

Association of Luxembourg Compliance Officers
Work Group Number 5
Definition of the Function of Compliance Officer

WORK GROUP NUMBER 5
DEFINITION OF THE FUNCTION OF COMPLIANCE OFFICER
for Luxembourg Financial Sector Professionals (“FSP”)

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INTRODUCTION

The financial sector in Luxembourg must permanently merit the confidence of its clients and of other financial markets. This is why the financial sector has made certain values its own: respect of laws and regulations, attention to the general interest and needs of its clients, transparency in financial operations etc.

These values constitute the basis of action for Luxembourg financial institutions vis à vis their clients and counterparties. They are therefore the basis of the institutions code of ethics. A certain number of requirements follow from this, and it is the mission of the Compliance Officer to ensure that they are followed.

ALCO formulates directives and standards and recommends to those who are engaged in Compliance in the Luxembourg financial sector to be aware of them and to conform to them.

A statement of Professional Standards and Guidelines for Compliance Officers has been formulated by ALCO. All those who form part of a Compliance function in Luxembourg are recommended to be aware of and conform with the spirit of these Standards and Guidelines so that a consistently high level of support can be provided to line management. This will be achieved by the provision of a quality advisory, monitoring and control service focused upon areas of significant risk.

1. COMPLIANCE RESPONSIBILITIES

- 1.1 Each Luxembourg Financial Sector Professional (“FSP”) should observe high standards of integrity and fair dealing in the conduct of its business and should act with due skill, care and diligence.
- 1.2 To those ends, each FSP should:
 - comply with all relevant laws, rules, regulations, codes and standards of good market practice in Luxembourg and in any other jurisdictions where the FSP operates; and
 - ensure that any irregularities which arise are promptly resolved in a manner which protects the good name and reputation of the FSP and of the market and which, as much as possible, minimises the financial loss.
- 1.3 Responsibility for ensuring that each FSP complies rests with the Compliance Officer. Of course, the Compliance Officer may delegate authority to a Compliance function or to nominated executives to ensure that regulatory requirements are adhered to at an operational level.
- 1.4 A key responsibility for the direction is to provide strong senior management support to ensuring thorough compliance with each FSP's obligations.

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2. THE ROLE AND SCOPE OF THE COMPLIANCE FUNCTION

ROLE

2.1 The primary role of the Compliance function is to assist the management and employees of an FSP in protecting its customers interests. It also facilitates the management of compliance risk by those responsible for the conduct of each FSP's business, thereby:

- enabling the FSP to demonstrate to the regulatory authorities that they are fit and proper to undertake their business;
- giving priority to the legitimate interests of customers;
- maintaining high levels of integrity among employees; and thus:
- protecting the good reputation of the FSP and the market;
- avoiding disciplinary action by the regulators; and
- avoiding civil action by customers.

Examples of how the role may be carried out are attached in **Appendix 1**.

SCOPE

2.2 One of the many aspects of Compliance risk is "the risk of penalty arising from failure to comply with relevant regulations and ethical codes governing the conduct of specific business in specific countries." This is composite risk made up of litigation risk, the risk of regulatory sanction, financial risk and reputational risk. These risks are inter-related but reputational risk is normally of particular concern.

2.3 It should be noted that, where cross-border transactions are undertaken there may well be other regulatory requirements to be met. In such circumstances Compliance personnel covering Luxembourg (or where the transactions originate) will need to liaise, where relevant, with the Compliance personnel of its associates in other countries to identify and address any relevant Regulations.

2.4 It should also be noted that where there is agreement for monitoring of certain regulations to be conducted by delegated functions other than the Compliance function, the latter will require to see copies of the reports of findings.

2.5 The scope of the Compliance function extends to all rules and regulations to which each FSP is subject but primarily focuses on material conduct of business regulations as well as material financial regulations.

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- 2.6 Continued liaison with other departments who implement relevant regulations on a daily basis is important in order that:
- any significant exceptions with regulatory implications occurring within the areas of responsibility of the other functions are notified to Compliance; and
 - line management can satisfy itself that there are no functional cracks through which any regulatory obligation could fall, since management must ensure compliance with all regulations (even if no significant compliance risk exists).

MATERIALITY AND SIGNIFICANCE

- 2.7 The notion of what constitutes a material or significant breach of relevant regulations will vary according to circumstance. However, suggestions for defining materiality and significance are contained in **Appendix 2**.

PROFESSIONAL STANDARDS AND GUIDELINES

- 2.8 It should be noted that the Professional Standards and Guidelines mentioned in the Introduction to this Working Paper have been drawn up to meet what is considered to be best practice. It is recognised that the demands placed upon Compliance personnel by the requirement to meet these Professional Standards and Guidelines will vary with the level of compliance risk presented by the relevant FSP.
- 2.9 In FSPs where risks are perceived by the direction to be low, the level of workload in terms of controlling and recording and of resources and detailed regulatory knowledge necessary to provide a quality service consistent with the standards laid down, may be considered to be low. Even in such FSPs, however, the principles underlying the seven sections are valid and it is important that best efforts are made so that the level of achievement of the standards laid down is the highest appropriate to the FSP in question. However, it should be remembered that there is a clear trend towards a growing sensitivity to Compliance risks within the financial sector.
- 2.10 The Standards and Guidelines are set out in detail in **Appendix 3**. In brief they cover:
- Independence
 - Knowledge of Business and Regulations
 - Staffing and Training
 - Resources
 - Relationships
 - Due Care
 - Recording

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COMPLIANCE CULTURE

- 2.11 A "compliance culture" could be fostered throughout each FSP by regular information for employees on regulatory requirements and by the establishment, maintenance and enforcement of related operating procedures and controls. This is a responsibility of line management but is most effectively achieved with the advice and assistance of those within the Compliance function. Line management should be encouraged to take every opportunity in internal communications, planning documentation and "mission statements" etc to pass on Compliance messages so as to raise awareness levels in the FSP at large of Compliance issues and, more generally, of the value to the business of effective Compliance processes.

3. COMPLIANCE DUTIES

The duties of a Compliance Function will vary according to the particular circumstances of an FSP. However, for suggestion, some examples of the relevant duties are laid out in **Appendix 4**.

4. COMPLIANCE TRAINING

- 4.1 It is essential that all staff are adequately trained to equip them to fulfil their regulatory responsibilities properly. Such training should be delegated to the business as part of an employee's on-the-job training.
- 4.2 It should be the responsibility of the Compliance function (in conjunction with the relevant department) to provide technical support, or, as the case may be, to provide training directly to business areas in the procedures and practices necessary to achieve compliance.

Compliance Training Programme

- 4.3 All new staff should be, as part of their programme of induction, introduced to regulation and compliance. Thereafter, staff should receive a regular update on such issues. (For example, this may be presented in conjunction with the annual training in Anti-Money Laundering procedures.)
- 4.4 A programme of detailed compliance training should be prepared for all relevant staff by their managers on an annual basis. This is to ensure that all staff are aware of their individual regulatory obligations and that they are updated in regulatory developments occurring during the year.

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APPENDIX 1

COMPLIANCE ROLE - SUGGESTED METHODS

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COMPLIANCE ROLE – SUGGESTED METHODS

As stated in the attached principal text, the role of the Compliance function is to facilitate the protection of customers and the management of compliance risk by those responsible for the conduct of each FSP's business. Some examples of the ways in which a Compliance function could do this are by:

- providing, inter alia, advice, solutions, instructions and procedures to employees in order to assist them in carrying out their work in a compliant manner e.g. in the areas of integrity, suitability, conflicts of interest etc;
- identifying and assessing risk (e.g. by monitoring new and changing regulatory requirements and advising line management of their impact upon the businesses and ensuring that, where there is significant exposure, action is taken);
- supporting line management in the containment and management of risk (e.g. by initiating changes to relevant operational manuals, reviewing new products/activities for compliance implications, advising on system enhancements, monitoring the businesses for adherence to the rules, conducting quality control reviews of the Compliance function and providing input to audit and training programmes);
- assisting line management in the conduct of crisis management (e.g. by carrying out ad hoc investigations) where such crises impact on customers or the FSP's relations with the regulator e.g. instances of fraud etc.;
- recommending to line management policies and standards and disseminating agreed policies and standards around the FSP on matters which impact customers or the FSP's relations with the regulator e.g. supervising the complaints process etc.;
- providing a reporting mechanism independent of local management for all executives with defined Compliance responsibilities but also drawing line management's attention to Compliance issues e.g. CSSF Circular 2000/8, anti-money laundering, banking secrecy etc.;
- assisting in, or co-ordinating, the resolution of Compliance issues;
- managing relationships with the regulator(s), including assisting and co-ordinating the submission of responses to regulators output e.g. CSSF Circulars.

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APPENDIX 2

GUIDELINES ON THE DEFINITION OF MATERIALITY AND SIGNIFICANCE

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GUIDELINES ON THE DEFINITION OF MATERIALITY AND SIGNIFICANCE

As mentioned in the attached principal text, the notion of what constitutes a material or significant breach of regulations will vary according to circumstance. The following are simply guidelines offered to an FSP to assist in its own definition:

- (i) breach constitutes, or could constitute, a fraudulent or criminal act involving dishonesty; or
- (ii) breach has given, or could give, rise to strong disciplinary action by the regulators; or
- (iii) breach has generated, or could generate, adverse publicity such as to damage the FSP's reputation; or
- (iv) breach has given rise to a fine levied by a court of law or a regulatory body – the level of the fine to be determined as appropriate by the relevant FSP; or
- (v) breach has involved, or could involve, a monetary loss to the FSP (the FSP could incur monetary loss by way of compensation to customers paid either voluntarily or as a result of a civil judgement against it), other than a fine covered in (iv) above; or a customer incurred a monetary loss of an amount to be determined as appropriate by the relevant FSP; or
- (vi) while not in any of the above categories, a breach which, in the judgement of the person making the report, is of a particularly sensitive nature, must be regarded as material or significant; or
- (vii) while not in any of the above categories, a non-material breach which is repeated in such a way as to suggest the breakdown of Compliance controls must be regarded as material or significant.

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APPENDIX 3

**PROFESSIONAL STANDARDS AND GUIDELINES FOR COMPLIANCE
PERSONNEL**

1. Independence

2. Knowledge of Businesses and Regulations

3. Staffing and Training

4. Resources

5. Relationships

6. Due Care

7. Recording

Note: The format of the document shows the essential element of the Compliance Standards in bold italics with additional guidance in normal type.

The nature of the subject dictates that the standards and guidance are written in general terms. Judgement must be exercised when applying them to specific circumstances.

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1. INDEPENDENCE

Compliance personnel must be sufficiently independent to be able to perform their duties objectively.

- (a) The Compliance Officer should have unfettered right to report to the Chief Executive any matter which he/she considers necessary. Where a conflict of interest arises with the Chief Executive, the Compliance Officer should have the possibility to raise this with another director or with the Board.
- (b) Compliance personnel should have sufficient seniority and authority so as not to be inhibited in carrying out their duties.
- (c) They should have short and clear reporting lines to the most senior level of line management of the business areas for which they are responsible. Compliance should have no reporting line to a manager/director carrying out an operational role, nor should Compliance carry out any operational role. This restriction, however, does not prevent Compliance providing advice on operational matters.
- (d) Compliance personnel should have the right of access to all records, assets and personnel as they consider necessary for the proper execution of their duties.
- (e) Compliance personnel should have an objective approach so that they can exercise judgement, express opinions and present recommendations with impartiality. In particular:
 - (i) Compliance personnel should avoid any conflict of interest between their personal and professional interest; and
 - (ii) Senior management are recommended to ensure that Compliance personnel's status and compensation package are designed in a way which does not compromise their objectivity.

2. KNOWLEDGE OF BUSINESS AND REGULATIONS

Compliance personnel should have sufficient knowledge and experience of the business activities covered by their Compliance responsibilities and of the regulatory requirements which apply to that business, to enable them to perform their duties effectively.

- (a) It is not expected that Compliance personnel should be experts on all aspects of the relevant FSP's business. However, they should have an adequate working knowledge sufficient to enable them to advise competently on significant regulatory issues within their area of responsibility. They should have access to relevant line managers in the business who do have detailed expert knowledge of the business and operational systems.
- (b) Compliance personnel should have:

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- (i) an awareness of the existence and general requirements of all relevant Regulations;
- (ii) a thorough understanding of the objectives of these Regulations; and
- (iii) up-to-date Circulars , rule books, files or circulars and other relevant material which may be used for reference.

3. STAFFING AND TRAINING

Compliance personnel should have adequate training, experience and personal qualities to equip them to fulfil their responsibilities properly.

- (a) Compliance personnel should have personal qualities and skills which will enable them to:
 - (i) understand and advise on relevant regulatory requirements;
 - (ii) advise on the design and implementation of in-house rules, systems and procedures which are necessary to meet regulatory requirements;
 - (iii) make sound judgements;
 - (iv) communicate effectively, both orally and in writing; and
 - (v) gain the respect and co-operation of both line management and the regulators.
- (b) All Compliance personnel and any other resources which can readily be called upon, should have the necessary skills and knowledge to fulfil their responsibilities.
- (c) Only individuals with the appropriate background and personal qualities should be appointed. Thereafter, steps should be taken to provide the necessary experience, training and education on a continuing basis.

4. RESOURCES

The resources made available to the Compliance function should be sufficient to enable objectives to be achieved and adequate standards to be maintained.

- (a) There are a number of ways in which a Compliance function can be organised and resourced, for example:
 - (i) central Compliance team;
 - (ii) Compliance personnel in relevant FSP businesses;

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- (iii) compliance responsibilities for monitoring and reviews placed upon line management with Compliance personnel carrying out tests to see that the work has been carried out satisfactorily;
 - (iv) separate in-house lawyers for legal advice;
 - (v) use, as appropriate, of relevant Internal Audit / Control functions to assist in carrying out compliance reviews and investigations;
 - (vi) specific tasks delegated to other in-house functions such as Tax, Human Resources, Finance and Company Secretariat;
 - (vii) bought-in services of external lawyers, accountants or consultants; and
 - (viii) use of information technology.
- (b) The resources which are available should be drawn upon and managed in the most efficient way in order to achieve the overall Compliance objectives by the most economic means.

5. RELATIONSHIPS

In order for Compliance and an FSP to operate effectively there should be good working relationships not only with line management and the business-generating personnel of the operating areas but with all other functions with which Compliance personnel work. It is also important for good relationships to be maintained with the regulators and external auditors.

- (a) Those relationships should be developed on a basis of sound professional work which in turn promotes trust and mutual confidence.
- (b) In view of the confidential and sensitive nature of some of the work of the Compliance function, care must be exercised when dealing with the different parties who may need to become involved. This will apply in particular when:
- (ii) informing line management promptly of any problems which emerge, obtaining their comments and agreeing on action to be taken;
 - (ii) keeping the most senior levels of management promptly informed of material problems;
 - (iii) keeping the regulators informed of any matters which might reasonably be expected to be disclosed to them;
 - (iv) keeping Internal Audit / Control informed of any matters which might reasonably be expected to be disclosed to them;

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- (v) informing the external auditors of any matters which may be relevant to their annual audit and report; and
 - (vi) passing on information to others only where there is both a right to receive the information and a “need to know”. In all other cases strict confidentiality should be maintained.
- (c) Whilst always wishing to maintain good working relationships, Compliance personnel must not allow their independence and objectivity to be impaired.

6. DUE CARE

In carrying out their duties Compliance personnel should exercise a level of skill, care and judgement such as would be expected of any responsible and competent Compliance employee in comparable circumstances.

- (a) The question of whether due care has been exercised in a particular case may well be subjective. The failure of an FSP to comply with the relevant regulatory requirements would not of itself indicate that the Compliance function has not carried out its responsibilities properly. It would be necessary to examine the detailed circumstances. In such cases, in order that Compliance personnel may best be able to demonstrate that due care has been exercised they should be able to demonstrate that their work has been conducted in a manner consistent with these Standards and Guidelines.
- (b) At all times, in both their personal and business affairs, the honesty and integrity of Compliance personnel must be beyond reproach.

7. RECORDING

Compliance personnel should maintain adequate records to enable them to demonstrate that they have properly fulfilled their responsibilities and that advice and recommendations which they have given can be adequately supported.

- (a) Where Compliance personnel delegate tasks to other personnel they can only review that work properly if it is adequately recorded.
- (b) Compliance personnel should specify the standard of documentation which they require from their teams and from any other personnel upon whose work they rely.
- (c) Supporting documentation and working papers should be sufficiently structured and detailed so as to give a clear picture to the reviewer of the objectives, the work carried out, evidence obtained and conclusions reached.

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APPENDIX 4

COMPLIANCE DUTIES - EXAMPLES

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COMPLIANCE DUTIES - EXAMPLES

1. Documentation

- 1.1 In order to demonstrate an organised, aware Compliance function, it is recommended that the Compliance Officer responsible for each FSP will ensure the preparation of:

Compliance Manual – detailing the regulations applicable to that FSP. The Manual should also include best practice that will help avoid compliance risk. This manual should be circulated to all staff; and

Compliance Procedures Manual – detailing the procedures to be followed to ensure compliance with the applicable regulations, policy and best practice; and

Compliance Monitoring Programme – detailing the independent monitoring of the business to be carried out to ensure that the procedures are being followed.

2. Information Gathering and Dissemination

- 2.1 Once constructed, the Compliance Manual should be circulated to all department managers, in the first instance. It should be the responsibility of all department managers to ensure that their Compliance Manual is up-to-date.
- 2.2 Where appropriate, on receipt of regulatory or FSP policy updates, the Compliance Officer should ensure the preparation of a covering memorandum for all Compliance Manual holders. This memorandum should summarise the contents of the updates and their impact on the FSP.
- 2.3 A copy of these memoranda and the accompanying regulatory or FSP policy update should be maintained on a file held centrally by the Compliance function.
- 2.4 Where there are significant amendments to the rules or guidance, training sessions should be prepared by the Compliance function for presentation to and discussion with relevant personnel within the FSP.
- 2.5 Where the amendment to the rules or guidance require significant amendments to systems, controls and/or procedures, a project team should be drawn together and the Compliance function represented on the team to ensure that all regulatory issues are satisfactorily covered. New procedures should be drafted by the relevant line department(s) and reviewed by the Compliance and Internal Audit / Control functions. Likewise specifications for system amendments should be prepared by the relevant line department(s) and reviewed by the Compliance and Internal Audit / Control functions.

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3. Remedial Action

- 3.1 All matters arising from routine compliance monitoring and from general day-to-day compliance queries should be documented by the Compliance Officer. It should be the responsibility of the Compliance Officer to ensure that matters are dealt with adequately and in a timely manner. Where appropriate, the Compliance Officer should notify the Board of such matters for further action.
- 3.2 All breaches should be notified to the Compliance Officer where information is held centrally. Individual departments within the FSP should also maintain their own breach logs which record, inter alia, the remedial action taken to ensure that there is no repetition of the breach logged.

4. General Duty to Monitor and Report

- 4.1 There should be sufficient independent monitoring of each FSP in place to obtain reasonable assurance that compliance with regulatory requirements materially affecting conduct of business and other significant Compliance risks is at an acceptable level.
- 4.2 Where any material failure or breach is identified the Compliance Officer would be expected to draw the matter to the attention of line management for early rectification, and report exceptions.
- 4.3 Monitoring can take a variety of forms from relatively informal day to day contact with line management to formal reviews based on a detailed programme. There is no hard and fast rule as to what is required, and this will need to be assessed on a case by case basis. However, the Compliance Officer should be required to undertake sufficient monitoring in order that the reports made to the direct report or the relevant Board reflect the reality of business undertaken.
- 4.4 As stated above, a formal schedule of reviews (e.g. a Compliance Monitoring Programme) should be developed and incorporated into the Compliance Officer's planning.
- 4.5 Independent monitoring by the Compliance function in no way detracts from line management's responsibility to supervise the activities of its employees. Account should be taken of other control functions which are in place (e.g. Internal Audit / Control) as Compliance is normally only one part of the internal control system of an FSP.

5. Monitoring of Delegates

- 5.1 The delegation of tasks does not involve the delegation of responsibilities. Therefore, Compliance should ensure that where any function is delegated to third parties (within its Group or elsewhere), those delegates should manage the function to the equivalence of Luxembourg regulatory standards.

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- 5.2 Compliance with these standards should be monitored by the delegate's local Compliance function, but should be reviewed periodically by the Compliance Officer of the FSP or by a designated person. The content of the periodic monitoring should include both a review of the local Compliance Monitoring Programme and the actual arrangements for ensuring adherence to the equivalence of Luxembourg regulatory standards. This will normally involve a regular visit to the delegate concerned and the reception of a copy of the delegate's Management Letter.
- 5.3 The delegate should be asked to provide reports of a sufficient frequency to the FSP's Compliance Officer. These reports should be expected to include details of the monitoring undertaken and the results of that monitoring. The delegate should also be expected to immediately inform the FSP's Compliance Officer of any significant matters. In many instances quarterly reporting may be appropriate e.g. NAV Errors, Investment & Borrowing Restriction breaches etc.
- 5.4 The arrangements between the FSP and its delegates should be laid out in a legal agreement setting out the roles and responsibilities of those delegates, including specifically its Compliance responsibilities. Copies of these agreements should be included in the Compliance function's Procedures Manual.

6. Self-Monitoring

- 6.1 Line departments within the FSP also have a responsibility to monitor themselves. The findings of their self-monitoring should be reported to the Compliance Officer via quarterly self-monitoring certificates set up by the FSP.