ΕΠΙΤΡΟΠΗ ΚΕΦΑΛΑΙΑΓΟΡΑΣ ΚΥΠΡΟΥ
CYPRUS SECURITIES AND EXCHANGE COMMISSION

TO : **Regulated Entities**
i. Cyprus Investment Firms
ii. Management Companies[1]

FROM : **Cyprus Securities and Exchange Commission**

DATE : **7 April 2021**

CIRCULAR No. : **C441**

SUBJECT : **Common deficiencies and good practices identified through desk-based reviews regarding certain aspects of the compliance function requirements of the Investment Services and Activities and Regulated Markets Law ('the Law')**

The Cyprus Securities and Exchange Commission ("CySEC") has recently carried out a review of the compliance of the Regulated Entities with the compliance function requirements ("the Review") pursuant to Article 17(2) of the Law.

The Review identified that certain good practices have been implemented. It has also uncovered common deficiencies and/or omissions that CySEC wishes to highlight to all Regulated Entities, aimed at helping them to increase the effectiveness of their compliance function, despite the fact that the Review covered only a sample of them.

The circular sets out CySEC' s key findings and invites all Regulated Entities to consider whether they comply with their obligations as per Article 17(2) of the Law, and, where appropriate, to take corrective measures.

A. Regulatory framework

1. The applicable regulatory framework with regard to the Review is provided below:

   i. Article 17(2) of the Law (for Cyprus Investment Firms).

[1] AIFMs when providing services pursuant to section 6(6) of Law 56(I)/20013, as in force and UCITS Management companies when providing services pursuant to section 109(4) of Law 78(I)/2012, as in force.

ii. Article 22 of the Delegated Regulation (EU) 2017/565 as regards organisational requirements and operating conditions for investment firms (the "Regulation").
iii. Paragraphs 11(6)-(7) of CySEC Directive DI87-01.
iv. ESMA Guidelines on certain aspects of the MiFID compliance function dated 6 July 2012 (ESMA/2012/388).

2. CySEC Circular C030 on certain aspects of the compliance function requirements is also relevant.

B. Areas of concern/ Weaknesses identified

I. <u>Risk Assessment, Monitoring Activities and Compliance Programme (Article 22 of the Regulation)</u>

3. Regulated Entities shall ensure that the compliance function follows a risk-based approach in monitoring the policies and procedures established by the Regulated Entities. The focus and the scope of compliance monitoring and advisory activities should be defined in the risk assessment.

   In doing so, the compliance function should identify the scope of the CIF's compliance risk, taking into consideration the investment services and activities and ancillary services provided by the CIF as well as the types of financial instruments traded and distributed, taken into account also the information resulting from the monitoring of the CIF's complaints-handling process.

   The risk assessment forms the basis for the objectives of the monitoring activities/ programme of the compliance function. Appropriate sources, methodologies and tools should be used for the necessary monitoring activities.

In relation to the aforementioned, the following weaknesses were identified:

1. In general, Regulated Entities took into consideration the severity of risks (i.e. the level of potential impact/ damage that could be caused), however, in some cases, they did not specify or determine the potential impact, e.g. financial, reputational, regulatory risk, etc. or even in some cases the risk rating was not defined/specified and/or the identification of the risks was vague.

2. Even though the determination for the annual compliance monitoring programme should be focused on the evaluation of the compliance risks and Regulated Entities provided a compliance monitoring program that included areas and frequency of their monitoring tools and methodologies, in some cases the annual compliance monitoring programme was not based on the results of the risk analysis.

3. Furthermore, in some cases it was not mentioned in the risk assessment analysis that the types of financial instruments offered and distributed were taken into account by the Regulated Entities when determining their risk assessment.

4. Additionally, CySEC observed that there have been instances where the identification of risks and the monitoring priorities of the compliance function were vaguely determined without specifying the monitoring methodologies/tools for each compliance risk and the frequency of targeted assessments and monitoring activities were thus not justifiable.

5. It was also observed that the compliance function omitted to ensure that regular written compliance reports are prepared at appropriate intervals (e.g. quarterly reports) and sent to the management board. For example, in cases of core compliance areas (i.e. higher risks areas) that require daily or monthly reviews, disclosures of identified deficiencies, breaches, significant findings and/or remedial measures undertaken by the compliance function were only mentioned in the Annual Compliance report without reference as to whether any other regular/ad hoc written reports were brought to the attention of the management board.

   In CySEC's view, the management board should convene regular meetings where the compliance function can properly present material deviations or situations requiring urgent resolution in order to rectify any urgent compliance matters and the compliance function should properly record such meetings.

6. In particular to the management reports, some Regulated Entities indicated that the compliance officer only prepares the annual compliance report and any additional compliance matters are communicated via email to the senior management without specifying if these are properly recorded in a log or taking into account the need of producing additional written reports to the senior management.

7. Even though, the risk assessment should also take into account the results of previous monitoring activities by the compliance function and any relevant findings of internal

or external audits, this should not form the basis for the objectives and priorities of the compliance function's monitoring programme.

II. Reporting Obligation (Article 22 (2)(c) and (3) (b) of the Regulation)

The compliance officer shall report to the management body at least once a year.

Such report(s) should contain a description of the implementation and effectiveness of the general control measures as well as an overview of the identified risks and the necessary measures that have been taken or are intended to be taken (i.e. proposals for necessary remedial measures and the timeframe for their implementation).

1. As a general comment, even though Regulated Entities stated that compliance officers conduct interviews, thematic and desk-based reviews, the annual compliance report mainly focuses on findings from the evaluation of the Regulated Entities' written policies and procedures. Specifically, such evaluations mainly focus on the determination on whether the firms' policies are up-to-date and in compliance with the regulatory framework rather than including findings on the implementation of those policies by all employees in practice.

2. Furthermore, the different types of reviews conducted by the compliance function should be more accurately reflected in the Annual Report, for example by including a table with details such as the date and type of the assessment, the subject of the assessment, if it was on a sample basis or following a wrongful act by an employee, to which department or staff of the company was the audit focused, etc.

3. With regard to the product governance monitoring obligation, it is noted that while most CIFs report in the Annual Compliance Report that the CIF's requirements have been assessed, no further findings or comments were made. In particular, in some cases no positive /negative market findings were made in the report even though the in the target market assessment the compliance officer states that improvement is needed.

4. Furthermore, in some cases the Annual Compliance Report did not include information on the measures taken or to be taken to address the deficiencies that were found or include timeframes for the completion of any such measures.

III. Advisory obligations of the compliance function (Articles 22(2)(b) and 27(3) of Delegated Regulation)

Regulated Entities shall ensure that the compliance function fulfils its advisory responsibilities including: providing support for staff training, day-to-day assistance for staff and participating in the drawing up of new policies and procedures within the firm.

1. It is noted that in some cases even though it is stated in the Annual Compliance Report that staff knowledge assessments are carried out, not enough evidence or details of regular internal and external training is provided such as records of training logs.

C. Good Practices identified

With regard to good practices, the following practices were observed:

1. Formal meetings of the senior management were held on a quarterly basis, with the physical presence of all members and the compliance officer in attendance, thus safeguarding the consistency of the board's decisions with the relevant legislative framework.

2. More specifically, minutes of such quarterly meeting were kept with a brief description of the issues discussed, a brief reference to the important views/suggestions expressed, as well as a satisfactory description of the handling/decision/suggestions put forward. Therefore, having the work of the senior management duly documented in writing (e.g. either in the form of minutes or board resolutions) is considered as a step in the right direction indicating the intention of the senior management in encouraging the promotion of a compliance culture with all staff involved and the establishment of a robust corporate governance structure.

3. Another good practice that was observed was the preparation of quarterly reports for core compliance areas such as the monitoring of the Regulated Entity's post trading reporting obligation for the senior management's attention. This will assist the Regulated Entity to properly record the findings of targeted reviews and to properly monitor any remedial actions or measures needed, as well as for the senior management to keep trace of such work made by the compliance officer.

4. Furthermore, with regard to the requirement to establish a robust corporate governance, a good practice was the inclusion of the review conducted on the order

of board meetings in the Annual Compliance Report. For example by evaluating and documenting that meetings were properly summoned and that the agenda and the right materials are sent to the senior management beforehand, as well as an evaluation on the interaction of the senior management with the compliance officer.

5. Moreover, another good practice that was observed during the Review was the inclusion of the extent and frequency of training to staff in the Annual Compliance Report and documenting/justifying why trainings should be tailored on each department's needs and activities. Also including a training log in the Annual Compliance report is noted as a good practice.

6. The inclusion of a communication log in the Annual Compliance Report listing the communication with CySEC was observed as good practice, as it will assist the compliance function to monitor and keep trace with important regulatory issues.

D. Next Steps

All Regulated Entities should consider the issues raised in this circular against their policies and arrangements in place in relation to the compliance with the compliance function requirements. If, when reviewing the policies and arrangements in place, Regulated Entities identify any weaknesses - they must take immediate actions to ensure compliance. In the context of its ongoing supervision monitoring and given the above key findings, CySEC will continue assessing the Regulated Entities' policies and arrangements relating to the compliance function requirements and will consider, if deemed necessary, taking further actions (e.g. enforcement actions).

Yours sincerely,

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