliance function;
    - Permanence of the compliance function;
    - Independence of the compliance function;
    - Proportionality with regard to the effectiveness of the compliance function;
    - Combining the compliance function with other internal control functions;
    - Outsourcing of the compliance function;
  - III. Competent authority review of the compliance function.
13. In order to facilitate the reading of the document, a correlation table between the proposed guidelines and the 2012 guidelines has been set out in Annex IV.



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

### *Guideline 1 – Compliance risk assessment*

14. Most of general guideline 1 is now incorporated into paragraph 2 of Article 22(2) of the MiFID II Delegated Regulation. This is reflected in guideline 1 which has been reorganised accordingly. The majority of the supporting guidelines have been confirmed as they are in line with NCAs' supervisory practices and still provide a valuable contribution in terms of how the requirements should be applied in practice. They have just been cleared of the parts now incorporated in MiFID II level 2 provisions and it has been specified that ad hoc reviews of the compliance risk assessment may be triggered by, *inter alia*, changes in the regulatory framework.

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

### *Guideline 2 – Monitoring obligations of the compliance function*

15. Guideline 2 has been reorganised since general guideline 2 was integrated in the second paragraph of Article 22(2) of the MiFID II Delegated Regulation. Consequently, the first supporting guideline of the 2012 guidelines has now become general guideline 2.
16. The other supporting guidelines of the 2012 guidelines have been confirmed as well as they still reflect NCAs' views and still provide a valuable contribution in terms of how the requirements should be applied in practice.
17. The only addition to the supporting guidelines has been made in paragraph 26 which now indicates that the compliance function may, as an additional tool for monitoring activities, also interview the firm's clients.

**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.**

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

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

### *Guideline 3 – Reporting obligations of the compliance function*

18. Guideline 3 has been reorganised since parts of it (general guideline 3, ad hoc reports due to senior management in case the compliance function discovers significant compliance matters...) were integrated in Article 22(2) of the MiFID II Delegated Regulation.

19. The supporting guidelines relating to the content of the compliance function reports have been further developed and rearranged into the following main sections: “General information”, “Manner of monitoring and reviewing”, “Findings”, “Actions taken (including related timeline and organisational units involved)” and “Others”.
20. In line with the new responsibilities of the compliance function in respect of the firm’s product governance arrangements (Article 9(6) and (7) and Article 10(6) and (8) of the MiFID II Delegated Directive), in addition to the information expressly required by the MiFID II Delegated Directive (i.e. information on financial instruments manufactured/distributed and on the distribution strategy) the compliance reports should now systematically include information about:
  - the compliance function’s role in the elaboration, monitoring and review of the firm’s product governance requirements; and
  - if relevant, all points listed in paragraph 32 of the guidelines (general information, manner of monitoring and reviewing, findings, actions taken (including related timeline and organisational units involved) and others) but in respect of the firm’s product governance arrangements.
21. The supporting guidelines now also spell out what the parts of the report addressing the financial instruments manufactured/distributed by the firm and its distribution strategy (in accordance with Article 9(6) and (7) and Article 10(6) and (8) of the MiFID II Delegated Directive) should cover, as a minimum: i) the number and nature of the products manufactured/distributed, their target markets and other information to assess the product’s compliance-risk (e.g. complexity of the product, product-related conflicts of interests, etc.); ii) for manufacturers, as part of the information on the respective distribution strategy, the respective distributors of the products; and iii) whether the products are distributed outside their (positive) target market and to which extent.
22. This will help the firm’s management body to comply with its obligations to have effective control over the firm’s product governance process as well as the firms’ national competent authorities to monitor the firm’s product governance obligations.
23. However, the supporting guidelines also include a reminder that the proportionality principle (of the second paragraph of Article 22(1) of the MiFID II Delegated Regulation) also applies to the reporting responsibilities of the compliance function. As such, for example, the information provided by the compliance function in its reports in relation to the product governance arrangements of the firm may be more high level for simple and common products (compared to more complex and risky products).
24. Lastly, the reports of the compliance function should include any issue arising out of the implementation of the arrangements the firm has in place to assess, minimise and manage any conflict of interest from the compliance function also acting as the firm’s complaints handling 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.**
- 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.**
- 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.**
- 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?**
- Q9: Do you believe that further topics/areas should be included in the compliance function reports?**

*Guideline 4 – Advisory and assistance obligations of the compliance function*

25. The guidelines on this topic have been barely amended considering that the Level 1 and Level 2 texts have not changed.
26. ESMA however inserted a couple of examples of the types of policy and procedures that the compliance function should help elaborate, monitor and review: the firm's remuneration policy and product governance policy and procedures. This is in line with new Article 27(3) of the MiFID II Delegated Regulation and the compliance function's attributions in relation to product governance arrangements.
27. The guidelines now also specify that the "compliance culture" of the firm should be supported by senior management.
- 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.**

*Guideline 5 – Effectiveness of the compliance function*

28. General guideline 5 and its supporting guidelines have been (mostly) left untouched as the relevant requirements have not changed.

29. General guideline 5 was however amended and supplemented as follows:

- the wording already included in Article 22(3)(a) of the MiFID II Delegated Regulation has been deleted (this was already a level 2 requirement under MiFID I); and
- the second paragraph of general guideline 5 has now become a new general guideline 6 relating to the “skills, knowledge, expertise and authority of the compliance function”. As a result, parts of the supporting guidelines that were previously related to this paragraph of general guideline 5 have been moved to new guideline 6; and
- a new paragraph provides that the firm should have in place the arrangements necessary to ensure effective communication between the compliance function and the other control functions (such as internal audit and risk management) as well as with any internal or external auditors.

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

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

30. New guideline 6 results from the split of guideline 5: guideline 6 is solely focused on the skills, knowledge, expertise and authority of the compliance function. Given the importance and nature of the role of the compliance function (including its advisory role to senior management), ESMA believes that it is important to emphasise and insist on this aspect.
31. In addition, whilst the relevant parts of general guideline 5 formerly focused solely on the knowledge, expertise and experience of the compliance officer, new general guideline 6 relates to all compliance staff.
32. The new additions to the supporting guidelines mainly detail good supervisory practices which national competent authorities and firms may consider to, respectively, supervise and integrate in their compliance function arrangements.
33. In addition, the new supporting guidelines expressly provide that the compliance officer should demonstrate high professional ethical standards and personal integrity. Indeed, given the importance and nature of the role of the compliance function, ESMA believes that the compliance officer should be irreproachable in terms of ethics and personal integrity.

**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.**

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

*Guideline 7 - Permanence of the compliance function*

34. This guideline has been left untouched as the level 1 and level 2 requirements have not changed.

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

*Guideline 8 – Independence of the compliance function*

35. As the relevant level 1 and level 2 requirements applicable remain the same, guideline 8 (guideline 7 in the 2012 guidelines) has not been amended. Only the last sentence of general guideline 8 has been deleted as it is now part of the level 2 text (Article 22(3)b of the MiFID II Delegated Regulation).

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

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

36. Guideline 9 (guideline 8 in the 2012 guidelines) has been amended to delete former general guideline 8 that has been incorporated into Article 22(4) of the MiFID II Delegated Regulation.

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

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

37. A new paragraph has been added at the end of guideline 10 (guideline 9 of the 2012 guidelines). ESMA believes that taking into account the nature, scale and complexity of the business of the firm, and the nature and range of investment services and activities undertaken in the course of that business, although a firm may have compliance staff working on other control units at the same level, it should consider establishing and maintaining a core team within compliance staff members whose sole area of responsibility is MiFID II compliance.

**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.**

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

*Guideline 11 – Outsourcing of the compliance function*

38. Guideline 11 (guideline 10 in the 2012 guidelines) has been amended to clearly state that a firm cannot discharge its compliance function responsibilities by outsourcing all or part of its compliance function and the relevant responsibilities attached to the functions and/or tasks outsourced will always rest with the firm.

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

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

*Guideline 12 – Review of the compliance function by competent authorities*

39. Guideline 12 (guideline 11 in the 2012 guidelines) has been simplified as some of the good practices detailed previously here (related to how certain national competent authorities license or approve nominated compliance officers) have been moved to new guideline 6.

40. Guideline 12 has been further amended to reflect good practices that certain NCAs use to supervise the compliance function requirements.

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

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

### **3. Annexes**

#### **3.1 Annex I - Summary of questions**

- Q1: Do you believe that guideline 1 should be further amended and/or supplemented? Please also state the reasons for your answer.**
- 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.**
- Q3: Do you believe that further guidance is needed to clarify the compliance function's monitoring obligations?**
- Q4: Do you agree with the addition to paragraph 26?**
- Q5: Do you agree with the suggested general content of the compliance function reports (paragraph 31 of the guidelines)? Please also state the reasons for your answer.**
- Q6: Do you agree with the suggested content of the compliance function reports in relation to product governance arrangements (paragraph 32 of the guidelines)? Please also state the reasons for your answer.**
- 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.**
- 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?**
- Q9: Do you believe that further topics/areas should be included in the compliance function reports?**
- 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.**
- Q11: Do you believe that guideline 5 should be amended and/or supplemented further? Please also state the reasons for your answer.**
- 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.**

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

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

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

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

**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.**

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

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

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

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

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



## 3.2 Annex II - Cost-benefit analysis

1. Under the MiFID I framework, the compliance function had a crucial role within firms, responsible for identifying, assessing, monitoring and reporting on the firms' compliance risk.
2. After the publication and entry into application of MiFID, the financial crisis highlighted the need for further 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 took second place to other areas of risk within a firm, which could lead to the deficient implementation of appropriate compliance processes.
3. ESMA published the 2012 guidelines to enhance clarity and foster convergence in the implementation of the MiFID I organisational requirements relating to certain aspects of the compliance function. The guidelines were also aimed at reinforcing the importance of the compliance function.
4. MiFID II confirmed the key role of the compliance function for the firm's compliance risk. While the objectives of the compliance function, as well as the key principles underpinning the regulatory requirements, have remain unchanged, the MiFID II Delegated Regulation strengthened as well as expanded the role and responsibilities of the compliance function.
5. Indeed, although the relevant Level 1 provisions under MiFID I<sup>7</sup> and MiFID II<sup>8</sup> are identical, the Level 2 provisions that existed under MiFID I<sup>9</sup> have been enhanced under MiFID II<sup>10</sup> as they now include some of the recommendations set out in the 2012 guidelines.
6. In addition, MiFID II expanded the role of the compliance function in relation to certain specific topics. In particular: the compliance function is assigned specific responsibilities in relation to MiFID II's product governance requirements<sup>11</sup>; the compliance function may also double as the complaints management function of the firm<sup>12</sup>; the compliance function is also advising the management body of the firm on the firm's remuneration policy<sup>13</sup>.
7. The purpose of these draft guidelines is to enhance clarity by emphasising a number of important issues, and to foster convergence in the implementation of the MiFID II

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<sup>7</sup> Article 13(2) of MiFID I.

<sup>8</sup> Article 16(2) of MiFID II.

<sup>9</sup> Article 6 of the MiFID I Implementing Directive.

<sup>10</sup> Article 22 of the MiFID II Delegated Regulation.

<sup>11</sup> Compliance function's responsibilities cover both for the manufacturing and distribution of financial instruments by the firm. Furthermore the compliance reports to senior management must now systematically include information about the firm's product governance (Article 9(6) and (7) and Article 10(6) and (8) of the MiFID II Implementing Directive).

<sup>12</sup> Article 26(3) of the MiFID II Delegated Regulation.

<sup>13</sup> Article 27(3) of the MiFID II Delegated Regulation.

organisational requirements relating to the compliance function. The aim is to help firms to improve their implementation of these requirements and thereby enhance existing standards.

8. For 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 firm. Greater convergence leads to improved investor protection (consumer outcomes), which is a key ESMA objective.

### **The impact of the draft ESMA guidelines**

9. In light of the main objectives of these draft Guidelines (extensively illustrated in the background), the following preliminary assessment aims at explaining the benefits and costs of the key policy choices that are presented for consultation.
10. It should be preliminary observed that since the organisational requirements relating to the compliance function are provided under MiFID II and the MiFID II Delegated Regulation, the impact of the proposed guidelines should be considered having in mind those legal provisions that they support. While market participants will likely incur certain costs for implementing these guidelines, they will also benefit from the increased legal certainty and the harmonised application of the requirements across Member States. The proposed Guidelines should also facilitate competent authorities' efforts to improve the overall compliance with MiFID requirements increasing the investor confidence in the financial markets, which is considered necessary for the establishment of a genuine single capital market. Lastly, greater convergence leads to improved investor protection (consumer outcomes), which is a key ESMA objective.
11. Finally, it is important to remind that those existing 2012 guidelines which are confirmed should not imply any additional impacts/costs for both firms and NCAs.

### *Benefits*

12. It is possible to illustrate the main benefits linked to the proposed Guidelines as follows:
  - a) a stronger compliance function and, consequently, the reduction of the compliance risk and its related financial and reputational consequences;
  - b) reduction of risks linked to regulatory or supervisory arbitrage due to an increased degree of harmonisation and more consistent supervisory convergence;
  - c) positive effects from improved harmonisation and standardisation of the processes that firms have to put in place when implementing the MiFID II compliance function requirements;
  - d) positive effects from improved harmonisation and standardisation for competent authorities on the costs and activities needed to implement the new supervisory processes related to the compliance function requirements;

- e) restoring investors' confidence in financial markets.

### *Costs*

13. With reference to the costs, it should be firstly reminded that the importance of a strong compliance function had been made clear already under the MiFID I regime. The crucial role of the compliance function was also stressed in the 2012 guidelines and in the peer review that ESMA developed on the same issue.<sup>14</sup>
14. In light of what has been said, it can be reasonably expected that those firms having already in place a complete set of arrangements to comply with the provisions, principles and good practices issued under the MiFID I regime (including the 2012 guidelines) will presumably incur less overall costs when implementing the new framework and these guidelines.
15. ESMA considers that potential and incremental costs that firms will face when implementing the compliance function requirements under the MiFID II regime (including but not limited to these draft guidelines) might have both one-off and ongoing nature, arguably linked to:
  - a) (direct) costs linked to the update/review of the existing procedural and organisational arrangements (e.g. the review and/or the update of the compliance function reports' structure and content); and
  - b) (direct) initial and ongoing IT costs.
16. ESMA believes that the proposed options in this area provide the most cost-efficient solution to achieving the general objectives of these Guidelines.

### *Conclusions*

17. In light of what has been illustrated above, ESMA believes that the overall (compliance) costs associated with the implementation of the new regime on the compliance function requirements (which includes the proposed guidelines) will be fully compensated by the benefits from the strengthened and expanded role of the compliance function and from the subsequent reduction of compliance risk and improved investor protection. These benefits will interest all the market participants contributing to the restoration of the fundamental trust in the financial markets.
18. ESMA also considers that the proposed guidelines are able to achieve an increased level of harmonisation in the interpretation and application of the compliance function requirements across Member States, minimising the potential adverse impact on firms

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<sup>14</sup> ESMA42-111-4285.

linked to compliance costs. These benefits will outweigh all associated costs in respect of these Guidelines.

19. Finally, ESMA believes that the adoption of guidelines is the best tool to achieve the explained objectives since this topic is already covered by existing guidelines. Furthermore, the adoption of guidelines further reduces the risk of diverging interpretations that might lead to discrepancies in the application and supervision of the relevant regulation and requirements across Member States (determining a risk of regulatory arbitrage and circumvention of rules).

### **3.3 Annex III - Guidelines**

#### **I. Scope**

##### **Who?**

1. These guidelines apply to competent authorities and firms (as defined below).

##### **What?**

2. These guidelines apply in relation to the provision of the investment services and activities listed in Section A and the ancillary services listed in Section B of Annex I of MiFID II (as defined below).

##### **When?**

3. These guidelines apply from 60 calendar days after the reporting requirement date referred to in paragraph 12.
4. The previous ESMA guidelines issued under MiFID I<sup>1</sup> will cease to apply on the same date.

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<sup>1</sup> ESMA/2012/388 – Guidelines on certain aspects of the MiFID compliance function requirements.

## II. Legislative references, abbreviations and definitions

### Legislative references

<i>AIFMD</i>	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 Regulations (EC) No 1060/2009 and (EU) No 1095/2010 <sup>2</sup> .
<i>CRR</i>	Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 <sup>3</sup> .
<i>ESMA Regulation</i>	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>4</sup> .
<i>MiFID II</i>	Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU <sup>5</sup> .
<i>MiFID II Delegated Regulation</i>	Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive <sup>6</sup> .
<i>MiFID II Delegated Directive</i>	Commission Delegated Directive (EU) 2017/593 of 7 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to safeguarding of financial instruments and funds belonging to clients, product governance obligations and the rules applicable to the provision or reception of fees, commissions or any monetary or non-monetary benefits <sup>7</sup> .

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<sup>2</sup> OJ L 174, 01.07.2011, p. 1-73.

<sup>3</sup> OJ L 176, 27.6.2013, p. 1-337.

<sup>4</sup> OJ L 331, 15.12.2010, p. 84.

<sup>5</sup> OJ L 173, 12.06.2014, p. 349.

<sup>6</sup> OJ L 87, 31.3.2017, p. 1-83.

<sup>7</sup> OJ L 87, 31.3.2017, p. 500-517.

### *UCITS Directive*

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)<sup>8</sup>.

## **Abbreviations**

*ESMA* European Securities and Markets Authority

## **Definitions**

5. Unless otherwise specified, terms used in MiFID II, in the MiFID II Delegated Regulation and in the MiFID II Delegated Directive have the same meaning in these guidelines. In addition, for the purposes of these guidelines, the following definitions apply:

*compliance function* The function within a firm responsible for identifying, assessing, advising, monitoring and reporting on the firm's compliance risk.

*compliance officer* As defined in Article 22(3)(b) of the MiFID II Delegated Regulation, the person appointed and replaced by the management body and responsible for the compliance function and any reporting as to compliance required by MiFID II and Article 25(2) of the MiFID II Delegated Regulation.

*compliance risk* The risk that a firm fails to comply with its obligations under MiFID II, and the respective national laws, as well as the applicable standards set out by ESMA and competent authorities on these provisions.

*firms* Investment firms (as defined in Article 4(1)(1) of MiFID II), credit institutions (as defined in Article 4(1)(1) of the CRR) when providing investment services and activities within the meaning of Article 4(1)(2) of MiFID II, investment firms and credit institutions when selling or advising clients in relation to structured deposits, UCITS management companies and external Alternative Investment Fund Managers (AIFMs) (as

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<sup>8</sup> OJ L 302, 17.11.2009, p. 32.

defined in Article 5(1)(a) of the AIFMD) when providing investment services and activities in accordance with Article 6(3) of the UCITS Directive and Article 6(4) of the AIFMD, respectively.

6. Guidelines do not reflect absolute obligations. For this reason, the word “should” is often used. However, the words “must”, “shall” or “are required” are used when describing a MiFID II requirement.
7. Descriptions of specific practices of competent authorities in these guidelines aim to provide the reader with additional information on differing approaches of competent authorities without setting up additional requirements for firms or competent authorities (and thereby triggering the obligation under Article 16(3) of the ESMA Regulation to comply or explain).



### **III. Purpose**

8. The purpose of these guidelines is to clarify the application of certain aspects of the MiFID II compliance function requirements in order to ensure the common, uniform and consistent application of Article 16 of MiFID II, Article 22 of the MiFID II Delegated Regulation, and specified related provisions (including articles 21(1) (d) and (e), 25(2) and (3), 26(3) and (7), 27(3) and 31 MiFID II Delegated Regulation as well as articles 9(6) and (7) and 10(6) and (8) of the MiFID II Delegated Directive).
9. ESMA expects these guidelines to promote greater convergence in the interpretation of, and supervisory approaches to, the MiFID II compliance function requirements by emphasising a number of important issues, and thereby enhancing the value of existing standards. By helping to ensure that firms comply with regulatory standards, ESMA anticipates a corresponding strengthening of investor protection.

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

### **Status of the guidelines**

10. This document contains guidelines issued under Article 16 of the ESMA Regulation. In accordance with Article 16(3) of the ESMA Regulation, competent authorities and financial market participants must make every effort to comply with these guidelines.
11. Competent authorities to whom these guidelines apply should comply by incorporating them into their national legal and/or supervisory frameworks, as appropriate, including where particular guidelines are directed primarily at financial market participants. In this case, competent authorities should ensure through their supervision that financial market participants comply with the guidelines.

### **Reporting requirements**

12. Within two months of the date of publication of the guidelines on ESMA's website in all EU official languages, competent authorities to which these guidelines apply must notify ESMA whether they (i) comply, (ii) do not comply, but intend to comply, or (iii) do not comply and do not intend to comply with the guidelines.
13. In case of non-compliance, competent authorities must also notify ESMA within two months of the date of publication of the guidelines on ESMA's website in all EU official languages of their reasons for non-complying with the guidelines
14. A template for notifications is available on ESMA's website. Once the template has been filled in, it shall be transmitted to ESMA.
15. 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**

16. As part of its responsibility for ensuring that the firm complies with its obligations under MiFID II, senior management must ensure that the compliance function fulfils the requirements set out in Article 22 of the MiFID II Delegated Regulation.
17. The guidelines should be read together with the proportionality principle as set out in Article 22(1), second paragraph, of the MiFID II Delegated Regulation. The guidelines apply to 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.

### **V.1 Responsibilities of the compliance function**

#### **Compliance risk assessment**

#### **Relevant legislation: Article 22(1) and (2), second paragraph of the MiFID II Delegated Regulation**

##### ***General guideline 1***

18. In accordance with article 22(2), second paragraph, of the MiFID II Delegated Regulation, the compliance function shall, amongst others, conduct a risk assessment to ensure that compliance risks are comprehensively monitored. The compliance function shall establish a risk-based monitoring programme on the basis of this compliance risk assessment to determine its priorities and the focus of the monitoring, advisory and assistance activities.

##### ***Supporting guidelines***

19. The findings of the compliance risk assessment should be used to set the work programme of the compliance function and to allocate the functions resources efficiently. The compliance risk assessment should be updated 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.
21. The compliance risk assessment should take into account the applicable obligations under MiFID II, national implementing regulation and the policies, procedures, systems and controls implemented within the firm in the area of investment services and activities. The assessment should also take into account the results of any monitoring activities and of any relevant internal or external audit findings.

22. The identified risks should be reviewed on a regular basis and when necessary also on an ad-hoc-basis to ensure that any emerging risks are taken into consideration (for example, resulting from new business fields, other changes in the firm's structure or relevant changes in the regulatory framework).

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

#### **Relevant legislation: Article 22(2)(a) and 22(2), second paragraph, of the MiFID II Delegated Regulation**

#### ***General guideline 2***

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, organisation and control measures remain effective and appropriate.

#### ***Supporting guidelines***

24. Where a firm 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.
25. The risk-based approach to compliance should form the basis for determining the appropriate tools and methodologies used by the compliance function, as well as the extent of the monitoring programme and the frequency of monitoring activities performed by the compliance function (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 how policies and procedures are implemented in practice, for example through on-site inspections at the operative business units. The compliance function should also consider the scope of reviews to be performed.
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.
27. The monitoring programme should reflect changes to the firm's risk profile, which may arise, for example, from significant events such as corporate acquisitions, IT system changes, or reorganisation. It should also extend to the implementation and effectiveness of any remedial measures taken by the firm in response to breaches of MiFID II, related delegated acts and/or any national implementing provisions thereof.
28. Monitoring activities performed by the compliance function should also take into account:
- (a) the business area's obligation to comply with regulatory requirements;
  - (b) 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); and
  - (c) reviews by the risk management function, internal audit function or other control functions in the area of investment services and activities.
29. Reviews by control functions should be coordinated with the monitoring activities performed by the compliance function while respecting the different functions' independence and mandate.
30. The compliance function should have a role in overseeing 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. In this regard, firms should grant the compliance function access to all customer complaints received by the firm.

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

**Relevant legislation: Article 16(2) of MiFID II, Article 21(1)(e), 22 (2)(c) and (3)(b), 25 (2) and (3) and 26 (3) and (7) of the MiFID II Delegated Regulation, Article 9(6) and (7) and Article 10(6) and (8) of the MiFID II Delegated Directive<sup>9</sup>**

#### ***General guideline 3***

31. The written compliance report to senior management should cover all business units involved in the provision of investment services, activities and ancillary services. Where the report does not cover all of these activities of the firm, it should clearly state the reasons.

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<sup>9</sup> Commission Delegated Directive (EU) 2017/593 of 7 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to safeguarding of financial instruments and funds belonging to clients, product governance obligations and the rules applicable to the provision or reception of fees, commissions or any monetary or non-monetary benefits.

### *Supporting guidelines*

32. In addition to the topics listed in Article 22(2) of the MiFID II Delegated Regulation, the following matters should be addressed in these written compliance reports, where relevant:

(a) General information

- information on the adequacy and effectiveness of the firm's policies and procedures designed to ensure that the firm and its staff comply with the obligations under Directive 2014/65/EU or rather its European and national implementing acts;
- relevant changes and developments in regulatory requirements over the period covered by the report;
- a summary of the compliance function's structure, including the overall personnel employed, their qualifications and reporting lines;

(b) Manner of monitoring and reviewing

- how the compliance-function monitors the development and review of the obligations under Directive 2014/65/EU or rather its European and national implementing acts and how possible risks of failure by the firm or its staff to comply with these obligations are discovered at an early stage.
- a summary of on-site inspections or desk-based reviews performed by the compliance function
- a summary of the planned monitoring activities for the subsequent review;

(c) Findings

- a summary of major findings of the review of the policies and procedure including risks identified in the scope of the compliance function's monitoring activities;
- breaches and deficiencies in the firm's organisation and compliance process;
- the number of complaints received in the period under review. Where, as a result of the review of clients' complaints, specific compliance or risk issues are identified in relation to the procedures adopted by the firm for the provision of investment services, these aspects should be specifically reported;

(d) Actions taken (including related timeline and organisational units involved)

- any action taken to address any risk of failure by the firm or its staff to comply with the obligations under Directive 2014/65/EU or rather its European and national implementing acts;
- measures taken and to be taken to ensure compliance with changed regulatory requirements;

- reaction to complaints received and any payout performed based on the complaint. Actions regarding specific compliance or risk issues identified in relation to the procedures adopted by the firm for the provision of investment services as a result of the review of clients' complaints;
- (e) Others
- other significant compliance issues that have occurred since the last report;
  - overview of material correspondence with competent authorities; and
  - information as regards any deviation by senior management from important recommendations or assessments issued by the compliance function.
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:
- 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,

with the aim to assess whether the firm's product governance arrangements function as intended. To do so, 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. 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.

34. Where the firm's compliance function also acts as its complaints management function, the compliance report should address any issue arising out of the implementation of the arrangements the firm has in place to assess, minimise and manage any conflicts of interest between the two functions, including notably, any failure identified as regards the firm's compliance with its complaints handling obligations.
35. The compliance function should consider the need for additional reporting lines to any group compliance function.
36. ESMA notes that some competent authorities require firms to provide them with compliance function reports on a regular or ad hoc basis. 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. These practices provide competent authorities with first-hand insight into a firm's compliance activities, as well as any breaches of regulatory provisions.

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

**Relevant legislation: Article 22(2)(b) and 27(3) of the MiFID II Delegated Regulation.**

#### ***General guideline 4***

37. Firms should ensure that the compliance function fulfils its advisory responsibilities including: providing support for staff training; providing day-to-day assistance for staff and participating in the establishment of policies and procedures within the firm (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.
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 the 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. Training and other support should focus particularly, but not exclusively, on:
  - (a) the internal policies and procedures of the firm and its organisational structure in the area of investment services and activities; and



- (b) MiFID II, 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.
40. Training should be performed on a regular basis, and needs-based training should be performed where necessary. Training should be delivered as appropriate – for example, to the firm’s entire staff as a whole, to specific business units, or to a particular individual.
  41. Training should be 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).
  42. The compliance function should periodically assess whether staff in the area of investment services and activities hold the necessary level of awareness and correctly apply the firm’s policies and procedures.
  43. 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.
  44. Firms should ensure that the compliance function is involved in the development of the relevant policies and procedures within the 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 all strategic decisions or new business models, or about the launch of a new advertising strategy in the area of investment services and activities. If the compliance function’s advice is not followed, the compliance function should document this accordingly and present it in its compliance reports.
  45. Firms should ensure that the compliance function is involved in all significant modifications of the organisation of the 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 as well as the definition of staff remuneration policies. In this context, the compliance function should be given the right to participate in the product approval process for manufacturers and distributors as applicable. Senior management should therefore encourage business units to consult with the compliance function regarding their operations.
  46. Firms should ensure that the compliance function is involved in all material non-routine correspondence with competent authorities in the area of investment services and activities.

## **V.2 Organisational requirements of the compliance function**

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

#### **Relevant legislation: Article 22(3)(a) and 21(1)(d) of the MiFID II Delegated Regulation**

##### ***General guideline 5***

47. When ensuring that appropriate human and other resources are allocated to the compliance function, firms should take into account the scale and types of investment services, activities and ancillary services undertaken by the firm.

##### ***Supporting guidelines***

48. 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 firm. Where a firm's business unit activities are significantly extended, the firm should ensure that the compliance function is similarly extended as necessary in view of changes to the firm's compliance risk. Senior management should monitor regularly whether the number of staff and their expertise is still adequate for the fulfilment of the duties of the compliance function.
49. In addition to human resources, sufficient IT resources should be allocated to the compliance function.
50. Where the firm establishes budgets for specific functions or units, the compliance function should be allocated a budget that is consistent with the level of compliance risk the firm is exposed to. 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.
51. In ensuring compliance staff have access to the relevant information for their tasks at all times, firms should provide access to all relevant databases and records (such as recordings of telephone conversations and electronic communications referred to in Art. 76 of MiFID II Delegated Regulation). In order to have a permanent overview of the areas of the firm where sensitive or relevant information might arise, the compliance officer should have access to all relevant information systems within the firm as well as any internal or external audit reports or other reporting to senior management or the supervisory function, if any. Where relevant, the compliance officer should also be able to attend meetings of senior management or the supervisory function. Where this right is not granted, this should be documented and explained in writing. The compliance officer should have in-depth knowledge of the firm's organisation, corporate culture and decision-making processes in order to be able to identify which meetings are important to attend.
52. In particular, it is important that the firm puts in place necessary arrangements to ensure an effective exchange of information between the compliance function and other control

functions (e.g. internal audit and risk management) as well as with any internal or external auditors.

### **Skills, knowledge, expertise and authority of the compliance function**

#### **Relevant legislation: Article 21(1) (d) and 22(3) (a) and (b) of the MiFID II Delegated Regulation**

##### ***General guideline 6***

53. Firm's compliance staff shall have the necessary skills, knowledge, expertise and authority to discharge their obligations. This requirement should in particular be taken into account by firms when appointing the compliance officer. Having regard to the function and tasks assigned to the compliance officer, he or she should demonstrate high professional ethical standards and personal integrity.

##### ***Supporting guidelines***

54. In order to ensure that compliance staff have the authority required for their duties, the senior management of the firm should support them in the exercise of these duties. Authority implies possessing adequate expertise and relevant personal skills (such as, for instance, judgment), and may be enhanced by the firm's compliance policy explicitly acknowledging the specific authority of the compliance staff.

55. Within the compliance function there should at least be knowledge of MiFID II and all related delegated acts and of the respective national laws and regulations as well as of all applicable standards and guidelines issued by ESMA and competent authorities on these provisions, as far as these are relevant for the performance of their tasks. Compliance staff should be regularly trained in order to maintain their knowledge. A higher level of expertise is necessary for the designated compliance officer.

56. 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. In order to demonstrate the necessary level of knowledge and/or of experience, different options may be foreseen at national level in the Member State concerned. For instance, 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 nominated person and/or an exam to be passed. This sort of process may help to strengthen the position of the compliance function within the firm and in relation to third parties. Other regulatory approaches impose the responsibility for the assessment of the compliance officer's qualification solely on the senior management of the firm. Senior management assesses the prospective compliance officer's qualifications before appointment. Whether the firm properly complies with this requirement is then assessed within the general review of the firm's compliance with the relevant MiFID II requirements.

57. The compliance officer should demonstrate sufficient professional experience as is necessary to be able to assess the compliance risks and conflicts of interest inherent in the 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. In some jurisdictions, the professional experience is only taken into consideration if it has been acquired during a minimum period of time and provided it is not outdated.
58. The compliance officer should have specific knowledge of the different business activities provided by the firm. The relevant expertise required may differ from one firm to another, as the nature of the main compliance risks that firms face will differ. In respect of Article 21(1)(d) of the MiFID II Delegated Regulation, a newly employed compliance officer may therefore need additional specialised knowledge focused on the specific business model of the firm even if the person has previously been the compliance officer for another firm.

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

#### **Relevant legislation: Article 22(2)(a) of the MiFID II Delegated Regulation**

##### ***General guideline 7***

59. MiFID II requires firms to ensure that the compliance function performs its tasks and responsibilities on a permanent basis. Firms should therefore establish adequate arrangements for ensuring that the responsibilities of the compliance officer are fulfilled when the compliance officer is absent, and adequate arrangements to ensure that the responsibilities of the compliance function are performed on an ongoing basis. These arrangements should be in writing.

##### ***Supporting guidelines***

60. The firm should ensure, e.g. through internal procedures and stand-in arrangements, that the responsibilities of the compliance function are fulfilled adequately during any absence of the compliance officer.
61. The responsibilities and competences as well as the authority of the compliance staff should be set out in a 'compliance policy' or other general policies or internal rules that take account of the scope and nature of the firm's investment services and activities. This should include information on the monitoring programme 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.
62. 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 compliance risk 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.

### **V.3 Independence of the compliance function**

**Relevant legislation: Article 22(3)(b), (d) and (e) of the MiFID II Delegated Regulation**

#### ***General guideline 8***

63. 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.

#### ***Supporting guidelines***

64. 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 should be carried out independently from senior management and other units of the firm. In particular, the firm's organisation should ensure that other business units may not issue instructions or otherwise influence compliance staff and their activities.

65. Where senior management deviates from important recommendations or assessments issued by the compliance function, the compliance officer should document this accordingly and present it in the compliance reports.

### **Proportionality with regard to the effectiveness of the compliance function**

**Relevant legislation: Article 22(4) of the MiFID II Delegated Regulation**

#### ***General guideline 9***

66. Firms should decide which measures, including organisational measures and the level of resources, are best suited to ensuring the effectiveness of the compliance function in the firm's particular circumstances.

#### ***Supporting guidelines***

67. In deciding whether the requirements under Art. 22 (3) point (d) or (e) of the MiFID II Delegated Regulation are proportionate and whether its compliance function continues to be effective, 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 firm (including those not related to investment services, activities and ancillary services);

- (b) the interaction between the investment services and activities and ancillary services and other business activities carried out by the firm;
  - (c) 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 firm from commissions and fees and other income in the context of the provision of investment services, activities and ancillary services;
  - (d) the types of financial instruments offered to clients;
  - (e) the types of clients targeted by the firm (professional, retail, eligible counterparties);
  - (f) staff headcount;
  - (g) whether the firm is part of a group within the meaning of Article 2(11) of Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC;
  - (h) services provided through a commercial network, such as tied agents, or branches;
  - (i) cross-border activities provided by the firm; and
  - (j) organisation and sophistication of the IT systems.
68. Competent authorities may also find these criteria useful in determining which types of firms may benefit from the proportionality exemption under Article 22(4) of the MiFID II Delegated Regulation.
69. A firm may fall, for example, under the proportionality exemption if the performance of the necessary compliance tasks 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.
70. While a compliance officer must always be appointed, it may be disproportionate for a smaller firm with a very narrow field of activities to appoint a separate compliance officer (i.e. one that does not perform any other function). Where a firm makes use of the exemption, conflicts of interest between the tasks performed by the relevant persons should be minimised as much as possible.
71. A firm that does not need to comply with all the requirements set out in Article 22(3) of the MiFID II Delegated Regulation under the proportionality principle, may combine the legal and compliance function. However, a firm with more complex activities or greater size should avoid such combination if it could undermine the compliance function's independence.

72. Where a firm makes use of the proportionality exemption, it should record how this is justified, so that the competent authority is able to assess this.

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

#### **Relevant legislation: Article 22(3) (d) of the MiFID II Delegated Regulation**

##### ***General guideline 10***

73. A firm should generally not combine the compliance function with the internal audit function. The combination of the compliance function with other control functions may be acceptable if this does not compromise the effectiveness and independence of the compliance function. Any such combination should be documented, including the reasons for the combination so that competent authorities are able to assess whether the combination of functions is appropriate in the circumstances.

##### ***Supporting guidelines***

74. Compliance staff should generally not be involved in the activities they monitor. However, a combination of the compliance function with other control units at the same level (such as money laundering prevention) may be acceptable if this does not generate conflicts of interests or compromise the effectiveness of the compliance function.
75. 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. However, for practical reasons (for example, decision making), and in certain circumstances (for example, in firms of only two persons), it may be more appropriate to have one person responsible for both functions. In this regard, firms should consider discussing the combination with the relevant supervisory authority. In addition, where this combination occurs, the firm must, of course, ensure that the responsibilities of each function are discharged properly (i.e. soundly, honestly and professionally).
76. 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.
77. Whether or not the compliance function is combined with other control functions, the compliance function should coordinate its activities with the second-level control activities performed by other units.
78. If appropriate to the nature, scale and complexity of the business, and taking into account the nature and range of investment services and activities undertaken by a firm in the course of that business, the firm should consider establishing and maintaining a core team within the compliance function staff members whose sole area of responsibility is MiFID compliance.

## **Outsourcing of the compliance function**

**Relevant legislation: Article 22 and 31 of the MiFID II Delegated Regulation.**

### ***General guideline 11***

79. Firms should ensure that all applicable compliance function requirements are fulfilled where all or part of the compliance function is outsourced.

#### *Supporting guidelines*

80. The MiFID II outsourcing requirements for critical or important functions apply in full to the outsourcing of the compliance function.
81. The requirements that apply to the compliance function are the same whether or not any or all of the compliance function is outsourced; Firms can only outsource tasks or functions, but not responsibilities: firms wishing to engage in outsourcing remain fully responsible for the tasks that are outsourced. In other words, the ability to direct and control outsourced tasks must always be retained by the firm initiating the outsourcing.
82. The firm should perform a due diligence assessment before choosing a service provider 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.
83. Firms should also ensure that when outsourced partially or fully, the compliance function remains permanent in nature, i.e. the service provider should be able to perform the function on an ongoing basis and not only in specific circumstances.
84. Firms should monitor whether the service provider performs its duties adequately, which includes monitoring the quality and the quantity of the services provided. Senior management is responsible for supervising and monitoring the outsourced function on an ongoing basis, and should have the necessary resources and expertise to be able to fulfil this responsibility. Senior management may appoint a specific person to supervise and monitor the outsourced function on their behalf.
85. Outsourcing of the compliance function within a group does not lead to a lower level of responsibility for the senior management of the individual 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.



86. If a firm, due to the nature, size and scope of its business activities, is unable to employ compliance staff who are independent of the performance of services they monitor, then outsourcing of the compliance function is likely to be an appropriate approach to take.

#### **V.4 Competent authority review of the compliance function**

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

**Relevant legislation: Articles 7 and 22 of MiFID II.**

##### ***General guideline 12***

87. Competent authorities should review how firms plan to meet, implement and maintain the MiFID II compliance function requirements. This should apply in the context of the authorisation process, as well as, following a risk-based approach, in the course of ongoing supervision.

##### ***Supporting guidelines***

88. Article 7 of MiFID II states that a competent authority shall not grant authorisation to a 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 II. 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.
89. Additionally, as part of the ongoing supervisory process, a competent authority should – following a risk-based approach – assess whether the measures implemented by the firm for the compliance function are adequate, and whether the compliance function fulfils its responsibilities appropriately. Firms are responsible for determining whether amendments to the resources and organisation of the compliance function are required due to changes in the business model of the firm. Competent authorities should also, as part of their ongoing supervision and following a risk based approach, assess and monitor - where and if appropriate - whether such amendments are necessary and have been implemented. The competent authority should provide a reasonable timeframe for the firm to make amendments. However, firms' amendments are not necessarily subject to approval by the competent authorities.
90. As mentioned under paragraph 56 above, some competent authorities license or approve the nominated compliance officer following an assessment of the qualifications of the compliance officer.
91. Other regulatory approaches impose the responsibility for the assessment of the compliance officer's qualification solely on the senior management of the firm. Some Member States require 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.

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. This evaluation grid includes questions related to all investment services (to be) provided by the firm. Questions are also related to the monitoring and control of the activity to be performed by the applicant. e.g. how the control functions are organized, who they report to, whether some functions are outsourced, etc., as well as a number of open fields asking the firm to describe any relevant changes and developments compared to the previous year. The answers could be validated by the firm's senior management and then sent to the competent authority. This questionnaire could be a standardised, machine-readable report to enable data extraction, incorporate qualitative indicators and flags anomalies in a resource-efficient manner. 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.
93. The above practices could be helpful to other competent authorities.

### 3.4 Annex IV - Correlation table between the ‘new’ draft guidelines and the 2012 guidelines

New guidelines	2012 guidelines
<b>V.1 Responsibilities of the compliance function</b>	
<b>Compliance risk assessment</b> <i>General guideline 1</i>	<b>Compliance risk assessment</b> <i>General guideline 1</i>
<b>Monitoring obligations of the compliance function</b> <i>General guideline 2</i>	<b>Monitoring obligations of the compliance function</b> <i>General guideline 2</i>
<b>Reporting obligations of the compliance function</b> <i>General guideline 3</i>	<b>Reporting obligations of the compliance function</b> <i>General guideline 3</i>
<b>Advisory and assistance obligations of the compliance function</b> <i>General guideline 4</i>	<b>Advisory obligations of the compliance function</b> <i>General guideline 4</i>
<b>V.2 Organisational requirements of the compliance function</b>	
<b>Effectiveness of the compliance function</b> <i>General guideline 5</i>	<b>Effectiveness of the compliance function</b> <i>General guideline 5</i>
<b>Skills, knowledge, expertise and authority of the compliance function</b> <i>General guideline 6</i>	
<b>Permanence of the compliance function</b> <i>General guideline 7</i>	<b>Permanence of the compliance function</b> <i>General guideline 6</i>
<b>Independence of the compliance function</b> <i>General guideline 8</i>	<b>Independence of the compliance function</b> <i>General guideline 7</i>
<b>Proportionality with regard to the effectiveness of the compliance function</b> <i>General guideline 9</i>	<b>Exemptions</b> <i>General guideline 8</i>

New guidelines	2012 guidelines
<b>Combining the compliance function with other internal control functions</b> <i>General guideline 10</i>	<b>Complying the compliance function with other internal control functions</b> <i>General guideline 9</i>
<b>Outsourcing of the compliance function</b> <i>General guideline 11</i>	<b>Outsourcing of the compliance function</b> <i>General guideline 10</i>
<b>V.3 Competent authority review of the compliance function</b>	
<b>Review of the compliance function by competent authorities</b> <i>General guideline 12</i>	<b>Review of the compliance function by competent authorities</b> <i>General guideline 11</i>