

# MiFID II

**Compliance function and complaints handling**

December 2016

## Key Points

- Under MiFID II, the MiFID I high-level requirements in relation to the compliance functions of investment firms will be replaced by more detailed rules.
- The rules on complaints handling will also become more detailed and specific.
- The rules will be set out in the MiFID II Delegated Regulation.

## The compliance function

### *The compliance function under MiFID I*

Under the MiFID I regime, the compliance function in a regulated firm has a specific role, which is set out in several high-level statements. Article 13(2) of the MiFID I Directive states that:

*“An investment firm shall establish adequate policies and procedures sufficient to ensure compliance of the firm, including its managers, employees and tied agents with its obligations under this Directive as well as appropriate rules governing personal transactions by such persons.”*

This MiFID I obligation for an investment firm to have adequate policies and procedures to ensure compliance is carried forward in identical terms in MiFID II.<sup>1</sup>

The high-level statement in the MiFID I Directive is supplemented by the MiFID Implementing Directive, which sets out the role of the compliance function in ensuring the compliance of the firm with its MiFID obligations. The provisions in the MiFID Implementing Directive are intended to ensure that the compliance function monitors policies and procedures within the firm, advises relevant persons in the firm, has the necessary authority, resources, experience, and access to information, is not involved in the services that it monitors, and is able to function objectively.<sup>2</sup>

This is subject to the principle of proportionality, namely that the compliance function should be appropriate to the:

- nature, scale and complexity of the business; and
- nature and range of its services and activities.

Following the implementation of MiFID I, ESMA proposed guidelines to reinforce the role of the compliance function<sup>3</sup>. By issuing these guidelines, ESMA intended to supplement the high-level principles in MiFID I with more concrete examples of best practice. These guidelines have been used as the basis for new requirements under MiFID II.

### *ESMA proposals for the compliance function under MiFID II*

ESMA provided Technical Advice to the European Commission on the MiFID II regime in relation to the requirements for compliance functions. It recommended that firms should ensure that the compliance function:

- carries out a compliance risk assessment;
- adopts a risk-based approach when establishing its monitoring programme;
- establishes a permanent risk-based monitoring programme that takes into consideration all areas of the firm’s investment services, activities and any relevant ancillary services;
- sends regular (at least annual) compliance reports to the firm’s management body, on the implementation and effectiveness of the overall control environment for investment services and activities, on the risks that have been identified, and on complaints handling reporting;
- has its compliance officer appointed and replaced by the management body or, if applicable, the supervisory function;
- reports directly to the management body whenever a significant compliance risk is detected, e.g. a significant risk of failure to comply with MiFID;
- should perform tasks on a permanent basis; and
- should have oversight of the complaints process, and should consider complaints to

<sup>1</sup> Article 16(2), MiFID II Directive..

<sup>2</sup> Article 6, MiFID Implementing Directive.

<sup>3</sup> ESMA, Final report: Guidelines on certain aspects of the MiFID compliance function requirements, 6 July 2012, ESMA/2012/388.

be a source of information for its monitoring responsibilities.<sup>4</sup>

ESMA integrated these new requirements for the compliance function into its Technical Advice alongside the existing provisions of the MiFID Implementing Directive as described above.

ESMA's final report also clarified the meaning of the new requirement that firm maintain a "permanent" compliance function. According to ESMA, this implies that firms should arrange for the role of compliance officer to be covered during his or her absence, and ensure that the responsibilities of the compliance function are performed on an ongoing basis.<sup>5</sup>

### *The MiFID II Delegated Regulation*

The European Commission published its draft MiFID II Delegated Regulation on 25 April 2014.<sup>6</sup> Article 22 of the Delegated Regulation requires firms to:

- establish, implement and maintain adequate policies and procedures designed to detect any risk of failure by the firm to comply with its obligations under the MiFID II Directive, as well as the associated risks;
- put in place adequate measures and procedures designed to minimise such risk; and
- enable the competent authorities to exercise their powers effectively under the MiFID II Directive.

The requirement in Article 22 is intended to be proportionate. Investment firms are required to take into account the nature, scale and complexity of the business of the firm, and the nature and range of its investment services and activities. Recital 37 of the Delegated Regulation provides some additional guidance on the proportionality of the rules on the compliance function. The Recital explains that:

- even if the risk management and compliance functions are performed by the same person, this does not necessarily prevent each function from functioning independently;
- it may not be proportionate for a small investment firm to ban persons involved in the compliance function from also performing the functions that they monitor;
- however, this would only be disproportionate for larger firms in exceptional circumstances.

In line with the Technical Advice proposed by ESMA, the Delegated Regulation requires firms to establish and maintain a permanent and effective compliance function which operates independently, and which has the following responsibilities:

- to monitor the adequacy and effectiveness of its measures, policies and procedures;
- to advise the relevant persons responsible for carrying out investment services and activities to comply with the firm's obligations under the MiFID II Directive;
- to provide a report to the management body, on at least an annual basis, on the implementation and effectiveness of the overall control environment for investment services and activities, on the risks that have been identified and on the complaints-handling reporting as well as remedies undertaken or to be undertaken;
- to monitor the operations of the complaints-handling process and consider complaints as a source of relevant information.

In addition, in order to enable the compliance function to discharge its responsibilities properly and independently, investment firms are required by the MiFID II Delegated Regulation to ensure that the following conditions are satisfied:

- the compliance function has the necessary authority, resources, expertise and access to relevant information;
- a compliance officer is appointed and replaced by the management body and is responsible for the compliance function and for any reporting as to compliance;
- the compliance function reports on an ad-hoc basis directly to the management body

<sup>4</sup> ESMA, Final Report: Technical Advice to the Commission on MiFID II and MiFIR, 19 December 2014 (ESMA/2014/1569) (the "**Technical Advice**"), Chapter 2.3. See also ESMA, Consultation Paper, 22 May 2014, Chapter 2.3.

<sup>5</sup> ESMA, Technical Advice, 19 December 2014, Chapter 2.3

<sup>6</sup> Commission Delegated Regulation (EU) 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 (the "**MiFID II Directive**").

where it detects a significant risk of failure by the firm to comply with its MiFID II obligations;

- the relevant persons involved in the compliance function are not involved in the performance of services or activities which they monitor;
- the method of determining the remuneration of the relevant persons involved in the compliance function does not compromise their objectivity and is not likely to do so.

## Complaints handling

### *Complaints handling in MiFID I*

Under the MiFID Implementing Directive, firms are required to have procedures for the effective handling and recording of complaints from their customers. Specifically, firms must:

- have effective and transparent procedures for the reasonable and prompt handling of complaints received from retail clients, including potential retail clients; and
- keep a record of each complaint and the measures taken for its resolution.<sup>7</sup>

### *Complaints handling in MiFID II*

Under MiFID II, this provision will be replaced by more detailed requirements in the MiFID II implementing measures. ESMA proposed that the G20 high-level principles on financial consumer protection and the joint ESMA/EBA consultation on complaints handling<sup>8</sup> should be treated as the basis for the implementing measures.<sup>9</sup>

ESMA emphasised that under MiFID II, the complaints handling requirements should apply to all clients, including professional clients, regardless of whether they are per se or elective professional clients. ESMA further reiterated that the requirements will apply to potential clients of firms, noting that the complaints guidelines define a complaint as a statement of dissatisfaction addressed to a firm by a client or a potential client relating to the provision of investment services. ESMA believes that this

concept can prove useful in the application of the proposed requirements.<sup>10</sup>

Article 26 of the MiFID II Delegated Regulation states that:

- Firms should establish and maintain a complaints management policy. This should have clear, accurate and up-to-date information on the firm's complaints handling process, and should be endorsed by the firm's management body.
- Firms should publish details of the process to be followed when handling a complaint, which should be provided on request or when acknowledging a complaint.
- Clients, and potential clients, should be able to submit complaints free of charge.
- Firms should have a complaints management function that enables complaints to be investigated. This role may be carried out by the compliance function.
- Firms should communicate to clients in plain language that is clearly understood and provide a response to the complaint without any unnecessary delay.
- Firms should explain to clients and potential clients the firm's position on the complaint and set out the client's options, where relevant, to refer to an alternative dispute resolution ("ADR") entity, or for the client to take civil action.
- Firms should provide information on complaints and complaints handling to the relevant national competent authority ("NCA") or ADR entity.
- Firm's compliance functions should analyse complaints and complaints handling data to ensure that they identify and address any issues.

## Timescales for implementation

The MiFID II Directive came into force on 3 July 2014, and most of its provisions will come into effect in member states from 3 January 2018. Member states have until 3 July 2017 to transpose the MiFID II Directive into national law.

The relevant sections in the MiFID Implementing Directive will be replaced by

<sup>7</sup> Article 10, MiFID Implementing Directive.  
<sup>8</sup> ESMA/EBA Consultation Paper on draft guidelines for complaints handling (6 November 2013) JC-CP-2013.  
<sup>9</sup> ESMA, Consultation Paper, 22 May 2014, Chapter 2.4.

<sup>10</sup> ESMA, Technical Advice, 19 December 2014, Chapter 2.4. See Recital 38, MiFID II Delegated Regulation.

provisions in the MiFID II Delegated Regulation which will become effective from 3 January 2018. The MiFID II Delegated Regulation will have direct effect and the member states will not need to implement these changes into national law.

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