

AFGG'S RESPONSE CONSULTATION

ESMA Guidelines

Certain aspects of
MIFID II Compliance
Function Requirements

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The Association Française de la Gestion financière (AFG) represents and promotes the interests of third-party portfolio management professionals. It brings together all asset management players from the discretionary and collective portfolio management segments. The latter manage nearly €4,000 billion worth of assets, i.e. a quarter of continental Europe's asset under management.

The AFG's remit:

- Representing the business, financial and corporate interests of members, the entities that they manage (collective investment schemes) and their customers. As a talking partner of the public authorities of France and the European Union, the AFG makes an active contribution to new regulations,
- Informing and supporting its members; the AFG provides members with support on legal, tax, accounting and technical matters,
- Leading debate and discussion within the industry on rules of conduct, the protection and economic role of investment, corporate governance, investor representation, performance measurement, changes in management techniques, research, training, etc.
- Promoting the French asset management industry to investors, issuers, politicians and the media in France and abroad. The AFG represents the French industry – a world leader – in European and international bodies. AFG is of course an active member of the European Fund and Asset Management Association (EFAMA), of PensionsEurope and of the International Investment Funds Association (IIFA).

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AFG's response to the ESMA consultation on Guidelines on certain aspects of MIFID II compliance function requirements

The Association Française de la Gestion financière (AFG) ¹ is grateful to have the opportunity to respond to the ESMA's consultation on certain aspects of MIFID II compliance function requirements. AFG fully supports the authorities' objective to seek feedback from the stakeholders on this matter, which is of utmost importance.

I. Guideline 1 – Compliance risk assessment

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

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

II. Guideline 2 – Monitoring obligations of the compliance function

Q2: Do you agree with the suggested approach in relation to the compliance function's monitoring obligations?

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

We also agree that compliance and relevant monitoring activities cannot be conceived as solely "desk-based" and should include on-site visits. At the same time, a risk-based approach should identify the best way policies and procedures are to be implemented in

¹ The Association Française de la Gestion financière (AFG) represents the France-based investment management industry, both for collective and discretionary individual portfolio managements. 600 management companies are based in France. AFG members manage 4,000 billion euros, making the Paris fund industry a leader in Europe for the financial management of collective investments. In the field of collective investment, our industry includes – beside UCITS – the whole range of AIFs, such as: employee savings schemes, regulated hedge funds/funds of hedge funds, private equity funds, real estate funds and socially responsible investment funds. AFG is an active member of the European Fund and Asset Management Association (EFAMA) and of PensionsEurope. AFG is also an active member of the International Investment Funds Association (IIFA).

practice and in different cases. With this in mind, we can agree with taking into consideration the potential support of any other “control or risk” function in the firm and “additional reports”. However, some of the additional tools suggested in para 26 of the draft Guidelines to be used by the compliance function, e.g. interviewing firm’s clients, are overly prescriptive and problematic. Therefore, we would suggest removing these prescriptive references from the Guidelines.

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

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

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

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

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

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

III. Guideline 3 – Reporting obligations of the compliance function

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

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

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

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

Please also state the reasons for your answer.

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

independent role of the function. Applying the product governance requirements is primarily the responsibility of the product and distribution functions.

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

Furthermore we would expect a proportionate approach in line with the proportionality principle ref. Article 22(1) of the MiFID II Delegated Regulation. It must be noted that the guidelines do refer to the proportionality principle but only in the context of the detail required within compliance function reporting (e.g. less detail on simpler/common products).

Q7: Do you agree that the information that should be included in the compliance function reports should be proportional to the complexity and level of risks of the financial instruments manufactured and/or distributed by the firm? Do you believe that additional criteria should be taken into account? Please also state the reasons for your answer.

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

Q8: Do you believe that further guidance is needed to clarify how firms should address the potential conflicts arising from the combination of the complaints management function with the compliance function? What practical solution could be envisaged?

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

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

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

IV. Guideline 4 – Advisory and assistance obligations of the compliance function

Q10: Do you agree with the approach taken for the review of guideline 4? Do you believe that guideline 4 should be amended and/or supplemented further? Please also state the reasons for your answer.

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

It should be taken into consideration that compliance with financial regulation needs to meet the underlying objectives of the regulation, which include investor protection, but not only. The objectives of financial stability and market integrity are also key and we would therefore suggest adding them along investor protection in terms of engaging with staff and improving compliance culture within the firm. Moreover, the assessment of the awareness and level of application of the staff in relation to the investment services and activities (mentioned in para 42) are a task more for the human resources or the management team rather than the

compliance function. The compliance function can take into consideration this outcome of this assessment, but cannot be tasked with carrying it.

Lastly, we understand the need for compliance function taking into account the business models and strategic decisions of the firm, however it can't get involved with them and hence, can't provide "expertise and advice to business units about all strategic decisions or new business models". We would therefore suggest removing this reference from para 44.

V. Guideline 5 – Effectiveness of the compliance function

Q11: Do you believe that guideline 5 should be amended and/or supplemented further?

Please also state the reasons for your answer.

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

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

Q12: Do you agree with the creation of a new guideline solely focused on the skills, knowledge, expertise and authority of the compliance function? Please also state the reasons for your answer.

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

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

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

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

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

Please see our comments to the previous question.

VII. Guideline 7 - Permanence of the compliance function

Q14: Do you believe that guideline 7 should be further amended and/or supplemented?

Please also state the reasons for your answer.

We have no further comments.

VIII. Guideline 8 – Independence of the compliance function

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

Please also state the reasons for your answer.

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

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

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

Please also state the reasons for your answer.

Proportionality is a really important aspect and has to be in line with the permanence of the compliance function. We have no further comments.

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

Q17: Do you agree that, subject to the proportionality principle, a firm should consider establishing and maintaining a core team of compliance staff whose sole area of responsibility is MiFID II? Please also state the reasons for your answer.

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

With this in mind, we do not consider it proportional to establish a core team within the compliance function dealing solely with MiFID II compliance. Compliance with MiFID II cannot be an isolated function as the main challenge with monitoring that relates to making the right links to the company's overall business. Therefore, MiFID compliance needs to be looked at together with monitoring compliance with other key regulatory frameworks (e.g.

UCITS Directive, AIFMD, EMIR, MAR, AMLD, Benchmark Regulation). Important also to keep in mind that the UCITS Directive and AIFMD partially cover the same principles as MiFID.

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

Q18: Do you believe that guideline 10 should be further amended and/or supplemented?

Please also state the reasons for your answer.

We have no further comments.

XI. Guideline 11 – Outsourcing of the compliance function

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

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

Q20: Do you believe that guideline 11 should be further amended and/or supplemented?

Please also state the reasons for your answer.

We have no further comments.

XII. Guideline 12 – Review of the compliance function by competent authorities

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

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

Q22: Do you believe that guideline 12 should be further amended and/or supplemented?

Please also state the reasons for your answer.

We have no further comments.