

European Securities and Markets Authority
103, Rue de Grenelle
75007 Paris
France

Submitted online at www.esma.europa.eu

Futures and Options Association (FOA) response to Consultation Paper: ESMA/2011/446 – Guidelines on certain aspects of the MiFID compliance function requirements

The FOA welcomes the opportunity to comment on this consultation paper. By way of background, we are the industry association for more than 160 firms and institutions which engage in derivatives business, particularly in relation to exchange-traded transactions, and whose membership includes banks, brokerage houses and other financial institutions, commodity trade houses, power and energy companies, exchanges and clearing houses, as well as a number of firms and organisations supplying services into the futures and options sector (see a list of FOA members at Appendix 1).

We welcome the work ESMA is doing to enhance clarity and foster convergence in the implementation of MiFID, including in relation to the organisation of compliance functions. We support much of what is written in these guidelines and for the sake of brevity, we have focussed our comments on matters that in our view should be clarified, or where we have particular concerns.

General comments

Scope and contents of the guidelines

In the Executive summary of the Consultation Paper, ESMA notes that *'separate guidelines are proposed for ... the application of the exception set out in Article 6(3)(2) of the MiFID Implementing Directive, the extent of interaction of the compliance function with other functions, and the outsourcing of tasks of the compliance function'*¹. The Consultation Paper then goes on to discuss and propose guidelines in each of these areas, respectively at paragraphs 52, 59, and 64 at Annex III. It is unclear therefore, whether these proposals will be subject to revision at a later date. For the benefit of certainty, clarification on this would be very welcome.

Status of the guidelines

We have been working closely with our members and other trade associations in relation to ESMA's final guidelines on systems and controls in an automated trading environment², and as with those guidelines, there continues to be a lack of clarity as to their legal status. It is necessary for the benefit of legal certainty and a consistent application of these and further guidelines across the Union - and of course to achieve the ultimate purpose of ESMA guidelines - that the competent authorities agree on the interpretation of Article 16(3) of the ESMA Regulation³ without delay. Such

¹ See page 5, paragraph 6 of the Consultation Paper.

² Final Report: ESMA/2011/456 – Guidelines on systems and controls in an automated trading environment for trading platforms, investment firms and competent authorities, 22 December 2011.

³ 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.

agreement and clarity is necessary to further the establishment of a genuine European single rule book.

Responses to ESMA's questions at Annex I

Question 1 – comprehensive risk assessments

It seems entirely sensible to us that in the context of a risk-based approach, that risk assessments should be conducted to understand the nature of risks within a firm, and in turn to ensure that compliance resource is directed as efficiently as possible.

Question 2 – monitoring obligations

We welcome the clarity that has been provided around the establishment of compliance monitoring programmes and believe this is one area where the principles of risk-based compliance and proportionality are vital. While it may be possible for compliance to monitor everything, this may not be the best use of resources. We therefore seek further clarity on what ESMA has in mind when it refers to '*comprehensively monitored*'⁴. We would encourage ESMA to consider inserting into this general guideline, explicit reference to a 'risk-based monitoring programme', and within the supporting guidelines, that monitoring expectations are 'reasonable', given the nature, size, scale [but in particular the activities] of the firm.

We caution against inadvertently restricting compliance monitoring practices in the context of groups. We understand ESMA's intentions here and agree that responsibility for the compliance function rests with the individual investment firm, irrespective of whether they form part of a bigger group company. It is common practice to organise compliance monitoring functions across groups, to enable the assessment of group-wide (as well as legal entity specific) compliance risks. It would be helpful if the supporting guideline at page 23, paragraph 14 could recognise the value of this structure to avoid any confusion around the appropriateness of these arrangements.

Question 3 – reporting obligations

The proposed guidelines on reporting obligations seem sensible to us. ESMA has referred to a number of practices in place at competent authorities and it is not clear whether ESMA has a particular preference as to the approach that should be taken, and indeed whether those authorities that do not currently require firms to provide them with compliance reports, should do so. We seek clarity therefore, for the benefit of certainty around these expectations.

Question 4 – advisory obligations

ESMA notes that the '*compliance function should periodically assess whether staff hold the necessary level of awareness ...*'⁵. We would welcome further clarity from ESMA on what period it thinks is appropriate in this context. While firms could look to the proportionality principle, our view is that there is unlikely to be sufficient grounds on the basis of a firm's nature, size and scale, to warrant wholly differentiated expectations. Further clarity would therefore be welcome.

⁴ See page 23, paragraph 12 of Annex III of the Consultation Paper.

⁵ See page 26, paragraph 32 of Annex III of the Consultation Paper.

ESMA notes further that *'the compliance function should regularly be involved in all relevant correspondence with competent authorities'*⁶. This is unhelpfully ambiguous and in particular, given the reference to *'regularly'*, suggests [perhaps inadvertently] that the requirement to involve the compliance function is based on an undefined time period. Depending on ESMA's intent, we suggest that this is revised along the following lines: *'... should be involved in all correspondence ...'* or *'... should be involved in significant correspondence ...'*

Question 5 – effectiveness of the compliance function

ESMA notes that *'where an investment firm's business unit activities are significantly extended, the investment firm should ensure that the compliance function is similarly extended'*⁷. This implies that in all circumstances where there is *'significant'* expansion of activities, that additional compliance officers are required. We suggest instead, that this is re-worded as: *'...the investment firm should ensure that the compliance function remains appropriate'*. This would encourage firms to resource compliance functions in a way that addresses the risks posed by any such new business unit activities, rather than simply considering headcount.

Question 6 – permanence of the compliance function

We are concerned about the potential impact that the guideline on stand-in arrangements could have on smaller firms. While larger firms are more able to source a sufficiently qualified stand-in for the compliance officer at short notice and from within the organisation, smaller firms are more likely to face practical challenges in doing the same. The likely outcome is that small firms would have to enter into, for example, contractual arrangements to use a compliance consultant simply to cover a short holiday absence, which does not seem to us to be a proportionate outcome. Further clarity on the expectations of smaller firms, beyond reference to proportionality principles, would be helpful.

Questions 7 & 8 – independence of the compliance function

We agree strongly that it is important to maintain independent compliance functions. In practice, the ability to act independently will require enhanced measures to ensure that compliance officers have the right to all relevant information. While these measures seem to have been reflected in the guideline relating to the effectiveness of the compliance function, for the avoidance of doubt we would welcome explicit acknowledgement of this within the context of independence.

Question 9 – article 6(3) exemptions

We support the notion that compliance functions should not be organised in a way that is subordinate to other internal control functions. We question however, the intention behind the statement that, *'compliance functions should generally not be combined with the legal unit...where this could undermine the compliance function's independence'*⁸. While we recognise that this would only be required where the compliance function is potentially *undermined*, in general, the potential for conflicts between these functions (and the risk of compliance being undermined) is not immediately apparent to us. On the contrary, it is more common for legal functions to support the work of compliance functions, rather than to undermine them. As such, the risk that the compliance function is undermined does not seem significant enough to warrant explicit mention in this supporting guideline.

⁶ See page 26, paragraph 36 of Annex III of the Consultation Paper.

⁷ See page 27, paragraph 39 of Annex III of the Consultation Paper.

⁸ See page 30, paragraph 57 of Annex III of the Consultation Paper.

Given the very significant inter-relationships in legal and compliance work, it is quite usual for small and large firms alike to combine these functions. Any change in policy requiring separation may prove a considerable and costly restructuring exercise, the benefits of which are not clear. In our view these functions will need to work closely together irrespective of internal structure and any such forced re-structure would simply add inefficiencies and cost, to no obvious benefit.

Question 10 – combining the compliance function with other functions

While most of what is said in this guideline seems sensible, the statement that *‘the independence of the compliance function is not necessarily compromised by compliance staff overlapping with other control functions’*⁹, seems somewhat contradictory to aspects of the article 6(3) exemptions guideline. There is some uncertainty, in particular as to the policy rationale and expectations in relation to the combining of compliance and legal functions – please also see our response to question 9.

Question 11 – outsourcing of the compliance function

We agree with ESMA’s position on the MiFID outsourcing requirements but as drafted, it is likely to ignite a debate as to what constitutes *‘critical or important functions’*¹⁰, and therefore what outsourcing arrangements are in-scope. It would be useful therefore, for ESMA to provide clarity as to how these terms should be defined. ESMA may wish to look towards the UK FSA for example, which has provided more detail in its handbook, SYSC 8.1¹¹. Without further legal certainty from ESMA, there is a risk of an uneven application of these guidelines across the Union.

Questions 12 and 13 – review of the compliance function by competent authorities

Given that these guidelines relate to provisions in MiFID, we can see no reason why a firm’s competent authority should not review the firm’s application of these guidelines at both the point of authorisation, and as part of the on-going supervisory process. We would however wish to encourage competent authorities to do so in a risk-based and proportionate way.

ESMA has outlined three different approaches taken throughout the Union to the appointment of the compliance officer¹², and notes that these *‘could be helpful to other competent authorities’*¹³. While we agree with this, the approach taken by ESMA may not sufficiently encourage convergence to ensure the highest standards are applied across the Union.

We are happy to discuss any of these comments at your request, should that be useful.

Yours sincerely,

Blake Stephenson
Manager, Regulation
+44(0)20 7090 1347
stephensonb@foa.co.uk

⁹ See page 30, paragraph 60 of Annex III of the Consultation Paper.

¹⁰ See page 31, paragraph 65 of Annex III of the Consultation Paper.

¹¹ <http://fsahandbook.info/FSA/html/handbook/SYSC/8/1>

¹² See page 32, paragraphs 75 – 77 of Annex III of the Consultation Paper.

¹³ See page 32, paragraph 78 of Annex III of the Consultation Paper.

APPENDIX 1 - LIST OF FOA MEMBERS

FINANCIAL INSTITUTIONS

ABN AMRO Clearing Bank N.V.
 ADM Investor Services International Ltd
 Alpari (UK) Ltd
 Altura Markets S.A./S.V
 AMT Futures Ltd
 Bache Commodities Ltd
 Banco Santander
 Bank of America Merrill Lynch
 Banca IMI S.p.A.
 Barclays Capital
 Berkeley Futures Ltd
 BGC Partners Inc.
 BHF Aktiengesellschaft
 BNP Paribas Commodity Futures Ltd
 BNY Mellon Clearing International Ltd
 Capital Spreads
 Citadel Securities (Europe) Ltd
 Citigroup
 City Index Ltd
 CMC Group Plc
 Commerzbank AG
 Contango Markets Ltd
 Crédit Agricole CIB
 Credit Suisse Securities (Europe) Ltd
 Deutsche Bank AG
 ETX Capital
 Forex.com UK Ltd
 FXCM Securities Ltd
 GFI Securities Ltd
 GFT Global Markets UK Ltd
 Goldman Sachs International
 HSBC Bank Plc
 ICAP Securities Ltd
 IG Group Holdings Plc
 International FC Stone Group
 Jefferies Bache Ltd
 J.P. Morgan Securities Ltd
 Liquid Capital Group
 Macquarie Bank Ltd
 Mako Global Derivatives Ltd
 Marex Financial Limited
 Mitsubishi UFJ Securities International Plc
 Mizuho Securities USA, Inc London
 Monument Securities Ltd
 Morgan Stanley & Co International Ltd
 Newedge Group (UK Branch)
 Nomura International Plc
 Rabobank International
 RBC Europe Ltd
 Saxo Bank A/S
 Schneider Trading Associates Limited
 Scotia Bank
 SEB Futures
 Societe Generale Corporate & Investment Banking London
 Standard Bank Plc

Standard Chartered Bank (SCB)
 Starmark Trading Ltd
 State Street GMBH London Branch
 The Kyte Group Limited
 The Royal Bank of Scotland Plc
 UBS Limited
 Vantage Capital Markets LLP
 Wells Fargo Securities International Ltd
 WorldSpreads Ltd

EXCHANGE/CLEARING HOUSES

APX Group
 CME Group, Inc.
 Dalian Commodity Exchange
 European Energy Exchange AG
 Global Board of Trade Ltd
 ICE Futures Europe
 LCH.Clearnet Group
 MCX Stock Exchange
 MEFF RV
 Nasdaq OMX Europe
 Nord Pool Spot AS
 NYSE Liffe
 Powernext SA
 RTS Stock Exchange
 Shanghai Futures Exchange
 Singapore Exchange Ltd
 Singapore Mercantile Exchange
 The London Metal Exchange
 The South African Futures Exchange
 Turquoise Global Holdings Ltd

SPECIALIST COMMODITY HOUSES

Amalgamated Metal Trading Ltd
 Cargill Plc
 ED & F Man Commodity Advisers Ltd
 Engelhard International Ltd
 Glencore Commodities Ltd
 J.P. Morgan Metals Ltd
 Koch Supply & Trading Company Ltd
 Metdist Trading Ltd
 Mitsui Bussan Commodities Ltd
 Natixis Commodity Markets Ltd
 Noble Clean Fuels Limited
 Phibro Commodities Ltd
 Succden Financial Limited
 Toyota Tsusho Metals Ltd
 Triland Metals Ltd
 Vitol SA

ENERGY COMPANIES

BP Oil International Ltd
 Centrica Energy Ltd
 Chevron Global Trading Ltd
 ConocoPhillips (UK) Ltd
 E.ON EnergyTrading SE
 EDF Energy

EDF Trading Ltd
 International Power plc
 National Grid Electricity Transmission Plc
 PetroChina International (London) Co., Limited
 RWE Supply & Trading GMBH
 Scottish Power Energy Trading Ltd
 Shell International Trading & Shipping Co Ltd
 SmartestEnergy Ltd

PROFESSIONAL SERVICE COMPANIES

Actimize UK Ltd
 Ashurst LLP
 ATEO Ltd
 Baker & McKenzie
 Berwin Leighton Paisner LLP
 BDO Stoy Hayward
 Clifford Chance LLP
 Clyde & Co
 CMS Cameron McKenna LLP
 Complinet
 Deloitte LLP
 Dewey & LeBoeuf LLP
 Eukleia Training Ltd
 FfastFill Plc
 Fidessa Plc
 FOW Ltd
 Freshfields Bruckhaus Deringer LLP
 Henry Davis York
 Herbert Smith LLP
 International Capital Market Association (ICMA) Ltd
 ION Trading Group
 Katten Muchin Rosenman Cornish LLP
 Kinetic Partners LLP
 KPMG LLP
 Linklaters LLP
 Mpac Consultancy LLP
 Norton Rose LLP
 Options Industry Council
 Orrick, Herrington & Sutcliffe (Europe) LLP
 PA Consulting Group
 Pekin & Pekin LLP
 R3D Systems Ltd
 Reed Smith LLP
 Rostron Parry Ltd
 RTS Realtime Systems Ltd
 Sidley Austin LLP
 Simmons & Simmons
 SJ Berwin & Company LLP
 SmartStream Technologies Ltd
 SNR Denton UK LLP
 Speechly Bircham LLP
 Stellar Trading Systems
 SunGard Global Trading
 Swiss Futures and Options Association
 Thomson Reuters
 Trading Technologies UK Ltd
 Traiana Inc
 Travers Smith LLP
 Trayport Ltd