
TO : Regulated Entities
i. Cyprus Investment Firms
ii. Management Companies¹

FROM : Cyprus Securities and Exchange Commission

DATE : 24 February 2015

CIRCULAR NO. : C050

SUBJECT : Compliance with the regulatory framework in relation to compliance function

Following the Circular [C1144-2013-23](#) on compliance with the obligations under the legislation for the compliance function and the Circular [C030](#) on certain aspects of the compliance function requirements, the Cyprus Securities and Exchange Commission (the 'CySEC') wishes, with this circular, to remind the Regulated Entities on their obligations in relation to the above subject. In particular:

1. Detecting, recording and assessing compliance risks

The compliance officer for legislation matters ('the Compliance Officer') must, at least at the beginning of each year, detect and record any risk of failure to comply with the obligations under the legislation governing the operations of the Regulated Entity. In this context, the Compliance Officer must identify/assess the level of compliance risk that the Regulated Entity faces [paragraph 5(1) of Directive DI144-2007-01 2012, 'the Directive'].

2. Monitoring the compliance function

- i. Further to point 1 above, the Compliance Officer must develop the objectives and work program of the compliance function for the year under review, as well as establish a monitoring program [paragraphs 5(1) and 5(2)(a) of the Directive].
- ii. The aim of the monitoring program is to evaluate whether the Regulated Entity's operations are conducted in compliance with its obligations under the relevant legislation and whether the organisation/internal guidelines/control measures of the Regulated Entity remain effective and appropriate.

¹ This Circular refers to Management Entity when they provide the investment services of portfolio management to retail clients or of investment advice

iii. The monitoring program:

- takes into account all the services/activities/operations of the Regulated Entity,
- establishes priorities determined by the compliance risk assessment, ensuring that compliance risk is comprehensively monitored,
- determines the frequency of monitoring activities performed by the compliance function, based on the priorities set.

iv. The Compliance Officer applies, during the year under review, the monitoring program drawn up.

3. Compliance function records

- i. The Compliance Officer must record all audits carried out, supported by documentary evidence.
- ii. All relevant documents must be kept in appropriate records, which are available for inspection by the CySEC, whenever it is requested.
- iii. Records must be kept at the headquarters of the Regulated Entity.

4. Compliance Function Report ('the Report')

- i. The Compliance Officer must prepare a Report, at least annually, which it is addressed to the persons who effectively direct the business of the Regulated Entity [paragraph 9 (2) of the Directive].
- ii. The purpose of the Report is to inform the Board of Directors² of the Regulated Entity on the effectiveness and adequacy of policies, procedures and measures put in place in relation to compliance function and on the actions to be taken to address any deficiencies, setting a timetable for their implementation.
- iii. In order to achieve the above, the Report must include in detail, at least, all the aspects of paragraph 26 of Circular E030, as listed and specified further in the Annex attached.
- iv. Where the Report does not cover all the services/activities/operations of the Regulated Entity must clearly state the reasons.
- v. The Report is a standalone document and cannot be part of another report that the Regulated Entity is obliged to prepare (e.g. Anti-money laundering compliance function report).

² It is noted that paragraph 9 of the Directive will be amended in the near future as to the responsibility of senior management.

5. Responsibilities of the Board of Directors

- i. The Board of Directors is ultimately responsible for the failure of the Regulated Entity to comply with the obligations under the legislation governing its operations (paragraph 9 of the Directive).
- ii. The Board of Directors must regularly seek information on matters relating to the compliance function.
- iii. The Board of Directors must:
 - study the Report carefully and seek clarifications on issues raised in it, where necessary,
 - make decisions to improve / rectify the weaknesses identified in the Report and set a timetable for implementing its decisions,
 - oversee and monitor the implementation of its decisions,

6. Responsibilities of the Compliance Officer

- i. The Compliance Officer is also responsible for the compliance function, and for any reports prepared [paragraph 5(3)(b) of the Directive].
- ii. In case of outsourcing the compliance function, the responsibility lies with the service provider (physical person) and in no case the responsibility is limited through the outsourcing agreement.
- iii. The Compliance Officer must immediately disclose to the CySEC every important development that may substantially affect his ability to effectively perform the compliance function, and/or any major weakness identified and for which no corrective measures have been taken by the Board of Directors of the Regulated Entity.

It is noted that the disclosure in good faith to the CySEC does not constitute a breach of any contractual or legal restriction on disclosure of information and does not involve such person in liability of any kind.

7. Effectiveness of the Compliance Function

- i. The Regulated Entity must ensure that the Compliance Officer has sufficiently broad knowledge and experience and a sufficiently high level of expertise for the discharge of the responsibilities allocated to him.
- ii. The Regulated Entity must ensure that the Compliance Officer has the necessary authority to exercise his duties effectively, as well as access to all relevant information.

8. Permanence of the compliance function

- i. The Regulated Entity must ensure that the Compliance Officer performs his tasks and responsibilities on a permanent basis.
- ii. The Regulated Entity must establish adequate arrangements to ensure that the responsibilities of the Compliance Officer are fulfilled when the Compliance Officer is absent. These procedures must be recorded in the internal procedures manual of the Regulated Entity.

9. Submission of the Report to the CySEC

- i. The Regulated Entity must submit to the CySEC the Report and the minutes of the Board of Directors' meeting during which the Report has been discussed within twenty days from the date of the relevant meeting and not later than four months from the end of the calendar year [paragraph 9 (4) of the Directive].

It is provided that the Report submitted to the CySEC is the same with the one discussed at the Board of Directors' meeting.

- ii. The minutes of the Board of Directors' meeting must explicitly state the corrective measures to be taken with respect to the deficiencies mentioned in the Report, as well as a timetable for their implementation.

The CySEC expects that all Regulated Entities fully comprehend the importance of the compliance function and take every possible measure for full and continuous compliance with their obligations emanated by the relevant legislation.

Content of the Compliance Function Report

1. A description of the implementation and effectiveness of the overall environmental control of the services/activities/operations provided/performed by the Regulated Entity.

The overall control environment should illustrate the control mechanisms implemented by the management and departments (first line of defence) and control mechanisms implemented by the compliance function and risk management function (second line of defence).

A reference to the internal procedures manual and/or a general description of the above is not considered sufficient.

2. A description of the monitoring program, which is expected to have sufficient reference to:
 - i. all services/activities/operations provided/performed,
 - ii. priorities set for the year under review,
 - iii. the tools and methodologies used,
 - iv. the extent and frequency of monitoring activities.

A general reference to the tools and methodologies without indicating the specific tools and methodologies is not considered sufficient.

The attachment of the monitoring program in summary form as an appendix to the Report may be a good practice.

3. A summary of:
 - i. all on-site inspections and desk-based reviews carried out by the compliance function,
 - ii. the major findings of the review of the policies and procedures,
 - iii. the breaches and deficiencies identified in the organisation and compliance processes,
 - iv. the appropriate measures taken or to be taken as a result.
4. Risks identified in the scope of the compliance function's monitoring activities, recommendations for minimizing or facing them, and corrective measures taken during the period.

The recommendations and corrective measures taken must relate to each risk. If no corrective measures are taken, the Report must state the reasons.

5. Explicit reference to relevant changes and developments in regulatory/legislative requirements and the measures taken to comply over the period.
6. Other significant compliance issues that have occurred since the last report.
7. Material correspondence with the CySEC and other competent authorities (if the Board of Directors was not previously been made aware of these through other channels).