POSITION PAPER

ESBG's contribution to ESMA's consultations on the guidelines on certain aspects of the MiFID compliance function requirements and of the MiFID suitability requirements

ESBG (European Savings Banks Group)

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ESBG Register ID 8765978796-80

February 2012

The European Savings Banks Group (ESBG) welcomes the opportunity to make comments on ESMA's consultations on the guidelines related to the MiFID compliance function requirements (ESMA/2011/446) and on certain aspects of the MiFID suitability requirements (ESMA/2011/445).

After analysing the draft papers prepared by ESMA, ESBG welcomes the effort to harmonise the foundations of the compliance function throughout the European Union. However, ESBG has some concerns that will be detailed in this response. Therefore you may find below our comments on both consultation documents, starting by the one related to the MiFID compliance function.

I. ESMA consultation on the guidelines on certain aspects of the MiFID compliance function requirement

A. Guidelines on responsibilities of the compliance function

As a general comment, the ESBG wants to point out the relevance of the proportionality principle that should be applied in this regard. ESBG deems that this principle should be always applied from two perspectives: nature and size of the entities' activities and internal structure.

Q1: Do you agree that investment firms should ensure that, where the compliance function takes a risk-based approach, any comprehensive risk assessment is performed to determine the focus and the scope of the monitoring, reporting and advisory activities of the compliance function? Please also state the reasons for your answers.

ESBG agrees with this general statement. The risk-based approach is consistent with other internal procedures already in place, notably regarding anti-money laundering and even more because it leads to prioritise the action plans.

However the text is not clear enough in ESBG's opinion. The text simply states that "Risk assessment should be used to determine the focus of the monitoring and advisory activities of the compliance function". There are no remarks on how the assessment should actually be performed. To avoid confusion we would suggest outlining the assessment process more clearly, and what factors should be considered. For example, we would suggest adding a statement that the assessment should consider each relevant law and regulation in turn and should be based on a consideration of all relevant policies, procedures, systems and controls, the results of the level one monitoring, the results of the level two monitoring and any internal or external audit findings.

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

§13. ESBG agrees that the compliance function should be run on a decentralised model. ESBG also considers possible that the compliance function is run by a group department or unit, in broader terms than those provided in this paragraph. The final goal is to have a compliance function that is able to fully comply with its tasks and this could also be achieved by a group department or unit. This paragraph states that "the compliance function within each investment firm should take the group of which it is part into account […] it should nevertheless remain responsible for monitoring its own compliance risk." While conceptually we understand the point it could potentially create perverse results by arguably requiring separate compliance functions for each legal entity. That is certainly not what is contemplated. We therefore would suggest the removal of this paragraph from the paper or at least clarification that this is not intended. Additionally the geographical scope should be clarified. This paragraph should not apply to branches of investment firms outside the European Union.

§14. ESBG is in favour of a periodic update of the risk-based approach. Although on-site inspections have undeniable advantages, especially because it vitalises the function, ESBG would also note that these on-site inspection requirements may potentially have serious implications in terms of additional costs to compliance functions in both headcount and travel, and that this should be considered as part of the cost benefit exercise.

§15. ESBG welcomes the fact that this paragraph also highlights the quantitative and qualitative sides of the compliance function. Nevertheless, the ESBG would ask for a clarification and a more precise definition of what is meant by "use of aggregated risk measurements and the checking of calculations".

§16. ESBG agrees with ESMA on the evolving nature of the monitoring program. Nevertheless, a more comprehensive specification of "significant events" would be very helpful.

§17. ESBG would suggest that it is made clear that the monitoring envisioned relates to level two independent monitoring as opposed to monitoring of the level one controls. To the extent that the paper contemplates monitoring of the level one control this point should be made explicitly. In this paragraph, it is the responsibility of the compliance function to monitor the first level controls of the investment firms' business area as part of their monitoring obligation. It should be clarified that the principal responsibility of the business unit is the compliance with legal provisions, as well as the pro-active involvement of the compliance function on relevant matters. If relevant information is not passed from the business units in a timely manner, risks may not be detected and averted.

§18. ESBG would like to highlight that the compliance function should not be confused with customer complaint services. The compliance function only ensures that this service exists and works well, and the access to customer's complaints is an indicator of the conformity to the legislation. Furthermore it states that "the compliance function should not have a role in

overseeing the operation of the complaints process". This does not add clarity - it might even create the misunderstanding that there should be increased monitoring of the handling of customer complaints.

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

First of all, ESBG deems that ESMA should provide a clear concept for "senior management".

The second sentence of the guideline states that the compliance report should contain "a description of the implementation and effectiveness of the firm's compliance program" rather than a description of the overall control environment that it has to contain. ESBG suggests the latter is a more appropriate analysis as it looks beyond just the compliance controls and considers the business controls as well.

§20.(c) This indent requires that "future regulatory changes which are likely to have a significant impact on the business" should be addressed in the written reports. ESBG considers that this is too far reaching. Indeed, the Article 6, paragraph 2 (a) of the MiFID Implementing Directive does not permit to go as far as anticipating future regulatory changes. Therefore ESBG deems it necessary to limit the written report to present regulatory changes.

§21. The second sentence of this paragraph states that "The report should also provide suggestions for the necessary remedial steps". It is ESBG's opinion that it is not the role of the compliance function to make such proposals. ESBG considers that it should be the responsibility of the unit where there has been deficiency; otherwise the compliance function would also be responsible for evaluating the effectiveness and appropriateness of their own proposals, causing problems of independence.

§22. It is ESBG's opinion that only the annual reports should be provided to the supervisory function. *Ad hoc* reports should be provided only for events of major importance. In this context, it will also clarify that it is not the responsibility of the compliance function to communicate the reports to the supervisory body instead of the senior management. It is the ultimate responsibility of the senior management.

§24. The paragraph states that some competent authorities require investment firms to provide them with compliance function reports and that this practice provides competent authorities with first-hand insight into an investment firm's compliance activities, as well as any breaches of regulatory provisions.

In our opinion it is not a good measure to provide competent authorities with compliance function reports, as it may imply something similar to a self-accusation in some cases and also serious restrictions to defence faculties. It may also be an incentive for less clearer reports, damaging the objective of proving the senior management with the necessary information to make an assessment on the entity compliance risk profile and on the

measures to be taken. Therefore, we deem a better solution would be to leave the reports at the supervisor's disposal and not to be required to send them to the competent authorities.

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

ESBG welcomes that ESMA highlight the complimentary roles of the compliance function which are: advice, assistance and staff training.

§25. The second sentence of this paragraph, in ESBG's opinion, points in the wrong direction. The core function of compliance is to protect the institution and staff's jobs, through the compliance with regulations of which consumer protection is only the reflection. The compliance function is not a consumer protection agency but is made to reduce the risk of damage realisation for the institution.

§26. This paragraph put forward that the compliance function should be responsible for the training of the staff function. But the business unit is already responsible for the training of the staff. Therefore the role of the compliance function should be to advise and support the operational function in this area. With regards to the compliance contents, the compliance function remains responsible.

§27. It is ESBG's opinion that indicating that training should be performed on a regular basis is too far reaching. Indeed, this necessity depends on particular circumstances and should not be the rule.

§29. From ESBG's point of view, the periodical assessment may be done, for example, by regular desk reviews, a regular risk analysis and by analyzing reports issued by, for example, the Internal Audit.

§31-33. According to its contents, it would be more suitable if the numbers 31-33 were to be included in section V.II; "Guidelines on requirements of the compliance function". They are right in describing the role "that the compliance function should be involved" in processes and information flows, and therefore fit better later. However, it should be better taken into account that the inclusion of the compliance function in the relevant flows of information is an "obligation" of senior management and operational function. ESBG asks for a clarification in this regard.

B. Guidelines on organisational requirements of the compliance function

Due to the fact that presently a lot of investment firms are part of a corporate group, ESBG asks ESMA for clarification on the activities of a compliance function within a corporate group in the chapter "Guidelines on organisational requirements of the compliance function".

From ESBG's point of view, it would lighten and ensure the group-wide implementation of consistent compliance standards to establish a group-wide compliance function (as is already established for the Anti-Money-Laundering function, or regarding the identification of conflicts of interest in the area of Securities Compliance), responsible for ensuring that the subsidiaries comply with the legal and in-house provisions of the parent company.

Furthermore, ESBG proposes to consider the activities Compliance is faced with within a broader focus. Based on the comprehensive definition of Compliance (please be referred to the definition of Compliance risk in the "EBA Guidelines on Internal Governance"), Compliance within an investment firm is faced not only with activities regarding securities, but, amongst others, also regarding anti-money-laundering, counter-terrorism financing, dealing with sanctions and embargoes as well as with the topic of fraud/financial crime. In order to ensure standardised proceedings, ESBG recommends aligning the organisational requirements regarding these different topics (e.g. in the field of hierarchy and reporting chain).

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

§35. With regard to the obligation contained in this paragraph for the regular review of the staffing, ESBG requests clarification as to whether this task has to be fulfilled by the compliance function itself, or by the investment firm in general.

ESBG also considers problematic the statement that when an investment firm's business unit activities are extended, the compliance function have to be "similarly" extended. This is misleading; indeed to what extent an increase of the compliance function is necessary is a question of each individual case, and should not be strictly parallel.

§37. ESBG's opinion is that the obligation to allocate a budget to the compliance function is not appropriate for small and medium sized investment firms. These investment firms may not have a budget for their organisational units either for operational or for the compliance function, therefore a budget for the compliance function cannot be provided. Nevertheless, it is crucial that the investment firm provides adequate human and material resources for the compliance function.

§38. ESBG does not support the compliance officer right of attendance, where relevant, to the meetings of the senior management or the supervisory function. ESBG also does not support that where this right is not granted this should be documented and explained in writing. Each entity should be responsible for internally organizing how the compliance function gets involved in the senior management or supervisory function decisions. In this

regard, most of the entities have a compliance committee, composed by senior managers, in which all compliance issues are treated, and where managers have the faculty to discuss compliance aspects of the decisions to be taken.

Regarding the in-depth knowledge of the investment firm's organisation, corporate culture and decision-making processes, for newly appointed compliance officers it should be sufficient that they have experienced employees who support them, or that they need a period of vocational adjustment to reach that level of knowledge.

Q6: Do you agree that, in order to ensure that the compliance function performs its tasks and responsibilities on an ongoing permanent basis, investment firms should provide:

(ii) adequate stand-in arrangements for the responsibilities of the compliance officer which apply when the compliance officer is absent; and

(ii) arrangements to ensure that the responsibilities of the compliance function are performed on an ongoing basis?

ESBG supports that investment firms should be required to ensure that the compliance function performs its tasks and responsibilities on an ongoing, permanent, basis. However this may be achieved with internal arrangements in this regard and not necessarily by replacing the compliance officer during its absence.

Q7: Do you agree that investment firms should ensure that the compliance function holds a position in the organisational structure that ensures that the compliance officer and other compliance function staff are independent when performing their tasks? Please also state the reasons for your answer.

Q8: Do you agree that investment firms should ensure that the organisation of the compliance function guarantees that the compliance officer's daily decisions are taken in-dependently from any influence of the business units and that the compliance officer is appointed and replaced by senior management only?

ESBG agrees with questions 7 and 8. Nevertheless, it should be clearly specified that the compliance officer's daily decisions should not be confirmed by any manager and also that it cannot be cancelled by any business unit.

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

§50. ESBG would suggest deleting the reference to 'legal unit' as it is inconsistent with what appears in paragraphs 52 and 54 which specifically permits combing the compliance function with other control units besides the internal audit. In addition, ESBG would note that the more important part of the requirement is that there should not be a combination or subordination if it could undermine the compliance function's independence. Such a combination with legal would not *ipso facto* impact compliance's independence and in fact such combinations often create various synergies in terms of expertise and cost savings. As such, we suggest the deletion of the reference to legal.

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

ESBG deems the possibilities set by ESMA acceptable as long as they do not impair with the fundamentals of the function (independence, means, direct attachment to the highest hierarchical level and competence).

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

The compliance function is extremely relevant for the entities, however, ESBG does not consider it to be critical.

A function is regarded as critical or important if a defect or failure in its performance would materially impair the continuing compliance of a firm with the conditions and obligations of its authorization, its other obligations under the regulatory system, its financial performance, the soundness, or the continuity of its relevant services and activities. Of course, ESBG deems the compliance function to be extremely relevant, but it is not critical because a failure in its performance does not normally impair the continuity of the relevant services and activities.

§58. It should be made clear that the intensity of this assessment depends on nature, scale, complexity and risk of the outsourced tasks and processes.

§60. ESBG considers that it would be helpful to be more precise on how and how often the ongoing supervision should be performed. In case of the outsourcing of the compliance function within a group, a lower level of supervision should be sufficient. This could be done, for example, by reviewing existing audit reports of the company which provides the services.

Q12: Do you agree that competent authorities should also review, as part of the ongoing supervisory process, whether measures implemented by investment firms for the compliance function are adequate, and whether the compliance function fulfils its responsibilities appropriately? Please also state the reasons for your answer.

ESBG agrees with this guideline.

Q13: Do you agree that competent authorities should also assess whether amendments to the organisation of the compliance function are required due to changes in the scope of the business model of the investment firm, and where such amendments are necessary, monitor whether these amendments have been implemented?

ESBG agrees with this guideline. However, it should not imply that any internal change should be approved or necessarily reviewed by the competent authority. Just in case the change supposes modifications to the specific authorization.

II. ESMA consultation on the guidelines on certain aspects of the MiFID suitability requirements

Before commenting on the specific aspects mentioned in the consultation document, ESBG wants to highlight two issues that we consider of utmost importance. First, that it should be concluded after reading the document that the suitability test is a process and not a result. Entities must be liable for putting in place, applying, and monitoring sound processes for testing the suitability, but they should not be liable for the results obtained. The suitability test is an obligation for doing something and not for obtaining a specific result. Secondly, that the guidelines issued by ESMA should clarify that their main goal is to provide the entities with the necessary criteria in order to help them to correctly implement the regulatory measures. Therefore, wrongly complying with the guidelines should only have regulatory consequences.

Q1: Do you agree that information provided by investment firms about the services they offer should include information about the reason for assessing suitability? Please also state the reasons for your answer.

ESBG deems that the obligation to inform clients, clearly and simply, that the reason for assessing suitability is to enable the firm to act in the client's best interest, is not legally established. Moreover this new obligation implies costs and does not improve investors' protection levels. Therefore ESBG considers that it should be avoided from the proposed text.

Q2: Do you agree that investment firms should establish, implement and maintain policies and procedures necessary to be able to obtain an appropriate understanding regarding both the essential facts about their clients, and the characteristics of financial instruments available for those clients? Please also state the reasons for your answer.

We agree with this guideline.

Q4: Do you agree that investment firms should determine the extent of information to be collected about the client taking in to account the features of the service, the financial instrument and the client in any given circumstance? Please also state the reasons for your answer.

The document states that when providing access to complex (as defined in MiFID) or risky financial instruments, firms should bear in mind the need to collect more in-depth information about the client in order to be able to assess the client's capacity to understand, and financially bear, the risks associated with such instruments.

However ESBG does not consider that in such cases more in-depth information needs to be collected. Just the necessary information to be able to assess the client's capacity to understand, and financially bear, the risks associated with such instruments. Moreover, if we refer to a continuous assessment in which the firm is liable for following the investments, such an obligation is not necessary.

Q5:	**Do you agree that investment firms should take reasonable steps (and, in particular, those outlined above) to ensure that the information collected about clients is reliable and consistent? Please also state the reasons for your answer.**

ESBG deems that the main principle should be that the entity should just analyse the information provided by the client.

Q6:	**Do you agree that where an investment firm has an ongoing relationship with the client, it should establish appropriate procedures in order to maintain adequate and updated information about the client? Please also state the reasons for your answer.**

ESBG agrees with this guideline.

Q7:	**Do you agree that regarding client information for legal entities or groups, the investment firm and the client should agree on how the relevant client information will be determined and, as a minimum, information should be collected on the financial situation and investment objectives of the beneficiary of the investment ad-vice or portfolio management services ('end client')? Please also state the reasons for your answer.**

ESBG agrees with this guideline.

About ESBG (European Savings Banks Group)

ESBG – The European Voice of Savings and Retail Banking

The European Savings Banks Group (ESBG) is an international banking association that represents one of the largest European retail banking networks, comprising about one third of the retail banking market in Europe, with total assets of over € 7.400 billion, non-bank deposits of € 3.300 billion and non-bank loans of € 4.000 billion (all figures on 31 December 2011). It represents the interests of its members vis-à-vis the EU Institutions and generates, facilitates and manages high quality cross-border banking projects. ESBG members are typically savings and retail banks or associations thereof. They are often organised in decentralised networks and offer their services throughout their region. ESBG member banks have reinvested responsibly in their region for many decades and are a distinct benchmark for corporate social responsibility activities throughout Europe and the world.

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Published by the ESBG, February 2012