
TO : **Cyprus Investment Firms**
UCITS Management Companies (UCITS)¹
Alternative Investment Fund Managers (AIFMs)²

FROM : **Cyprus Securities and Exchange Commission**

DATE : **March 14, 2023**

CIRCULAR NO. : **C553**

SUBJECT : **Guidelines on certain aspects of the compliance function requirements**

The Cyprus Securities and Exchange Commission ('the **CySEC**') wishes herein to provide guidance on the application of certain aspects of the compliance function requirements provided in article 17(2) of the Investment Services and Activities and Regulated Markets Law ('the Law') and Article 22 of the MiFID II Delegated Regulation 2017/565, in order to ensure the common, uniform and consistent application of these legal requirements.

PART I - INTRODUCTION

1. The guidance provided in Part II covers the following aspects of the compliance function:

A. Responsibilities of the compliance function

Guideline 1: Compliance risk assessment

Guideline 2: Monitoring obligations of the compliance function

Guideline 3: Reporting obligations of the compliance function

Guideline 4: Advisory and assistance obligations of the compliance function

B. Organisational requirements of the compliance function

Guideline 5: Effectiveness of the compliance function

Guideline 6: Skills, knowledge, expertise and authority of the compliance function

Guideline 7: Permanence of the compliance function

Guideline 8: Independence of the compliance function

¹ Management companies when providing services pursuant to section 109(4) of Law 78(I)/2012, as in force (the 'UCITS Law').

² AIFMs when providing services pursuant to section 6(6) of Law 56(I)/20013, as in force (the 'AIFM Law').

Guideline 9: Proportionality with regard to the effectiveness of the compliance function

Guideline 10: Combining the compliance function with other internal control functions

Guideline 11: Outsourcing of the compliance function

C. Competent authority review of the compliance function

Guideline 12: Review of the compliance function by the competent authorities

2. The guidance does not reflect absolute obligations. For this reason, the word 'should' is often used. However, the words 'must' or 'are required' are used when describing a requirement of the Law.
3. Terms and abbreviations used in this circular are defined in Annex 1. Terms used in these guidelines that are not interpreted differently shall have the meaning given to them by the Law.
4. This circular should be read with circular [C447](#). Circulars [C030](#) and [C050](#) are repealed and replaced by this circular.

PART II - GUIDELINES ON CERTAIN ASPECTS OF THE COMPLIANCE FUNCTION REQUIREMENTS OF THE LAW

1. As part of its responsibility for ensuring that the Investment Firm complies with its obligations under the Law, the board of directors must ensure that the compliance function fulfils the requirements set out in Article 22 of the Regulation.

A. Responsibilities of the compliance function

Guideline 1 - Compliance risk assessment

[relevant legislation: (paragraph 1 and second subparagraph of paragraph (2) of Article 22 of the MiFID II Delegated Regulation]

2. 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.
3. 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.

4. In identifying the level of compliance risk the Investment 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 Investment Firm³. This should include the types of financial instruments traded and distributed, the categories of the Investment Firm's clients, the distribution channels and, where relevant, the internal organisation of the group.
5. The compliance risk assessment should consider the applicable obligations under the Law, national implementing rules and the policies, procedures, systems and controls implemented within the Investment 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.
6. 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 Investment Firm's structure or in the applicable regulatory framework).

Guideline 2 - Monitoring obligations of the compliance function

[relevant legislation: Point (a) and second subparagraph of paragraph (2) of Article 22 of the MiFID II Delegated Regulation]

7. The aim of the risk-based monitoring programme should be to evaluate whether the Investment Firm's business is conducted in compliance with its obligations under the Law, 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.
8. Where an Investment Firm is part of a group, responsibility for the compliance function rests with each firm in that group. An Investment Firm should therefore ensure that its compliance function remains responsible for monitoring its own compliance risk. This includes where an Investment 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.
9. 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

³ Including cross border activities.

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.

- 10.** 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 the Investment Firm's clients;
- 11.** The monitoring programme should reflect changes to the Investment 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 Investment Firm in response to breaches of the Law, related to MiFID II delegated or implementing acts and/or any national implementing provisions.
- 12.** Monitoring activities performed by the compliance function should also take into account:
 - a. the business area's obligation to comply with regulatory requirements, including additional regulatory requirements applicable from other national competent authorities (in case of cross border activities);
 - b. the first level of controls in the Investment 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.
- 13.** Reviews by control functions should be coordinated with the monitoring activities performed by the compliance function while respecting the different functions' independence and mandate.
- 14.** 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, Investment Firms should grant the compliance function access to all customer complaints received by the Investment Firm.

15. The compliance function ensures that all employees fall under the Directive regarding the Certification of Persons and the Certification Registers of 2019 to 2021 (R.A.D. 477/2021), hold the relevant certificate and are registered in the public register as required by the abovementioned Directive, or if they are not registered that they have been granted, by CySEC, a period of time to do so.
16. In addition, the compliance function ensures that the content of the CIF Record (information reported through CySEC portal) is complete and accurate and where amendments are required, that these are done immediately.

Guideline 3 - Reporting obligations of the compliance function

[relevant legislation: Section 17(2) of the Law, 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 11 and paragraphs (6) and (8) of Article 12 of the Directive DI87-01]

17. The mandatory compliance report 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 is a suitable tool to warrant the necessary management attention. The mandatory compliance report should cover all business units involved in the provision of investment services, activities and ancillary services provided by the Investment Firm. Where the report does not cover all of these activities and services of the Investment Firm, it should clearly state the reasons.
18. The mandatory compliance report should, inter alia, contain information on the following matters, where relevant:
 - a. General information:
 - information on the adequacy and effectiveness of the Investment Firm's policies and procedures designed to ensure that the Investment Firm and its staff comply with the obligations under the Law;
 - 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 the Law⁴ and how possible risks of failure by the

⁴ It is expected that the report will include a brief description of the priorities set for the year under review, the tools and methodologies used (including those used for the monitoring of cross border

Investment 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 for the subsequent review;

c. Findings

- a summary of major findings of the review of the policies and procedures, and risks identified in the scope of the compliance function's monitoring activities⁵;
- breaches and deficiencies in the Investment 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 Investment 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 Investment Firm or its staff to comply with the obligations under the Law;
- 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 Investment 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 CySEC and/or other competent authorities;
- information as regards any deviation by senior management from important recommendations or assessments issued by the compliance function;

activities, the firm's website in all foreign languages, the marketing communications/materials, social media, news, the communication with clients) and the extent and frequency of monitoring activities.

⁵ including major findings and risks related to cross border activities (e.g. risks emanating from the Investment Firms' marketing communications in a different language).

- 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 an Investment Firm makes use of the exemption to avoid appointing a compliance officer whose sole responsibility within the Investment Firm is the compliance function, assessment of the continuing appropriateness of the arrangements to minimize conflicts of interest.

19. In the section of the annual report covering the Investment Firm's product governance arrangements, the compliance function should also address, where relevant to the situation of the Investment 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 Investment Firm's product governance policies and procedures;
- b. all topics required under Article 22(2) MiFID II Delegated Regulation, regarding the monitoring of the Investment 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 Investment Firm, including information on the distribution strategy according to paragraphs 11(6) and 12(8) of Directive DI87-01, 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 Investment 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 Investment 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 Investment Firm's function or personnel working on product governance arrangements. According to the proportionality principle, when reporting, for example, on

the Investment 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.

20. Subject to the proportionality principle, Investment Firms should favour an organisation where the compliance function and the complaints management function are properly separated. Where the Investment 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 Investment 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 Investment Firm's compliance with its complaints handling obligations.
21. The compliance function should consider the need for additional reporting lines to any group compliance function.
22. Investment Firms should submit to CySEC the annual reports mentioned in article 25 of MiFID II Delegated Regulation within twenty days from the date the reports are discussed in the board of directors and not later than four months from the end of the calendar year. The board of directors should also provide CySEC with its explanations of the compliance function's findings (e.g. corrective measures to be taken with respect to the deficiencies mentioned in the report, as well as a timetable for their implementation).
23. The annual report, is a standalone document and cannot be part of another report that the Investment Firm is obliged to prepare (e.g. Anti-money laundering compliance function report).

Guideline 4 - Advisory and assistance obligations of the compliance function

[relevant legislation: Articles 22(2)(b) and 27(3) of the MiFID II Delegated Regulation]

24. Investment 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 Investment Firm (e.g. the Investment Firm's remuneration policy or the Investment Firm's product governance policies and procedures).
25. Investment Firms should promote and enhance a 'compliance culture' throughout the Investment 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.

- 26.** The Investment Firm needs to ensure that its staff is adequately trained⁶. 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 Investment Firm and its organisational structure in the area of investment services and activities; and
 - b. the Law, related to MiFID II delegated and implementing acts, national implementing provisions, 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.
- 27.** 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 Investment Firm’s entire staff as a whole, to specific business units, or to a particular individual.
- 28.** 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 Investment Firm’s business model).
- 29.** 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 Investment Firm’s policies and procedures.
- 30.** 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.
- 31.** Investment Firms should ensure that the compliance function is involved in the development of the relevant policies and procedures within the Investment Firm in the area of investment services, activities and ancillary services (for example the Investment Firm’s remuneration policy or the Investment 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

⁶ See [Guidelines for the assessment of knowledge and competence](#);

function should document this accordingly and present it in its compliance reports (possibly as ad-hoc reports, where necessary).

32. Investment Firms should ensure that the compliance function is involved in all significant modifications of the organisation of the Investment 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. The senior management should therefore request business units to consult with the compliance function in due time regarding their operations, where relevant.
33. Investment Firms should ensure that the compliance function is involved in all material non-routine correspondence with the competent authorities in the area of investment services and activities.

B. Organisational requirements of the compliance function

Guideline 5 - Effectiveness of the compliance function

[relevant legislation: Articles 21(1)(d) and 22(3)(a) of the MiFID II Delegated Regulation]

34. When ensuring that appropriate human and other resources are allocated to the compliance function, Investment Firms should take into account the scale and types of investment services, activities and ancillary services undertaken by the Investment Firm.
35. 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/performed by the Investment Firm. Where an Investment Firm's business unit activities are significantly extended (e.g. establishment of branches, use of affiliates, cross border activities), the Investment Firm should ensure that the compliance function is similarly extended as necessary in view of changes to the Investment 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.
36. In addition to human resources, sufficient IT resources should be allocated to the compliance function.
37. Where the Investment 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.

- 38.** In ensuring compliance staff have access to the relevant information for their tasks at all times, Investment 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 Investment Firm where sensitive or relevant information might arise, the compliance officer should have access to all relevant information systems within the Investment Firm as well as any internal or external audit reports or other reporting to senior management or board of directors, if any. Where relevant, the compliance officer should also be able to attend meetings of the senior management or the board of directors. 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 Investment Firm's organisation, corporate culture and decision-making processes in order to be able to identify which meetings are important to attend.
- 39.** In particular, it is important that the Investment 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 6 - Guideline on the skills, knowledge, expertise and authority of the compliance function

[relevant legislation: Articles 21(1)(d) and paragraphs (a) and (b) of 22(3) of the MiFID II Delegated Regulation]

- 40.** Investment Firms' 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 Investment 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.
- 41.** In order to ensure that the compliance function has the authority required for its duties, the senior management 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 Investment Firm's compliance policy explicitly acknowledging the specific authority of the compliance function.

42. Within the compliance function there should at least be knowledge of the Law and all related to MiFID II delegated and implementing acts and national implementing provisions 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.
43. 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. Senior management/board of directors assesses the prospective compliance officer's qualifications before appointment, ensures that he/she has integrity, morals and credibility, as well as ensures that the compliance officer is a holder of the CySEC's advance certificate and registered in the public register as required by paragraph 5(6) of the Directive regarding the Certification of Persons and the Certification Registers of 2019 to 2021 (R.A.D. 477/2021). Whether the Investment Firm properly complies with the requirements in Article 21(1)(d) and paragraphs (a) and (b) of Article 22(3) of the MiFID II Delegated Regulation is then assessed within the general review of the firm's compliance with the relevant regulatory requirements. An assessment of the qualifications of the nominated compliance officer is also performed by CySEC during the authorisation process and in the context of ongoing supervision. This assessment may include an analysis of the compliance officer's curriculum vitae, as well as an interview with the nominated person.
44. 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 Investment 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. The professional experience is only taken into consideration if it is not outdated (e.g. it has not been acquired years ago).
45. The compliance officer should have specific knowledge of the different activities provided by the Investment Firm. The relevant expertise required may differ from one firm to another, as the nature of the main compliance risks that Investment Firms face could differ. A newly employed compliance officer may therefore need additional specialised knowledge focused on the specific business model of the Investment Firm even if the person has previously been the compliance officer for another firm.

Guideline 7 - Permanence of the compliance function

[relevant legislation: first subparagraph of Article 22(2) of the MiFID II Delegated Regulation]

46. The first subparagraph of Article 22(2) of the MiFID II Delegated Regulation requires Investment Firms to ensure that the compliance function performs its tasks and responsibilities on a permanent basis. Investment 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.
47. The Investment 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.
48. 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 Investment 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.
49. 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 Investment 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 8 - Independence of the compliance function

[relevant legislation: points (b), (d) and (e) of Article 22(3) of the MiFID II Delegated Regulation]

50. Investment 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.
51. 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 Investment Firm. In particular, the Investment 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.

52. 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, and if deemed necessary, inform CySEC the soonest possible.

Guideline 9 - Proportionality with regard to the effectiveness of the compliance function

[relevant legislation: Article 22(4) of the MiFID II Delegated Regulation]

53. Investment 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 Investment Firm's particular circumstances.

54. 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 Investment 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 Investment 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 Investment 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 Investment Firm (professional, retail, eligible counterparties);
- f. staff headcount;
- g. whether the Investment Firm is part of a group within the meaning of section 2(1) of the Companies Law;
- h. services provided through a commercial network, such as tied agents, or branches;
- i. cross-border activities provided by the Investment Firm; and
- j. organisation and sophistication of the IT systems.

55. The abovementioned criteria should be also taken into account when determining whether the Investment Firm may benefit from the proportionality exemption under Article 22(4) of the MiFID II Delegated Regulation.

56. The Investment Firm may fall, 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 Investment Firm's business, and the nature and range of the investment services, activities and ancillary services offered.
57. While a compliance officer must always be appointed, it may be disproportionate for some Investment Firms, depending on the circumstances (for instance, small Investment 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 an Investment 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.
58. An Investment 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, an Investment Firm with more complex activities or greater size should avoid such combination if it could undermine the compliance function's effectiveness.
59. Where an Investment Firm makes use of the proportionality exemption, it should record how this is justified, so that the CySEC is able to assess this.

Guideline 10 - Combining the compliance function with other internal control functions

[relevant legislation: Article 22(3)(d) of the MiFID II Delegated Regulation]

60. An Investment 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 the CySEC is 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.
61. 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.

62. 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.
63. 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.
64. Where the compliance officer is not appointed as the single officer referred to in article 9 of Directive DI87-01, both the officer referred to in article 9 of Directive DI87-01 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 9 of the Directive DI87-01.
65. Where the compliance function is combined with other control functions as specified in paragraph 60 or where it is also responsible for other tasks (for example anti-money laundering), the Investment Firm should ensure that it allocates enough resources for compliance with the Law at all times.

Guideline 11 - Outsourcing of the compliance function

[relevant legislation: Articles 22 and 31 of the MiFID II Delegated Regulation]

66. Investment 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.
67. The outsourcing requirements for critical or important functions set out in section 17(5) of the Law and 31 of the MiFID II Delegated Regulation apply in full to the outsourcing of the compliance function.
68. Investment Firms can only outsource tasks, but not responsibilities: Investment 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 Investment Firm initiating the outsourcing.
69. The Investment 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 Investment 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.

- 70.** Investment 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.
- 71.** Investment 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.
- 72.** 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.
- 73.** In compliance with the proportionality principle set out in Article 22(4) of the MiFID II Delegated Regulation, if an Investment 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.
- 74.** 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 Investment Firm and the Commission to supervise compliance with the applicable requirements.
- 75.** 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.
- 76.** In case the outsourcing arrangement related to the compliance function is terminated, Investment Firms should ensure the continuity of the compliance function either by transferring it back to the firm or outsourcing it to another provider.

C. Competent authority review of the compliance function

Guideline 12 – Review of the compliance function by the competent authorities

[relevant legislation: Section 7 of the Law and Article 22 of the MiFID II Delegated Regulation]

77. CySEC reviews how Investment Firms plan to meet, implement and maintain the applicable compliance function requirements. This applies in the context of the authorisation process, as well as, following a risk-based approach, in the course of ongoing supervision.
78. Article 7 of the Law states that *«The Commission shall not grant a CIF authorisation unless and until such time as it is fully satisfied that the company that has been established in the Republic and is applying for a CIF authorisation, complies with all the requirements provided for in this Law, the directives issued pursuant to this Law and the acts issued pursuant to Directive 2014/65/EU»*.

Accordingly, the CySEC assesses whether an Investment Firm's compliance function is adequately resourced and organised and whether adequate reporting lines have been established. It requires, as a condition for authorisation that any necessary amendments to the compliance function are notified to CySEC.

79. Additionally, as part of the ongoing supervisory process, the CySEC – following a risk-based approach – assesses whether the measures implemented by the Investment Firm for the compliance function are adequate, and whether the compliance function fulfils its responsibilities appropriately. Investment 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 Investment Firm. The CySEC also, as part of its ongoing supervision and following a risk-based approach, assesses and monitors - where and if appropriate - whether such amendments are necessary and have been implemented. The CySEC provides a reasonable timeframe for the Investment Firm to make amendments.
80. The compliance function must immediately disclose to the CySEC every important development that may substantially affect his ability to effectively perform the compliance function and to fulfill its responsibilities appropriately.
81. As mentioned under paragraph 43 above, the CySEC performs an assessment of the qualifications of the compliance officer and interviews the nominated person during the authorisation process and in the context of ongoing supervision. The nominated compliance officer must be a holder of the CySEC's advance certificate and registered in the public register as required by the paragraph 5(6) of the Directive regarding the Certification of Persons and the Certification Registers of 2019 to 2021 (R.A.D. 477/2021). By way of derogation,

a person may be nominated as compliance officer, even if not registered in the public register provided that, following an assessment of his qualifications, CySEC is satisfied that the person has the relevant knowledge and expertise to perform such duties and he will succeed in the advanced examination and be registered in the public register within a determined time period decided by CySEC.

- 82.** In addition, as mentioned under paragraph 43 above, senior management assesses the compliance officer's qualification. Investment Firms should notify the CySEC of the appointment and replacement of the compliance officer. The CySEC may require a detailed statement on the grounds for the replacement.

DEFINITIONS AND ABBREVIATIONS

«*AIFM Law*» means the Alternative Investment Fund Managers Laws of 2013 (L.56(I) of 2013), as amended.

«*board of directors*» means the board of directors as defined in section 2(1) of the Law.

«*CySEC*» means the Cyprus Securities and Exchange Commission governed by the Cyprus Securities and Exchange Commission Law (L. 73(I)/2009), as amended.

«*Compliance function*» means the function within an Investment Firm responsible for identifying, assessing, advising, monitoring and reporting on the investment firm's compliance risk.

«*Compliance risk*» means the risk that an Investment Firm fails to comply with its obligations under the Law, Regulation and the directives issued pursuant to the Law.

«*Directive DI87-01*» means the Directive for the Safeguarding of Client Assets, Product Governance Obligations and Inducements.

«*ESMA*» means the European Securities and Markets Authority.

«*Investment Firm*» means a Cyprus Investment Firm (CIF), as defined in section 2(1) of the Law, an Alternative Investment Fund Manager, as defined in section 2(1) of the AIFM Law and a Management Company, as defined in section 2(1) of the the UCITS Law.

«*Law*» means the Investment Services and Activities and Regulated Markets Law of 2017 (L. 87(I)/2017), as amended.

«*MIFID II*» means the Directive 2014/65/EU on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU7.

«*MiFID II Delegated Regulation*» means the Commission Delegated Regulation (EU) 2017/565, as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of MiFID II.

«*national implementing provisions*» means the regulatory requirements imposed by member states within their territories for the purposes of MiFID II.

«*senior management*» means the senior management as defined in section 2(1) of the Law.

«*UCITS Law*» means the Open-Ended Undertakings for Collective Investment (UCI) Law of 2012 (L.78(I)/2012), as amended.