



European Securities and  
Markets Authority

# Final Report

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





European Securities and  
Markets Authority

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# 1 Executive Summary

## Reasons for publication

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>1</sup>. The guidelines have been substantially confirmed albeit clarified and refined where necessary. In addition, they take 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.

On 15 July 2019, ESMA published a Consultation Paper (CP) with proposed draft guidelines. The consultation period closed on 15 October 2019. ESMA received 29 responses, 4 of which confidential. The answers received are available on ESMA's website unless respondents requested otherwise. ESMA also received the advice of the Securities and Markets Stakeholder Group (SMSG).

This paper summarises and analyses the responses to the CP and explains how the responses have been taken into account. ESMA recommends reading this report together with the CP published on 15 July 2019 to have a complete view of the rationale for the guidelines.

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 gives an overview of the Final Report.

Annex II contains the cost-benefit analysis; Annex III summarises the opinion of the SMSG; Annex IV contains the feedback statement; Annex V contains the full text of the final guidelines.

## Next Steps

The guidelines in Annex V will be translated in the official EU languages and published on ESMA's website. The publication of the translations in all official languages of the EU will

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<sup>1</sup> ESMA/2012/388



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trigger a two-month period during which NCAs must notify ESMA whether they comply or intend to comply with the guidelines.

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## 2 Overview

### *Background*

The compliance function is a crucial function within firms, responsible for identifying, assessing, monitoring and reporting on the firms' compliance risk.

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.

Article 16(2) of MiFID II and Article 22 of the MiFID II Delegated Regulation (mainly but other provisions also 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 they are focused on the responsibilities of the compliance function.

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 risks 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.

The MiFID II level 2 provisions have been enhanced (Article 22 of the MiFID II Delegated Regulation<sup>2</sup>), compared to MiFID I (Article 6 of the MiFID I Implementing Directive<sup>3</sup>). Notably, they now include some of the recommendations set out in ESMA's 2012 guidelines. MiFID II also 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 product governance requirements under Article 9(6) and (7) and Article 10(6) and (8) of the MiFID II Implementing Directive<sup>4</sup>;
- The compliance function may also operate as the complaints management function of the firm (Article 26(3) of the MiFID II Delegated Regulation);

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<sup>2</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>3</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>4</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 shall also advise the management body of the firm on the firm's remuneration policy (Article 27(3) of the MiFID II Delegated Regulation).

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

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”).

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). ESMA also aimed to take into account the results of supervisory activities conducted by national competent authorities (NCAs) on the implementation of the compliance function requirements.

In order to avoid unnecessary repetitions and enhance clarity, ESMA has deleted from the 2012 guidelines, provisions that have been incorporated directly in the MiFID II Delegated Regulation to avoid unnecessary repetitions (for example, general guidelines 2,3 and 9, now incorporated directly in the MiFID II Delegated regulation).

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 business, and the nature and range of investment services and activities undertaken in the course of their business.

Descriptions of specific practices of competent authorities in these guidelines aim at providing 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).

### *Public consultation*

On 15 July 2019, ESMA published a Consultation Paper (CP) on the draft guidelines on certain aspects of the MiFID II compliance function requirements in order to explain its rationale and gather input from stakeholders. The consultation period closed on 15 October 2019.

ESMA received 29 responses, 4 of which confidential. The answers received are available on ESMA's website unless respondents requested otherwise. ESMA also sought the advice of the Securities and Markets Stakeholder Group's (SMSG).

### *Final report*

This Final Report summarises and analyses the responses to the CP, and explains how the responses, together with the SMSG advice, have been taken into account. ESMA recommends reading this report together with the CP published on 15 July 2019 to have a complete view of the rationale for the guidelines.



### **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 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?**

**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?**

**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?**

**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?**

**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

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.

After the publication and entry into application of MiFID, the 2008 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.

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.

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.

Indeed, although the relevant Level 1 provisions under MiFID I<sup>5</sup> and MiFID II<sup>6</sup> are identical, the Level 2 provisions that existed under MiFID I<sup>7</sup> have been enhanced under MiFID II<sup>8</sup> as they now include some of the recommendations set out in the 2012 guidelines.

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>9</sup>; the compliance function may also double as the complaints management function of the firm<sup>10</sup>; the compliance function is also advising the management body of the firm on the firm's remuneration policy<sup>11</sup>.

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 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.

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.

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<sup>5</sup> Article 13(2) of MiFID I.

<sup>6</sup> Article 16(2) of MiFID II.

<sup>7</sup> Article 6 of the MiFID I Implementing Directive.

<sup>8</sup> Article 22 of the MiFID II Delegated Regulation.

<sup>9</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>10</sup> Article 26(3) of the MiFID II Delegated Regulation.

<sup>11</sup> Article 27(3) of the MiFID II Delegated Regulation.



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

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.

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.

Finally, it is important to mention that the existing 2012 guidelines which are confirmed should not imply any additional impacts/costs for both firms and NCAs.

### *Benefits*

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*

With reference to the costs, it should be firstly mentioned 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.

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.

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:

- (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
- (direct) initial and ongoing IT costs.

ESMA believes that the proposed options in this area provide the most cost-efficient solution to achieving the general objectives of these Guidelines.

### *Conclusions*

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.

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

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 - Opinion of the Securities and Markets Stakeholder Group**

As provided by Article 16(2) of the ESMA Regulation, ESMA also sought the advice of the Securities and Markets Stakeholder Group's (SMSG)<sup>12</sup>. The SMSG's overall view of these guidelines was positive and it stated:

*“The SMSG welcomes the general approach followed by ESMA of not introducing a completely different regime, but to build upon the text of 2012, refining and supplementing the guidelines where necessary.”*

The SMSG had also some remarks notably related to the inclusion of references to the relevant pieces of regulation where some aspects are now directly incorporated in MiFID provisions and have been removed from the 2012 guidelines; the compliance risk assessment; independence of the compliance function; combining the compliance function with other internal control functions; the creation of a core compliance team; outsourcing.

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<sup>12</sup> The SMSG response has been published on the ESMA website (Ref: ESMA35-43-2019)

### 3.4 Annex IV - Feedback on consultation paper

#### Guideline 1: Guideline on the compliance risk assessment (Q1)

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

1. Most of general guideline 1 is now incorporated into paragraph 2 of Article 22(2) of the MiFID II Delegated Regulation. It has furthermore been specified that ad hoc reviews of the compliance risk assessment may be triggered by, inter alia, changes in the regulatory framework.
2. Respondents welcomed the approach that ESMA adopted when updating the existing guidelines and appreciated that the compliance function shall establish a risk-based monitoring programme based on the compliance risk assessment to determine its priorities and the focus of the monitoring, advisory and assistance activities.
3. Several respondents suggested to amend paragraph 18 of the draft guidelines in such a way that only “*significant changes*”, instead of relevant changes in the firm’s structure or in the applicable regulatory framework should lead to the review of the identified risks on an ad-hoc basis. ESMA amended the wording of paragraph 18 to introduce more proportionality and to take into account SMSG’s advice in this respect.
4. It was also observed that the newly introduced concept of “assistance activities” needed to be further clarified as regard the positioning of compliance function as a second line of defence or with the first line of defence. The notion of “*assistance activities*” has therefore been further clarified by cross-referring to article 22(2) of the MiFID II Delegated Regulation.
5. The SMSG considered that providing that the risk assessment should also consider the types of financial instruments traded or distributed would be an extension of the content of the compliance risk assessment, rather than of a simple clarification of the practical application of the requirements of the MiFID II Delegated Regulation. ESMA believes, nevertheless, that the content of paragraph 16 is useful and maintained its proposal. Contrarily to the SMSG’s advice, some respondents observed that the compliance function should take into account additional criteria on top of the types of financial instruments traded and distributed: for instance, the nature of the services provided, the categories of the clients’ firm, the distribution channels and the internal organisation of the group. ESMA agrees with these suggestions and has modified the guidelines accordingly.

#### Guideline 2: Monitoring obligations of the compliance function (Q2, 3, 4)

**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?**

6. Respondents welcomed the risk-based monitoring program approach developed in the guidelines. They agreed that a risk-based approach is the most appropriate tool to identify the policies and procedures which should be implemented in the various cases. They also welcomed the confirmation that whenever a firm is part of a group, responsibility for the compliance function rests with each firm in that group.
7. Some respondents raised concerns with regard the role of the compliance function noting that some provisions of the new guidelines may create a confusion between the first and second lines of defence of responsibilities (e.g. the wording of paragraph 21 which provides that the compliance function should verify how policies and procedures are implemented in practice, for example through on-site inspections at the operative business units).
8. Several respondents disagreed with the possibility for the compliance function to interview the firm's clients. They considered that the use of this tool might damage the commercial relationship with the client or that it might create a lack of independence of the compliance function. Some also mentioned that compliance with the rules could rather be achieved and evidenced on the basis of internal documents and records or by undergoing the regular complaints management processes. Those respondents mostly consider that the handling of complaints and the contacts with clients should lie within the 1st line of defence, which has appropriate product knowledge and client relationship. SMSG, in contrast, fully supported the guideline by confirming that the compliance function should be given the discretion to engage directly with clients and, especially, complainants, as and when appropriate. ESMA decided to follow this approach and maintained the possibility for the compliance function to interview clients but modified the guideline to reflect some of the concerns voiced by respondents.
9. SMSG considered that the reference to the mandatory compliance reports provided for by Articles 22(2)(c), 22(3)(c) and 25(2) and (3) are a fundamental tool to warrant the necessary management attention. A few respondents considered nevertheless that the responsibility to draft the reports in relation to the provisions set out in Articles 25(2) and (3) lies with other teams such as the internal audit. ESMA is of the view that it is the compliance function which is responsible for at least part of such report, as per the reference to Article 22 in Article 25(2) and (3) of the MiFID II Delegated Regulation. Therefore, ESMA decided to keep the suggested wording which highlights the importance of these reports.

### **Guideline 3 – Reporting obligations of the compliance function (Q5 – 9)**

**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?**

10. Respondents supported the content of the guideline, while suggesting a few clarifications. In relation to Question 7, most respondents agreed 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. Many of them considered that the guideline could be supplemented with an additional criteria such as the category of clients or the nature of the investment services. ESMA amended the guideline to insist on those aspects.
11. Most respondents considered that some parts of the guideline were overly prescriptive, notably when requiring a summary of the compliance function structure which includes a description of the qualifications of the compliance function staff. ESMA believes that the compliance report is a key tool for the compliance function. It is reminded that the compliance report is subject to the proportionality principle in accordance with Article 22(1) of the MiFID II Delegated Regulation.
12. As regards the roles of the compliance function and the management of complaints, many respondents stressed the need for a clear segregation between the compliance function and the complaints management function in order to prevent that conflicts of interest arise. ESMA has clarified the guideline accordingly.
13. In relation to Question 9, a majority of respondents replied that they do not believe that further topics should be included in the compliance function report.

#### **Guideline 4 – Advisory and assistance obligations of the compliance function (Q10)**

**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.**

14. Respondents expressed broad support to the content of guideline 4. They notably welcomed that the compliance culture should be supported by senior management.
15. Some respondents suggested amending the guidelines in order to highlight that the set objective should not be limited to investor protection but also encompass financial stability and market integrity. In line with recital 37 of MiFID II, ESMA agrees to include “financial stability” as an additional objective. ESMA also updated other parts of the guideline for clarity purposes.

#### **Guideline 5 – Effectiveness of the compliance function (Q11)**

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





16. Most of respondents including the SMSG showed strong support of the guideline confirming that appropriate human, IT and financial resources should be allocated to the compliance function.
17. Some respondents did not support the fact that senior management be made responsible for assessing the expertise of compliance function employees. ESMA considers that no major redrafting is needed for this guideline.
18. Some respondents suggested that further guidance be provided on some aspects, including the monitoring of resources. ESMA believes that the guideline should not be too granular on these aspects in order to enable firms to develop their own methodology.

#### **Guideline 6 – Skills, knowledge, expertise and authority of the compliance function (Q12 and 13)**

**Q12: Do you agree with the creation of a new guideline solely focused on the skills, knowledge, expertise and authority of the compliance function?**

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

19. Most respondents supported the creation of a new guideline focused on the skills, knowledge, expertise and authority aspects of the compliance function as these aspects are crucial for the effective performance of the tasks assigned to compliance function.
20. Some respondents highlighted that the responsibility for the compliance function should remain with senior management and that consequently the responsibility for assessing and appointing the compliance officer should also lie with senior management in order to determine the appropriate organisational requirements for an effective compliance function. ESMA believes that paragraphs 50 and 52 provide sufficient clarification on this matter.
21. Some respondents suggested that ESMA clarifies that descriptions of specific practices of competent authorities aim to provide the reader with additional information on differing approaches of competent authorities without setting up additional requirements for firms or competent authorities. ESMA clarified this point under the heading “*General approach followed for the review of the 2012 guidelines*” of this Final Report.

#### **Guideline 7 – Permanence of the compliance function (Q14)**

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

22. Respondents expressed a broad support to this guideline.
23. The SMSG suggested including a reference to the complexity of business and to the range of services and activities when describing the arrangements around the permanence of the compliance function. ESMA is of the opinion that the permanence of the compliance function should apply to any firm, subject to the proportionality principle, and consequently that the guideline should remain unchanged.

#### **Guideline 8 – Independence of the compliance function (Q15)**

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

24. Respondents expressed a broad support to the guideline.
25. The SMSG suggested to detail in the compliance reports whether there are deviations from the principle detailed in paragraph 60 that the other business units must not issue instructions or influence compliance staff and their activities. As ESMA considers that there should be no deviation to this principle, guideline 8 was not modified in this respect. The SMSG also suggested that an appropriate escalation process to senior management should be implemented. ESMA agrees with such suggestion and modified the guideline accordingly.

### **Guideline 9 – Proportionality with regard to the effectiveness of the compliance function (Q16)**

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

26. Most of respondents supported the guideline. Some respondents noted that when a separate compliance officer is not appointed according to paragraph 66, a conflict of interest might arise. One respondent suggested that the guideline might refer to criteria to be considered when assessing the proportionality principle (such as the type and complexity of activities which are performed and the number of staff members). ESMA has amended guideline 9 to clarify that, depending on the circumstances (for example, small firms with limited and non-complex activities and/or limited volumes), the firm may decide not to appoint a separate compliance officer.
27. The SMSG noted that when a firm makes use of the exemption not to appoint a separate compliance officer, the compliance officer should indicate in its report its assessment of the continuing appropriateness of the arrangements to minimize conflicts of interest. ESMA agrees with this suggestion and has updated the guidelines accordingly.

### **Guideline 10 – Combining the compliance function with other internal control functions (Q17 and Q18)**

#### **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?**

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

28. Respondents supported the idea that, subject to the principle of proportionality, firms should consider structuring a core compliance team dedicated to specialized areas. Nevertheless, almost all respondents raised the issue that small or medium firms might have difficulties having one or more staff member dedicated only to MiFID II compliance. They also indicated that some topics are crosscutting to several regulations or activities and that this setup would not allow to better address MiFID related issues. For example, PRIIPS and UCITS topics are regularly assessed alongside MiFID topics. Some respondents considered that the objective of proportionality presented in the guideline 9 was conflicting with guideline 10. ESMA amended the guideline to clarify that where the compliance function is combined with other control functions or where it is also responsible for other tasks, enough resources for MiFID-compliance needs to be kept at all times.

29. To the contrary, the SMSG suggested that, subject to the principle of proportionality, firms should consider structuring a core compliance team dedicated to investor protection rules, including MiFID II, and another team dedicated to MiFID II market-related rules. ESMA clarified that where the compliance function is combined with other control function or where it is responsible for other tasks, the firm should ensure that it allocates enough resources to MiFID compliance matters at all times.
30. In addition, ESMA amended general guideline 10 (now guideline 9) to resolve any existing inconsistency between general guideline 10 and Article 24 of the MiFID II Delegated Regulation which provides that, where an internal audit function has been established (because it is appropriate and proportionate in view of the nature, scale and complexity of the firm's business and the nature and range of the firm's investment services and activities) it shall be independent and separate from the other functions.

### **Guideline 11 – Outsourcing of the compliance function (Q19 and Q20)**

**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.**

31. A number of respondents expressed full support with the guideline, which is consistent with Article 31(1) MiFID Delegated Regulation which provides that a firm that outsources a critical function like the compliance function remains fully responsible for the tasks outsourced. One respondent favoured that due diligences processes be exercised by competent authorities and committees and suggested that a reference to the guidelines of the EBA on outsourcing be inserted. EBA did not favour such insertion noting that such reference might not be specific enough to the firms' specificities. ESMA agrees with the EBA and followed the EBA advice in this respect.
32. Guideline 11 was also amended to clarify that the outsourcing of functions to non-EU countries could make it more difficult for the compliance function to fulfil its oversight and supervisory tasks and that such outsourcing should consequently be subject to a closer monitoring and stricter due diligence processes by the compliance function.
33. The SMSG provided an additional comment related to the procedure in case of termination of the outsourcing of the compliance function to confirm that the firm, in case of termination, should give evidence of the prompt availability of the resources to perform the function internally. ESMA amended guideline 11 accordingly.

### **Guideline 12 – Review of the compliance function by competent authorities (Q21 and Q22)**

**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.**

34. A number of respondents supported the amendments made to the guideline 12 and considered appropriate that the NCAs may assess the specific situation in each Member



State. A large proportion of respondents agreed with the wording of the guideline 12 and have no further comment on the wording.

35. A few respondents disagreed with the proposal as they consider that the ultimate responsibility for the assessment of the compliance officer's qualification lies solely with senior management. Other respondents clarified that the provisions indicated within paragraph 91 should be checked comprehensively by internal and external audit. Some respondents suggested that the questionnaire mentioned in the paragraph 91 be used to fulfil the reporting obligation to senior management as provided in letter c) of paragraph 2 of Article 22 of MiFID II Delegated Regulation and referred to in the guideline 3.
36. Considering it received an overall broad support, ESMA decided not to amend the guideline.



## **3.5 Annex V - Guidelines on certain aspects of the MiFID II compliance function requirements**

### **1 Scope**

#### **Who?**

1. These guidelines apply to competent authorities and to the following financial market participants:
  - (i) investment firms when carrying out investment services or investment activities or when selling or advising clients in relation to structured deposits;
  - (ii) credit institutions when carrying out investment services or investment activities or when selling or advising clients in relation to structured deposits;
  - (iii) undertakings for collective investment in transferable securities (UCITS) management companies when providing the services referred to in Article 6(3) of the UCITS Directive, in accordance with Article 6(4) of that Directive; and
  - (iv) alternative investment fund managers (AIFMs) when providing the services referred to in Article 6(4) of the AIFMD, in accordance with Article 6(6) of that Directive.

#### **What?**

2. These guidelines apply in relation to Article 16(2) of MIFID II and Article 22 of the MiFID II Delegated Regulation.

#### **When?**

3. These guidelines apply from two months of the date of publication of the guidelines on ESMA's website in all EU official languages.
4. The Guidelines on certain aspects of the MiFID compliance function requirements<sup>13</sup> issued under MiFID I will cease to apply on the same date.

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<sup>13</sup> ESMA/2012/388.



## 2 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>14</sup>
<i>CRD</i>	Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC <sup>15</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>16</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>17</sup>
<i>MIFID I</i>	Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC <sup>18</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>19</sup>

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<sup>14</sup> OJ L 174, 01.07.2011, p. 1.

<sup>15</sup> OJ L 176, 27.6.2013, p. 338–436

<sup>16</sup> OJ L 176, 27.6.2013, p. 1–.

<sup>17</sup> OJ L 331, 15.12.2010, p. 84.

<sup>18</sup> OJ L 145, 30.4.2004, p. 1.

<sup>19</sup> OJ L 173, 12.06.2014, p. 349.



*MiFID II Delegated Regulation* 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>20</sup>

*MiFID II Delegated Directive* 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>21</sup>

*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>22</sup>

## Abbreviations

*ESMA* European Securities and Markets Authority

## Definitions

*firms* investment firms (as defined in Article 4(1)(1) of MiFID II) when providing investment services or investment activities or when selling or advising clients in relation to structured deposits; credit institutions (as defined in Article 4(1)(1) of the CRR) when providing investment services or investment activities or when selling or advising clients in relation to structured deposits; UCITS management companies (as defined in Article 2(1)(b) of the UCITS Directive) when providing the services referred to in Article 6(3) of the UCITS Directive, in accordance with Article 6(4) of that Directive; and AIFMs (as defined in Article 4(1)(b) of the

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<sup>20</sup> OJ L 87, 31.3.2017, p. 1.

<sup>21</sup> OJ L 87, 31.3.2017, p. 500.

<sup>22</sup> OJ L 302, 17.11.2009, p. 32.



AIFMD) that are external AIFMs when providing the services referred to in Article 6(4) of the AIFMD, in accordance with Article 6(6) of that Directive.





### **3 Purpose**

5. These guidelines are based on Article 16(1) of the ESMA Regulation. The objectives of these guidelines are to establish consistent, efficient and effective supervisory practices within the ESFS and to ensure the common, uniform and consistent application of certain aspects of the MiFID II compliance function relating to the requirements referred to in paragraph 2.
6. ESMA also expects these guidelines to promote greater convergence in the interpretation of, and supervisory approaches to, the MiFID II compliance function requirements by focusing on a number of important issues, and thereby enhancing the value of existing standards. By helping to ensure that firms comply with uniform regulatory standards, ESMA anticipates a corresponding strengthening of investor protection.



## **4 Compliance and reporting obligations**

### **Status of the guidelines**

7. In accordance with Article 16(3) of the ESMA Regulation, competent authorities and firms must make every effort to comply with these guidelines.
8. Competent authorities to which 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 firms. In this case, competent authorities should ensure through their supervision that firms comply with the guidelines.

### **Reporting requirements**

9. 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.
10. 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.
11. A template for notifications is available on ESMA's website. Once the template has been filled in, it shall be transmitted to ESMA.
12. Firms are not required to report whether they comply with these guidelines.

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

13. 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.

### **5.1 Responsibilities of the compliance function**

#### **Guideline on the compliance risk assessment**

*(paragraph 1 and second subparagraph of paragraph (2) of Article 22 of the MiFID II Delegated Regulation)*

#### **Guideline 1**

14. In accordance with Article 22(2) of the MiFID II Delegated Regulation, the compliance function shall, as part of its tasks, 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.
15. 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 reviewed on a regular basis, and, when necessary, updated to ensure that the objectives, focus and the scope of compliance monitoring and advisory activities remain valid.
16. In identifying the level of compliance risk the firm faces, the second subparagraph of Article 22(1) of the MiFID II Delegated Regulation requires the compliance function to take into account all the areas of the investment services, activities and ancillary services provided by the firm. This should include the types of financial instruments traded and distributed, the categories of the firm's clients, the distribution channels and, where relevant, the internal organisation of the group.
17. The compliance risk assessment should consider the applicable obligations under MiFID II, national implementing rules and the policies, procedures, systems and controls implemented within the firm in the area of investment services and activities. The assessment should also consider the results of any monitoring activities and of any relevant internal or external audit findings.
18. 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 relevant changes in the firm's structure or in the applicable regulatory framework).

## **Guideline on the monitoring obligations of the compliance function**

*(Point (a) and second subparagraph of paragraph (2) of Article 22 of the MiFID II Delegated Regulation)*

### **Guideline 2**

19. 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 as well as whether its internal policies and procedures, organisation and control measures remain effective and appropriate to ensure that compliance risk is comprehensively monitored.
20. 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.
21. 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.
22. Examples of suitable tools and methodologies for monitoring activities 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, interview of relevant staff and/or, where necessary, and at the discretion of the compliance function, of a relevant sample of firm's clients;
23. 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 or implementing acts and/or any national implementing provisions thereof.

24. 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 (namely 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.
25. Reviews by control functions should be coordinated with the monitoring activities performed by the compliance function while respecting the different functions' independence and mandate.
26. The compliance function should have a role in monitoring 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 the compliance function 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.

### **Guideline on the reporting obligations of the compliance function**

*(Article 16(2) of MiFID II, paragraphs (1)(e), (2)(c) and (3)(b) of Article 21, paragraphs (2) and (3) of Article 25 and paragraphs (3) and (7) of Article 26 of the MiFID II Delegated Regulation, paragraphs (6) and (7) of Article 9 and paragraphs (6) and (8) of Article 10 of the MiFID II Delegated Directive)*

### **Guideline 3**

27. The mandatory compliance reports according to paragraphs (2)(c) and (3)(c) of Article 22 and paragraphs (2) and (3) of Article 25 of the MiFID II Delegated Regulation are suitable tools to warrant the necessary management attention. The mandatory compliance reports should cover all business units involved in the provision of investment services, activities and ancillary services provided by a firm. Where the report does not cover all of these activities and services of the firm, it should clearly state the reasons.
28. The mandatory compliance reports should, *inter alia*, contain information on the following matters, 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 MiFID II;
    - relevant changes and developments in the applicable 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 and in following reports, any change thereto;

(b) Manner of monitoring and reviewing

- how the compliance-function monitors the development and review of the obligations under MiFID II and how possible risks of failure by the firm or its staff to comply with these obligations are identified 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 if not already reported through other sources. Where, as a result of the review of clients' complaints, specific compliance or risk issues are identified in relation to the policies or procedures adopted by the firm for the provision of investment services and activities, these aspects should be specifically reported;

(d) Actions taken

- a summary of any action taken to address any significant risk of failure by the firm or its staff to comply with the obligations under MiFID II;
- measures taken and to be taken to ensure compliance with changed applicable requirements;
- reaction to complaints received and any pay-out performed based on the complaint, if not already reported through other sources. Actions regarding specific compliance or risk issues identified in relation to the policies or procedures adopted by the firm for the provision of investment services and activities 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;
- information in relation to any deviation from the principle that the other business units must not issue instructions or otherwise influence compliance staff and their activities; and
- where a firm makes use of the exemption to avoid appointing a compliance officer whose sole responsibility within the firm is the compliance function, assessment of the continuing appropriateness of the arrangements to minimize conflicts of interest.

29. 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 (for example, taking into account its role as product manufacturer and/or distributor), at least:

- (a) the compliance function's role in participating to the elaboration, monitoring and reviewing of the firm's product governance policies and procedures;
- (b) all topics required under Article 22(2) MiFID II Delegated Regulation, 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 Articles 9(6) and 10 (8) of the MiFID II Delegated Directive, 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, notably with the firm's product governance policy (for example, complexity of the product, product related conflicts of interests, particularly relevant data from the scenario analysis, the cost-return ratio), with a specific focus on new types of products manufactured or distributed during the reporting period as well as the ones whose features have been significantly amended during that period.
- (in case of manufacturers) as part of the information on the respective distribution strategy: the respective distributors with a specific focus on new 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. According to the proportionality principle, 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.

30. Subject to the proportionality principle, firms should favour an organisation where the compliance function and the complaints management function are properly separated. 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.

31. The compliance function should consider the need for additional reporting lines to any group compliance function.
32. Competent authorities may take different approaches to supervising the reporting obligations of the compliance function. By way of example, some competent authorities require firms to provide them with compliance function reports on a regular or ad hoc basis while others also require senior management to provide 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 the applicable provisions.

### **Guideline on the advisory and assistance obligations of the compliance function**

*(Articles 22(2)(b) and 27(3) of the MiFID II Delegated Regulation)*

#### **Guideline 4**

33. Firms should ensure that the compliance function fulfils its advisory and assistance responsibilities, including providing support for staff and management training; providing day-to-day assistance for staff and management and participating in the establishment of policies and procedures within the firm (e.g. the firm's remuneration policy or the firm's product governance policies and procedures)
34. Firms should promote and enhance a 'compliance culture' throughout the firm, which should be supported by the senior management. The purpose of the compliance culture is not only to establish the overall environment in which compliance matters are treated, but also to engage staff with the principle of improving investor protection as well as contributing to the stability of the financial system.
35. The firm needs to ensure that its staff is adequately trained<sup>23</sup>. The compliance function should support the business units in the area of investment services and activities (namely all staff involved directly or indirectly in the provision of investment services and activities) in performing any relevant 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, its delegated and implementing acts, national implementing laws, the applicable standards, guidelines and other guidance set out by ESMA and competent authorities, any other supervisory and regulatory requirements that may be relevant and any changes to those.
36. 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.

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<sup>23</sup> See Guidelines for the assessment of knowledge and competence; ESMA71-1154262120-153 EN (rev)



37. 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).
38. The compliance function should monitor, in cooperation with the management team, which holds ultimate executive responsibility, 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.
39. 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.
40. 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 (for example the firm's remuneration policy or the firm's product governance policies and procedures). 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 (possibly as ad-hoc reports, where necessary).
41. 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 request business units to consult with the compliance function in due time regarding their operations, where relevant.
42. 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.

## 5.2 Guidelines on the organisational requirements of the compliance function

### Guideline on the effectiveness of the compliance function

*(Articles 21(1)(d) and 22(3)(a) of the MiFID II Delegated Regulation)*

#### Guideline 5

43. 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.
44. 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, and at least once a year, whether the number of staff and their expertise is still adequate for the fulfilment of the duties of the compliance function.
45. In addition to human resources, sufficient IT resources should be allocated to the compliance function.
46. 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 should contain detailed explanations.
47. In ensuring compliance staff have access to the relevant information for their tasks at all times, firms should provide access to all relevant database and records (such as recordings of telephone conversations and electronic communications referred to in Article 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 (which should remain exceptional) 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.
48. 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 (for example internal audit and risk management) as well as with any internal or external auditors.



## **Guideline on the skills, knowledge, expertise and authority of the compliance function**

*(Articles 21(1)(d) and paragraphs (a) and (b) of 22(3) of the MiFID II Delegated Regulation)*

### **Guideline 6**

49. Firm's compliance staff shall have the necessary skills, knowledge and expertise to discharge their obligations pursuant to Articles 21(1)(d) of the MiFID II Delegated Regulation. Furthermore, the compliance function shall have the necessary authority pursuant to Article 22(3)(a) of the MiFID II Delegated Regulation. These requirements 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.
50. In order to ensure that the compliance function has the authority required for its duties, the senior management of the firm should support it 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 function.
51. Within the compliance function there should at least be knowledge of MiFID II and all related delegated and implementing acts, the national implementing laws and regulations as well as of all applicable standards, guidelines and other guidance issued by ESMA and competent authorities, as far as these are relevant for the performance of the compliance tasks. Compliance staff should be regularly trained in order to maintain their knowledge. The designated compliance officer should possess a higher level of expertise.
52. 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 the requirements in Article 21(1)(d) and paragraphs (a) and (b) of Article 22(3) is then assessed within the general review of the firm's compliance with the relevant MiFID II requirements.
53. The compliance officer should demonstrate sufficient professional experience as it 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.

54. The compliance officer should have specific knowledge of the different 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 could differ. 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.

### **Guideline on the permanence of the compliance function**

*(first subparagraph of Article 22(2) of the MiFID II Delegated Regulation)*

#### **Guideline 7**

55. The first subparagraph of Article 22(2) of the MiFID II Delegated Regulation 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.
56. The firm should ensure, for example through internal procedures and stand-in arrangements, that the responsibilities of the compliance function are fulfilled adequately during any absence of the compliance officer.
57. The responsibilities and competences as well as the authority of the compliance function 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 the applicable requirements should be reflected promptly by adapting these policies/rules.
58. The compliance function should perform its activities on a permanent basis and not only in specific circumstances. This entails regular monitoring on the basis of a monitoring schedule. The monitoring activities should regularly cover all key areas of the investment services and activities provided by the firm, 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.



## **Guideline on the Independence of the compliance function**

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

### **Guideline 8**

59. Firms should ensure that the compliance function holds a position in their organisational structure that ensures that the compliance officer and other compliance staff act independently when performing their tasks.
60. 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 and an appropriate escalation process by the compliance function to senior management should be implemented.
61. 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.

## **Guideline regarding the proportionality with regard to the effectiveness of the compliance function**

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

### **Guideline 9**

62. 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.
63. In deciding whether the requirements under points (d) and (e) of Article 22(3) of the MiFID II Delegated Regulation are proportionate and whether their compliance function continues to be effective, firms should take at least the following criteria 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 point 11 of Article 2 of CRD;
  - 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.
64. 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.
65. 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.
66. While a compliance officer must always be appointed, it may be disproportionate for some firms, depending on the circumstances (for instance, small firms with limited and non-complex activities and/or limited volumes) to appoint a separate compliance officer that does not perform any other function. Where a firm makes use of the exemption (which should be assessed and justified on a case-by-case basis), conflicts of interest between the tasks performed by the relevant persons should be minimised as much as possible.
67. 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 effectiveness.
68. 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.

### **Guidelines on combining the compliance function with other internal control functions**

*(Article 22(3)(d) of the MiFID II Delegated Regulation)*

#### **Guideline 10**

69. A firm should favour an organisation where control functions are properly separated. 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. However, where an internal audit function has been established and is maintained within the investment firm in accordance

with Article 24 of the MiFID II Delegated Regulation, such function may not be combined with other control functions such as the compliance function, in accordance with Article 24.

70. 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.
71. 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.
72. 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 in charge of other control functions.
73. Where the compliance officer is not appointed as the single officer referred to in article 7 of the MiFID II Delegated Directive, both the officer referred to in Article 7 of the MiFID II Delegated Directive and the compliance officer should act independently, and the compliance officer should not supervise and/or issue any instruction to the single officer referred to in Article 7 of the MiFID II Delegated Directive.
74. Where the compliance function is combined with other control functions as specified in paragraph 69 or where it is also responsible for other tasks (for example anti-money laundering), the firm should ensure that it allocates enough resources for MiFID-compliance at all times.

### **Guidelines on outsourcing of the compliance function**

*(Articles 22 and 31 of the MiFID II Delegated Regulation)*

#### **Guideline 11**

75. Firms should ensure that all requirements applicable to the compliance function continued to be fulfilled where all or part of the compliance function is outsourced.
76. The outsourcing requirements for critical or important functions set out in Articles 16(5) of MiFID II and 31 of the MiFID II Commission Delegated Regulation apply in full to the outsourcing of the compliance function.
77. Firms can only outsource tasks, but not responsibilities: firms wishing to engage in outsourcing remain fully responsible for the tasks that are outsourced. In other words, as set out in Article 31(2)(e) of the MiFID II Delegated Regulation, the ability to control outsourced tasks and manage the risks associated with the outsourcing must always be retained by the firm initiating the outsourcing.
78. The firm should perform a due diligence assessment before choosing a service provider in order to ensure that the requirements 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 should be dependent on the nature, scale, complexity and risk of the compliance tasks and processes that are outsourced.

79. Firms should also ensure that when, outsourced partially or fully, the compliance function remains permanent in nature, namely that the service provider should be able to perform the function on an ongoing basis and not only in specific circumstances.
80. 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 tasks 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.
81. Outsourcing of the compliance function's tasks 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.
82. In compliance with the proportionality principle set out in Article 22(4) of the MiFID II Delegated Regulation, if a firm, due to the nature, scale and complexity of its business and the nature and range of investment services and activities, does not comply with Article 22(3)(d) of the MiFID II Delegated Regulation (namely its compliance staff is also involved in the performance of services or activities they monitor), then it may consider that the outsourcing of the compliance function's tasks is likely to be an appropriate approach to take.
83. In all cases, outsourcing of the compliance function should not (i) undermine its quality and independence, (ii) create undue additional operational risks, (iii) impair the activities of internal controls or (iv) impair the ability of the firm and the relevant competent authority to supervise compliance with the applicable requirements.
84. Outsourcing of all or part of the tasks of the compliance function to non-EU entities may potentially make oversight and supervision of the compliance function more difficult and should therefore be subject to a closer monitoring.
85. In case the outsourcing arrangement related to the compliance function is terminated, firms should ensure the continuity of the compliance function either by transferring it back to the firm or outsourcing it to another provider.

### **5.3 Competent authority review of the compliance function**

#### **Guidelines on the review of the compliance function by competent authorities**



## Guideline 12

86. Competent authorities should review how firms plan to meet, implement and maintain the applicable 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 on-going supervision.
87. 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 this Directive (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, as a condition for authorisation, that any necessary amendments to the compliance function are made as a condition for authorisation.
88. 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.
89. As mentioned under paragraph 52 above, some competent authorities license or approve the nominated compliance officer following an assessment of the qualifications of the compliance officer.
90. 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.
91. 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 firm’s business is intended to be conducted and monitored by the firm. This evaluation grid includes questions related to all investment services the firm is authorised to perform. Some questions also relate to the monitoring and control of the activity to be performed by the firm. (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 years). 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 by competent authorities to monitor the firm and to require the firm to adopt an action plan to remediate to the issues as well as to determine the priorities of the supervision of the competent authority and to calibrate its risk-based approach.

92. The above practices could be helpful to other competent authorities.

#### 5.4 Correlation table between the 2020 guidelines and the 2012 guidelines

2020 Guidelines	2012 Guidelines
<b>Responsibilities of the compliance function</b>	
<b>Compliance risk assessment</b> <i>Guideline 1</i>	<b>Compliance risk assessment</b> <i>General Guideline 1</i>
<b>Monitoring obligations of the compliance function</b> <i>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>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>Guideline 4</i>	<b>Advisory obligations of the compliance function</b> <i>General Guideline 4</i>
<b>Organisational requirements of the compliance function</b>	
<b>Effectiveness of the compliance function</b> <i>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>Guideline 6</i>	
<b>Permanence of the compliance function</b> <i>Guideline 7</i>	<b>Permanence of the compliance function</b> <i>General Guideline 6</i>
<b>Independence of the compliance function</b> <i>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>Guideline 9</i>	<b>Exemptions</b> <i>General Guideline 8</i>

<p><b>Combining the compliance function with other internal control functions</b> <i>Guideline 10</i></p>	<p><b>Complying the compliance function with other internal control functions</b> <i>General Guideline 9</i></p>
<p><b>Outsourcing of the compliance function</b> <i>Guideline 11</i></p>	<p><b>Outsourcing of the compliance function</b> <i>General Guideline 10</i></p>
<p><b>Competent authority review of the compliance function</b></p>	
<p><b>Review of the compliance function by competent authorities</b> <i>Guideline 12</i></p>	<p><b>Review of the compliance function by competent authorities</b> <i>General Guideline 11</i></p>