



February 24, 2012

Via *ESMA Website*

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

Dear Sir/Madam:

Response to Public Consultation: Guidelines on Certain Aspects of the MiFID Compliance Function Requirements (the “Consultation Paper”)

Managed Funds Association (“MFA”)¹ welcomes the opportunity to provide comments to ESMA in response to its Consultation Paper.

MFA’s responses are set out in the Annex to this letter.

MFA would like to take this opportunity to provide comments on a number of matters that we believe will assist ESMA in balancing the need for effective regulation with the reality of existing market practices. MFA supports a robust regulatory framework that includes an effective internal compliance function. We believe the role of the compliance function should be institutionally important and its success is more likely to be achieved where senior management strongly sponsors this function. A collaborative approach is more likely to lead to effective and sound decision-making by senior management who are ultimately accountable for the firm's failures. Although the letter covers several important issues, MFA would like to highlight the following key points that it has raised in this letter:

- (1) in the case of an investment firm which is part of a corporate group, it may be appropriate to have a centralised compliance function situated within another group entity;
- (2) compliance officers should not be required to have formal compliance or legal qualifications, provided that they have a good knowledge of the regulatory system combined with a thorough understanding of the business carried out by their investment

¹ MFA is the voice of the global alternative investment industry. Its members are professionals in hedge funds, funds of funds and managed futures funds, as well as industry service providers. Established in 1991, MFA is the primary source of information for policy makers and the media and the leading advocate for sound business practices and industry growth. MFA members include the vast majority of the largest hedge fund groups in the world who manage a substantial portion of the approximately \$1.9 trillion invested in absolute return strategies. MFA is headquartered in Washington D.C., with an office in New York.

firm gained through relevant experience. This is particularly important in the context of a corporate group with a centralized compliance function where the chief compliance officer for the group may be based in a jurisdiction outside of the EU;

- (3) it should be left to the investment firm's discretion to decide which types of functions may be combined with the compliance function; and
- (4) ESMA should clarify which types of external compliance services may amount to "outsourcing" of the compliance function.

We would be very happy to discuss our comments or any of the issues raised in the Consultation Paper with ESMA. If ESMA has any comments or questions, please do not hesitate to contact Jennifer Han (jhan@managedfunds.org) or the undersigned at +1 (202) 730-2600.

Respectfully submitted,

/s/ Stuart Kaswell

Stuart Kaswell
Executive Vice President
and Managing Director
General Counsel

ANNEX

MFA RESPONSES TO ESMA CONSULTATION OF 22 DECEMBER 2011
GUIDELINES ON CERTAIN ASPECTS OF THE MIFID COMPLIANCE FUNCTION
REQUIREMENTS

III. GUIDELINES ON RESPONSIBILITIES OF THE COMPLIANCE FUNCTION

III.I Compliance Risk Assessment

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

MFA Response

Yes. MFA agrees that investment firms should apply a risk-based approach to designing and implementing their compliance policies and procedures, including with respect to the scope of compliance monitoring, reporting, internal organizational arrangements and training of staff. The resources allocated to the compliance function and the measures taken to ensure compliance with legal and regulatory obligations of the investment firm should be appropriate and proportionate to the firm's assessment of the risks inherent in its business model, the nature and scale of the investment services or investment activities undertaken by the firm and its client base.

III.II. Monitoring Obligations of the Compliance Function

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

MFA Response

MFA has no comments on this guideline.

III.III. Reporting Obligations of the Compliance Function

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

MFA Response

MFA agrees with the proposed guidelines in this section. However, MFA believes that paragraph 24 should not form part of these guidelines. It should be left to competent authorities of Member States to decide whether they wish to require investment firms to produce regular or *ad hoc* compliance reports as one of their supervisory tools.

III.IV. Advisory Obligations of the Compliance Function

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

MFA Response

MFA has no comments on this guideline.

IV. GUIDELINES ON ORGANISATIONAL REQUIREMENTS OF THE COMPLIANCE FUNCTION

IV.1 Effectiveness of the Compliance Function

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

MFA Response

MFA agrees that investment firms should allocate appropriate human and other resources to the compliance function but wishes to make the following observations based on the experience of our members.

- *Reliance on compliance resources of other entities within the corporate group*

We note ESMA's observations with respect to compliance arrangements of investment firms which are part of a corporate group at paragraphs 13, 23, 46(f) and 61.

We believe that it is also important for ESMA to clarify that, in some cases, it may be appropriate for groups to have a centralized compliance function. For example, in the case of a small advisory firm which is a subsidiary of a large asset manager, the compliance function for that small advisory firm may be better carried out by the group compliance officer who is technically employed by the large asset manager (including where that large asset manager may not itself be in the EU). We believe that such an arrangement is consistent with the principle of proportionality in Article 6(1) of the MiFID Implementing Directive.

- *IT resources*

MFA is of the view that the statements made in paragraphs 36 to 38 require further clarification. MFA agrees with the principle that the compliance function must have access to all relevant information within the firm (including all information kept by the firm on internal drives or databases) and should have the support of the IT personnel employed by the firm, for example, in cases where the compliance officer requires to undertake complex searches or filtering of the information kept by the firm in order to carry out an internal investigation or in the course of compliance monitoring.

However, a statement such as “access to all relevant information for their tasks including all relevant databases” is somewhat unclear. This statement combined with the requirement to formally document and justify any decisions to make budget cuts is of particular concern to MFA members with small operations in the EU that do not have substantial budgets dedicated to local compliance and IT resources.

MFA believes that this statement should not imply that investment firms would be required to provide their compliance function with access to all types of subscription-based databases which may aid them in carrying out their tasks or assist them in their professional development. Any requirements for access to external databases or extensive IT support should be read in conjunction with the principle of proportionality embodied in Article 6(1) of the MiFID Implementing Directive and ESMA’s guidance on compliance risk assessment.

- *Attendance of the meetings of senior management and governing body*

MFA supports the principle that the compliance officer should have unrestricted access to the governing body of the firm and should have the right to attend meetings of senior management/governing body when the compliance officer believes that it is necessary for the effective exercise of the compliance function. In this respect, a compliance officer may consider that it is necessary for him or her to attend meetings where organizational changes or modifications to the investment firm's investment services/activities, ancillary services and new products are discussed, as noted at paragraph 32 of the Consultation Paper.

It would be helpful, however, if ESMA could clarify that this requirement does not imply that the compliance officer should be made a member of the senior management or the governing body of the investment firm. In this context, it is important for ESMA to emphasize that the primary role of the compliance function is to advise the senior management of the investment firm with respect to their decision-making. The compliance function should not be required to have an executive or decision-making role.

As a separate point, it should be made clear that compliance officers should not be required to justify to the management/governing body why they believe their attendance is necessary at a particular meeting. Conversely, if a compliance officer chooses not (or is unable) to attend a particular meeting, such compliance officer should not be required to justify his or her absence from the meeting to competent authorities.

- *Professional qualifications and expertise*

MFA agrees that the compliance officer should have sufficient knowledge of legal and regulatory requirements to be able to assess the potential compliance risks and conflicts of interest relevant to the investment firm’s business and activities and should have the support of senior management to develop and deepen this knowledge and understanding on an ongoing basis. However, MFA does not believe that compliance officers should be required to have formal compliance or legal qualifications.

Compliance officers should have a good knowledge of the regulatory system combined with a thorough understanding of the business and investment activities carried out by their investment firm to enable them to identify the risks inherent in such a business. However, this knowledge and understanding can be gained through relevant experience rather than formal qualifications.

In many smaller firms, individuals carrying out the compliance function will have background experience in finance, operational, risk management or investment matters. MFA believes that so long as such individuals are sufficiently familiar with the regulatory requirements and receive support from external legal and compliance advisers, they should be in the position to carry out the compliance function effectively.

As noted above, where an investment firm is part of a corporate group, the group may maintain a centralized compliance function. The chief compliance officer for such a group may be located in a jurisdiction outside the EU. In these circumstances, it would not be practical for such a chief compliance officer to have formal compliance qualifications in the relevant EU jurisdiction.

In this respect, we note ESMA's comments at paragraph 65 regarding the assessment of the qualifications and curriculum vitae of the compliance officer. We do not believe that paragraph 65 should form part of the ESMA's guidelines.

IV.II. Permanence of Compliance Function

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

- (i) adequate stand-in arrangements for the responsibilities of the compliance officer which apply when the compliance officer is absent; and
- (ii) arrangements to ensure that the responsibilities of the compliance function are performed on an ongoing basis?

Please also state the reasons for your answers.

MFA Response

MFA believes that provisions for continuity and permanence of all significant functions within the business should form the basis of the general organizational planning in accordance with Chapter II of the MiFID Implementing Directive. As such, investment firms should normally take account of their policies on staff absences as well as any foreseeable contingencies when allocating human resources to the compliance function. Such considerations would be necessary to ensure that the compliance function remains effective at all times.

In this regard, MFA does not believe that it is necessary for ESMA to provide a separate guideline on the permanence of the compliance function, particularly in view of the guidelines on the effectiveness of the compliance function.

IV.III. Independence of Compliance Function

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

MFA Response

MFA believes that this guideline should refer to the proportionality principle set out in Article 6(1) of the MiFID Implementing Directive. Compliance arrangements should be appropriate in view of the size of the firm, complexity of its operations and its organizational structure. As a general matter, the effectiveness of the compliance function cannot be necessarily ensured by its independence from the influence of senior management or other business units. Conversely, the independence of the compliance function cannot be guaranteed by the compliance officer holding a particular position in the organizational structure (i.e. a separate compliance function). A better approach might be to encourage collaboration of the compliance officer with senior management and business units. This collaboration would not necessarily undermine the independence of the compliance officer, provided that the compliance officer has sufficient authority and credibility to access and challenge senior management if required.

More important than independence is a strong culture of compliance grounded in the commitment and active involvement of the senior leaders of the firm. The role of the compliance function should be institutionally important and its success is more likely to be achieved where senior management strongly sponsors this function. A collaborative approach is more likely to lead to effective and sound decision-making by senior management who are ultimately accountable for the firm's failures.

MFA also notes that in smaller firms, the compliance function is often carried out by a member of senior management (and/or member of the governing body of the firm). In many cases, this individual may also be responsible for the provision of investment services. As a senior manager of the firm, such individual will have sufficient authority within the firm to carry out his or her compliance function effectively, provided that such authority is combined with sufficient knowledge of the regulatory requirements and appreciation of regulatory risks. On balance, this arrangement could result in a greater degree of effectiveness of the compliance function than if the compliance function were, for example, carried out by a more junior member of staff who was formally independent of the business function.

In this respect, MFA notes ESMA's comments in paragraph 49 and believes that ESMA should clarify that investment firms may decide that, in some cases, it would be more appropriate in view of the investment firm's organizational requirements that the compliance function is combined with a senior management or a business role.

IV.IV. Exemptions

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

MFA Response

As noted above, MFA does not agree that firms should be required to ensure the functional separation of compliance. Such functional independence does not necessarily guarantee effective compliance decision-making.

MFA broadly agrees with the general principle that the compliance officer may only be appointed and replaced by the senior management. However, we believe that these arrangements would depend on the organizational structure of the investment firm and the size of its operations. MFA's view is that, to ensure independence of the compliance function, the decisions with respect to appointment/removal of the compliance officer should only be made by the most senior manager or managers (e.g. the CEO). In some cases, it may be appropriate for these decisions to be made by the governing body of the investment firm, rather than individual senior managers.

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

MFA Response

Many EU-based MFA members currently combine legal and compliance units. We are not aware of any evidence that would indicate that such a combination undermines the independence of the compliance function, particularly in smaller or mid-sized investment firms. In this regard, MFA believes that paragraph 50 should be deleted in its entirety, as the question of combining compliance with other functions is discussed in section IV.V (*Combining the compliance function with other functions*), in any case.

IV.V. Combining the Compliance Function with Other Functions

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

MFA Response

Based on the experience of MFA members, the compliance function is often combined with the risk management function. MFA believes that this combination can be beneficial, particularly as such an arrangement is likely to ensure that legal and regulatory risks are taken into account in the overall assessment of the investment firm's risk profile and the adequacy of measures to

manage and mitigate the risks to the business. As noted above, the compliance function is also often combined with the legal unit.

MFA agrees that the compliance function should not be combined with internal audit function. However, as a matter of general principle, an investment firm should have the discretion to decide which combinations would be appropriate in view of its business and organizational structure.

Investment firms are under a general obligation to record and mitigate any conflicts of interest which may be created as a result of such combination under Articles 13(3) and 18 of MiFID and Articles 21 and 22 of the MiFID Implementing Directive. As such, investment firms should not be required to undertake a separate formal exercise to document their assessment as to why a particular combination is beneficial or to provide reasons why certain functions may overlap.

IV.VI. Outsourcing of the Compliance Function

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

MFA Response

MFA believes that using outsourced compliance resources can be beneficial to investment firms in a number of circumstances, particularly where the operations of the investment firm are small. As such, MFA believes that investment firms should be able to take account of outsourced compliance resources when establishing whether the compliance function is effective in line with ESMA's guidelines on organizational requirements of the compliance function (under Part IV.I of the Consultation Paper).

Many EU-based MFA members use compliance consultants to provide ongoing or *ad hoc* advice and support with carrying out the compliance function. MFA members typically use compliance consultants to provide the following types of services (including any combination thereof):

- (a) *ad hoc* advice and updates on regulatory developments;
- (b) project-based assistance (e.g. reviews and updates of policies and procedures; help with preparation for a regulatory visit; regulatory advice on changes to the business or risk profile);
- (c) provision of compliance training; and
- (d) independent audits of compliance (e.g. on an annual basis).

It would be helpful if ESMA could clarify the circumstances in which external compliance advice and assistance would amount to an “outsourced” compliance function within the meaning of Article 14 of the MiFID Implementing Directive. It would appear, for example, that in the above examples of compliance services, the compliance consultants simply act in an advisory

role, much in the same way as external legal advisers or accountants; thus, such services do not amount to outsourcing.

V. GUIDELINES ON COMPETENT AUTHORITY REVIEW OF THE COMPLIANCE FUNCTION

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

MFA Response

See our response to Question 5 above under “Professional qualifications and expertise”.

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

MFA Response

MFA has no comments on this guideline.