FINANCIAL REGULATOR
Rialtóir Airgeadais

Telephone Records and Electronic Communications under the European Communities (Markets in Financial Instruments) Regulations 2007

July 2009

Consultation Paper | CP38

Introduction

MiFID is a comprehensive regulatory regime covering investment services and financial markets in Europe and introduces common standards for investor protection throughout the European Union. It applies to both investment firms and credit institutions when providing investment services, and to regulated markets. MiFID comprises two Directives and a European Commission Regulation. The two Directives were transposed into Irish law on 15 February 2007 by means of a Statutory Instrument, No. 60 of 2007, entitled European Communities (Markets in Financial Instruments) Regulations 2007 [the MiFID Regulations]. The MiFID Regulations were further amended by two Statutory Instruments, No. 663, issued on 26 September 2007 and No. 773, issued on 21 November 2007. The European Commission Regulation automatically became law and did not require transposition. The MiFID Regulations came into effect on 1 November 2007.

Under the MiFID Regulations, there are no requirements on MiFID firms to record telephone lines. However, MiFID Regulation 40(6) does allow the Financial Regulator, after consultation with the Minister for Finance, to impose additional obligations on investment firms relating to the recording of telephone conversations or electronic communications involving client orders[1].

In this consultation paper the Financial Regulator is seeking views on the proposed introduction of such obligations.

[1] Please note, "involving client orders" refers to the reception, transmission and/or execution of a client's order.

Consultation Process

The closing date for submissions is **Friday 18 September 2009**. We welcome submissions from all interested parties. Please make your submissions in writing or, if possible, by e-mail.

We place a high value on the openness of the consultation process. We intend to make all submissions available on our website. For this reason we would ask you not to include any commercially or personally sensitive material in your submission. If you do include such material, please highlight it clearly so that we may take reasonable steps to avoid publishing that material. This may involve publishing submissions with the sensitive material deleted and indicating the deletions. In some cases it may not be possible to publish the submission at all. Despite the approach outlined above, we make no guarantee not to publish any information that you deem confidential. So be aware that, unless you clearly identify any commercially or personally sensitive information, you are making a submission on the basis that you consent to it being published in full. We will not publish any material that we deem potentially libellous.

Please clearly mark your submission 'Telephone Records' and send it to:

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Examination Findings

Background

The Financial Regulator undertook an examination to review the current procedures in place by MiFID firms and consider the introduction of obligations relating to the recording of telephone conversations or electronic communications involving client orders.

This examination involved:

- reviewing the telephone recording obligations that existed prior to the introduction of the MiFID Regulations;
- gathering information and views from industry representatives and competent authorities;
- issuing questionnaires to 147 MiFID firms; and
- based on the responses received from the questionnaires, visiting a number of firms that had telephone recording systems.

(i) Telephone Recording obligations pre-MiFID

Prior to the introduction of MiFID, investment firms were subject to the Handbook for Investment and Stockbroking Firms (the Handbook) while stockbroking firms were subject to the Rules of The Irish Stock Exchange Ltd (ISE Rulebook) and the Handbook. Both of these documents contained obligations regarding telephone records. The Handbook required that:

In any case where a firm tape records a telephone conversation, it shall maintain such tape recording for a period of at least six months and if it has reasonable cause to believe the tape recording is or might be relevant to a complaint, disciplinary action or investigation, shall retain such tape recording until it ceases to be of relevance to such complaint, disciplinary action or investigation.

The ISE Rulebook required that:

All member firms are required to record telephone lines and voicemails relating to the provision of advice and the acceptance and execution of instructions including orders between Registered Persons and the firm's clients whether they are institutional or private clients.

And:
In instances where a Registered Person takes an order from a client on an unrecorded phone line such as a mobile phone the Registered Person following completion of that conversation will be required to telephone the instructions into a recorded line of the firm and ensure that the order is placed in accordance with …. Clients' Best Advantage.

And:
Where a member firm records a telephone conversation it shall maintain such recording for a period of at least three months unless otherwise required by its home state regulator.

These obligations no longer applied once the MiFID Regulations came into effect on 1 November 2007.

(ii) Feedback from Competent Authorities

Several competent authorities were contacted to enquire if they had introduced any obligations relating to the recording of telephone conversations or electronic communications involving client orders.
Eight competent authorities responded and, of those, five have rules regarding the recording of telephone conversations. The minimum length of time these competent authorities require MiFID firms to maintain telephone records ranges between three months and five years.

(iii) Questionnaires received from MiFID firms

147 MiFID firms were sent a questionnaire requesting details of any telephone records and records of electronic communications involving client orders currently maintained. Completed questionnaires were received from 110 firms.

Below are listed some relevant statistics compiled from the information received in the questionnaires and the subsequent inspections:

Telephone Lines

- 32 of the 110 firms who responded accept orders via telephone lines;
    - 15 receive and transmit orders and execute orders;
    - 16 receive and transmit orders only;
    - 1 executes orders only.

- 24 of these 32 firms record telephone lines while another 18 firms record telephone lines even though they do not accept any orders by telephone.

- Of all the firms that record telephone lines, the minimum time these records are maintained appears to be three months while the longest time period is indefinitely.

Mobile Phone Lines

- 13 of the 110 firms who responded accept orders via mobile phone;
    - 4 receive and transmit orders and execute orders;
    - 6 receive and transmit orders only;
    - 3 execute orders only.

- 3 of the above 13 firms record mobile phone orders.

Electronic Communications

- 46 of the 110 firms who responded accept orders via electronic means, i.e. email, SMS, Reuters/Bloomberg, other; 43 of these firms keep records of these electronic communications while another 9 firms record electronic communications even though they do not accept orders via electronic communications.

(iv) Inspections of Firms with Telephone Recording Systems

Based on the responses received from the questionnaires, it was decided to visit seven firms that have telephone recording systems to gather further information on the nature and costs of the recording systems. These inspections were carried out over a number of weeks in December 2008 and January 2009. A summary of the findings from these inspections are listed below:

- Costs of installing the telephone recording systems range from approximately €6,000 to €200,000 depending on the size of the firm and the sophistication of the recording system employed. Similarly, annual maintenance costs range from between approximately €500 to €30,000.

- Three of the firms visited accept orders via mobile phone. However, only one firm records the conversation through their telephone recording system. One other firm 'rings into' a special recorded extension number when an order is received by mobile phone and the client is then called back on a recorded line to notify the client that the transaction has taken place. Another firm keeps written records of the order placed by mobile phone.

- Five of the seven firms inspected accepted orders via electronic communications including email, SMS, instant messaging and fix protocol i.e. Bloomberg, Reuters. Four of the five firms that accept orders via electronic communications keep records of these orders. The period these records are maintained for varies from a minimum of 5 years to indefinitely.

Proposed Obligations

Regulatory Impact Analysis (RIA) is a tool used to assess the likely effects of proposed new primary legislation, statutory instruments or significant EU Regulations. With regard to the proposed obligations below, the Financial Regulator believes that an RIA is unnecessary as:

- the introduction of the proposed obligations will not require any amendment to existing MiFID legislation;
- the obligations build on rules that existed prior to the implementation of MiFID
- ISE member firms were subject to the ISE Rulebook and were required to record telephone lines and voicemails relating to the provision of advice and the acceptance and execution of instructions. These records were to be maintained for at least three months. In addition, the Handbook required, where relevant, firms to maintain telephone records for at least six months; and
- the introduction of the proposed obligations would assist in the resolution of complaints and monitoring of market abuse thus enhancing consumer protection.

Based on the findings outlined, it is proposed to introduce the following obligations under Regulation 40(6) of the MIFID Regulations:

Effective from 1 May 2010, MiFID firms should record all telephone calls (including mobile phones) and electronic communications involving client orders. These records must be maintained for a period of at least 2 years and until the record is no longer of any relevance to any complaint, disciplinary action or investigation.

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