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MiFID II RECORDING OF COMMUNICATIONS



Storm-7 Consulting

is an international consulting company that provides premier intelligence, insight and support to global financial institutions.

EXECUTIVE SUMMARY

The recast Markets in Financial Instruments Directive (2014/65/EU) and the Markets in Financial Instruments Regulation ((EU) No 600/2014) (together **MiFID II**), are set to usher in a radical new era in the regulation of banking and financial services across the European Union (**EU**) when they take effect on 3 January 2018.

MiFID II will affect a very broad range of firms such as credit institutions, retail banks, private banks, investment banks, asset management firms, stockbrokers, portfolio managers, broker-dealers, and corporate finance companies.

MiFID II, together with the new market abuse framework governed by Directive 2014/57/EU (**MAD 2**) and Regulation (V) No 596/2014 (**MAR**), seek to significantly increase investor protection and transparency in the markets in order to foster increased competition and efficiencies in financial markets in the EU.

From a high level perspective MiFID II will ensure harmonised regulation of market infrastructures such as Regulated Markets (**RM**), Multilateral Trading Facilities (**MTFs**), Organised Trading Facilities (**OTFs**), and Systemic Internalisers (**SIs**). It puts into place new and more comprehensive internal organisational and corporate governance requirements for firms, it introduces new rules pertaining to synchronization of clocks, new rules relating to commodity derivatives, and new commodity derivative position reporting and limits.

MiFID II increases pre-trade and post-trade transparency of financial instruments by putting in place new and highly comprehensive pre-trade and post-trade transaction reporting and trade reporting relating to equity and equity-

like financial instruments and non-equity and non-equity-like financial instruments.

There are also new rules relating to the unbundling of research commissions, the regulation of algorithmic trading and High Frequency Trading (**HFT**), new rules relating to best execution, new rules relating to third-country firm access, and the introduction of a new consolidated tape for equities and equity-like financial instruments. Given the sheer breadth of scope, many investment firms are finding MiFID II compliance a significant challenge.

This whitepaper seeks to focus on one particular area of the new MiFID II regulatory compliance framework that firms are finding particularly challenging owing to its inherently complex nature. This relates to the new obligation for investment firms to record telephone conversations and electronic communications. The whitepaper will set out the new MiFID II framework relating to the recording of such communications and will also set out top strategic considerations for investment firms to consider prior to the 3 January 2018 MiFID II implementation date.



MiFID II RECITALS

The MiFID II recitals pertaining to the recording of communications are set out here in full as they provide a helpful insight into the background rationale relating to the need to record communications.

(57)

Commission Directive 2006/73/EC (1) allows Member States to require, in the context of organisational requirements for investment firms, the recording of telephone conversations or electronic communications involving client orders. Recording of telephone conversations or electronic communications involving client orders is compatible with the Charter of Fundamental Rights of the European Union (the Charter) and is justified in order to strengthen investor protection, to improve market surveillance and increase legal certainty in the interest of investment firms and their clients. The importance of such records is also referred to in the technical advice to the Commission, released by the Committee of European Securities Regulators on 29 July 2010. Such records should ensure that there is evidence to prove the terms of any orders given by clients and its correspondence with transactions executed by the investment firms, as well as to detect any behaviour that may have relevance in terms of market abuse, including when firms deal on own account.

To that end records are needed for all conversations involving a firm's representatives when dealing, or intending to deal, on own account. Where orders are communicated by clients through other channels than by telephone, such communications should be made in a durable medium such as mails, faxes, emails, documentation of client orders made at meetings. For example, the content of relevant face-to-face conversations with a client could be recorded by using written minutes or notes. Such orders should be considered to be equivalent to orders received by telephone. Where minutes are taken of face-to-face conversations with clients, Member States should ensure that appropriate safeguards are in place to ensure that the client does not lose out as a result of the minutes inaccurately recording the communication between the parties. Such safeguards should not imply any assumption of liability by the client.

In order to provide legal certainty regarding the scope of the obligation, it is appropriate to apply it to all equipment provided by the firm or permitted to be used by the investment firm and to require the investment firms to take reasonable steps to ensure that no privately owned equipment is used in relation to transactions. Those records should be available to competent authorities in the fulfilment of their supervisory tasks and in the performance of enforcement actions under this Directive and under Regulation (EU) No 600/2014, Regulation (EU) No 596/2014 and Directive 2014/57/EU of the European Parliament and of the Council (1) in order to help competent authorities identify behaviours which are not compliant with the legal framework regulating the activity of investment firms. Those records should also be available to investment firms and to clients to demonstrate the development of their relationship with regard to orders transmitted by clients and transaction carried out by firms. For those reasons, it is appropriate to provide in this Directive for the principles of a general regime concerning the recording of telephone conversations or electronic communications involving client orders.

(58)

In line with Council conclusions on strengthening European financial supervision of June 2009, and in order to contribute to the establishment of a single rulebook for Union financial markets, to help further develop a level playing field for Member States and market participants, to enhance investor protection and to improve supervision and enforcement, the Union is committed to minimising, where appropriate, discretions available to Member States across Union financial services law. In addition to the introduction in this Directive of a common regime for the recording of telephone conversations or electronic communications involving client orders, it is appropriate to reduce the possibility of competent authorities to delegate supervisory tasks in certain cases, to limit discretions in the requirements applicable to tied agents and to the reporting from branches.

(144)

Existing recordings of telephone conversations and data traffic records from investment firms executing and documenting the executions of transactions, as well as existing telephone and data traffic records from telecommunications operators constitute crucial, and sometimes the only, evidence to detect and prove the existence of market abuse as well as verify compliance by firms with investor protection and other requirements set out in this Directive or in Regulation (EU) No 600/2014. Therefore, competent authorities should be able to require existing recordings of telephone conversations, electronic communications and data traffic records held by an investment firm or credit. Access to data and telephone records is necessary for the detection and penalising of market abuse or of infringements of requirements set out in this Directive or in Regulation (EU) No 600/2014.

In order to introduce a level playing field in the Union in relation to the access to telephone and existing data traffic records held by a telecommunication operator or the existing recordings of telephone conversations and data traffic held by an investment firm, competent authorities should, in accordance with national law, be able to require existing telephone and existing data traffic records held by a telecommunication operator insofar as permitted under national law and existing recordings of telephone conversations as well as data traffic held by an investment firm, in those cases where a reasonable suspicion exists that such records relating to the subject-matter of the inspection or investigation may be relevant to prove behaviour that is prohibited under Regulation (EU) No 596/2014 or infringements of the requirements of this Directive or of Regulation (EU) No 600/2014. Access to telephone and data traffic records held by a telecommunications operator should not encompass the content of voice communications by telephone.

MiFID II AND THE RECORDING OF COMMUNICATIONS

Article 16 of MiFID II sets out a range of organisational requirements that investment firms must comply with. Although Articles 16(6) and 16(7) set out the primary obligations relating to the recording of telephone conversations or electronic communications (**TCEC**), as will be seen, other obligations under Article 16 will also impact the recording of TCEC framework. Electronic communications include, but are not limited to, facsimile (fax), email, video conferencing, Bloomberg mail, Skype, chat and instant messaging, Smart Messaging Service (**SMS**), and business to business devices.

Article 16(6) specifies that an investment firm must arrange for records to be kept of all services, activities, and transactions it carries out. These records must be sufficient to enable the National Competent Authority (**NCA**) to fulfil its supervisory tasks and to perform any attendant enforcement actions under MiFID II, MiFIR, MAD 2, and MAR. These records must also be sufficient to allow NCAs to ascertain that the investment firm has complied with all its obligations, including those with respect to clients (or potential clients) and to the integrity of the market.

The term '**records**' is specified to include the recording of TCEC relating to, at a minimum:

- 1** transactions concluded when dealing on own account;
- 2** the provision of client order services that relate to the reception, transmission and execution of client orders;
- 3** any TCEC relating to (1) or (2) even if those conversations or communications do not result in the conclusion of such transactions or in the provision of client order services.

Such records must be kept for a period of five years, however, if a NCA requests, an investment firm may be required to keep such records for a period of seven years. Any records kept by a firm must be provided to the client involved upon request.

INVESTMENT FIRM OBLIGATIONS



An investment firm has a number of obligations relating to clients. These include:

- 1** that the investment firm notifies new and existing clients that TCEC between the investment firm and its clients that result or may result in transactions will be recorded;
- 2** that this notification may be made once, prior to the provision of investment services to new and existing clients; and execution of client orders;
- 3** that the investment firm must not provide by telephone, investment services and activities to clients who have not been notified in advance about the recording of their TCEC, which such investment services and activities relate to the reception, transmission and execution of client orders.

There are two main organisational requirements that investment firms must adhere to. These are that the investment firm shall take all reasonable steps to:

- 1** record relevant TCEC, made with, sent from, or received by, equipment provided by the investment firm to an employee or contractor, or the use of which by an employee or contractor has been accepted or permitted by the investment firm; and dealing on own account;
- 2** prevent an employee or contractor from making, sending, or receiving relevant TCEC on privately-owned equipment which the investment firm is unable to record or copy.



ORDERS PLACED THROUGH OTHER CHANNELS

Where orders are placed by clients through other channels, investment firms must ensure that such communications are made in a durable medium¹ such as mails, faxes, emails or documentation of client orders made at meetings. The content of relevant face-to-face conversations with a client may be recorded using written minutes or notes. These orders will be considered equivalent to orders received by telephone.

THIRD PARTY DELEGATION OF OPERATIONAL FUNCTIONS

Where an investment firm relies on a third party to perform operational functions which are critical for the provision of continuous and satisfactory service to clients and the performance of investment activities on a continuous and satisfactory basis, it must take reasonable steps to avoid undue additional operational risk. Outsourcing of such functions must not be carried out in a way that materially impairs the quality of its internal control and the ability of the NCA to monitor the firm's compliance with all its obligations.

POLICIES AND PROCEDURES

Investment firms are required to establish adequate policies and procedures that are sufficient to ensure compliance of the firm (including its managers, employees, and tied agents) with its obligations under MiFID II, as well as appropriate rules governing personal transactions by such persons. In Policy Statement (10/17)² the Financial Services Authority (FSA) stated that investment firms were required to ensure that their internal policies and procedures adequately reflected the firm's business model.

CONTINUITY AND REGULARITY

Investment firms are required to take reasonable steps to ensure continuity and regularity in the performance of investment services and activities, and must employ appropriate and proportionate systems, resources and procedures. Investment firms must therefore map out in advance continuity and regularity contingency strategies in the event of unforeseen information technology (IT) or systems failures.

ALL REASONABLE STEPS

In Policy Statement (10/17) the FSA stated that what constituted 'reasonable steps' was fundamentally principles-based, meaning that they were not prescriptive about what they would expect from firms to be compliant. Each firm was required to deem what it deems necessary and reasonable to comply with the taping provisions. Firms were required to choose whether and how to restrict the types of devices, employees, and mobile functionalities. It was noted that in terms of reasonable steps, at a minimum firms would be expected to ensure their employees were made aware of their responsibilities to prevent relevant conversations taking place on private mobiles.

Firms were also expected to be alerted to any 'relevant conversations' that occurred off taped lines, but then resulted in a client order or conclusion of a transaction, i.e. via proper or order trails. It was also noted that the 'reasonable steps' requirement should prevent the need to develop complex technological solutions to record relevant conversations that only take place occasionally in circumstances where recording them would be highly impractical or costly.

¹ Durable medium is defined to mean any instrument which enables a client to store information addressed personally to that client in a way accessible for future reference and for a period of time adequate for the purposes of the information, and allows the unchanged reproduction of the information stored.

² Financial Services Authority Taping of mobile phones, Feedback on CP10/7 and final rules (November 2010).

10 STRATEGIC CONSIDERATIONS FOR INVESTMENT FIRMS



1 Mapping out internal transaction chains

Senior management should seek to map out internal 'transaction chains' in order to be able to ascertain which staff, business, and operational areas should be subject to internal recording requirements.

2 Investment firm recording policy

In ESMA's Technical Advice to the Commission on MiFID II and MiFIR (**ESMA Technical Advice**)³ investment firms are required to ensure that the management body has effective oversight and control over the policies and procedures relating to the recording of TCEC. The TCEC policy must be technology neutral, and must periodically re-evaluate the effectiveness of the firm's measures and procedures. Firms must adopt alternative or additional measures and procedures as are necessary and appropriate (at a minimum when a new communication medium is accepted or authorised by the firm).

3 Senior management application of proportionality

ESMA's Technical Advice states that investment firms are required to establish, implement and maintain an effective recording of TCEC policy that is set out in writing and is appropriate to the size and organisation of the firm, and the nature, scale and complexity of the business. This will require firms to consider issues such as existing IT controls, policies, and systems, interoperability of systems, and future voice recording requirements, strategy, and infrastructure..

4 Senior management list of technological means

Senior management must ensure that the TCEC policy identifies which relevant internal and external TCEC are subject to recording requirements, and which technological means fall within the TCEC policy (e.g. Skype, BlackBerry, SMS, chat and instant messaging).

5 Senior management list of exceptional circumstances

Senior management should set out the procedures to be followed and measures to be adopted to ensure firm compliance with TCEC recording obligations when the firm is unable to record conversations or communications owing to exceptional circumstances arising, e.g. dead batteries, malfunctioning equipment, loss of signal reception, building power outage, IT systems downtime or failure, etc.).



6 Periodical monitoring

Investment firms are required to periodically monitor the records of transactions and orders subject to these requirements (including relevant conversations), in order to monitor compliance with regulatory obligations using a risk-based and proportionate methodology.

7 Interaction with EU and non-EU privacy laws

If investment firms are dealing with clients across the EU and around the world, they must seek to ensure that internal TCEC recording frameworks accurately take into account the privacy and data protection requirements of other jurisdictions in the EU and around the world.

8 Interaction with the revised General Data Protection Regulation (GDPR)

Investment firms should be seeking to review to what extent existing or new TCEC recording technologies are able to adhere to or adapt to new General Data Protection Regulation ((EU) 2016/79) set to be implemented by 25 May 2018.

9 Interaction with MAD 2 MAR obligations

Investment firms should be seeking to review to what extent existing or new TCEC recording technologies are able to adhere to or adapt to existing MAD 2 MAR requirements.

10 Potential leveraging of MiFID II recording technologies

Investment firms should be seeking to evaluate what enhanced search tools can provide in terms of their ability to satisfy MiFID II compliance obligations (e.g. identification of particular client files). In addition, certain solutions that provide 'speech to text' offerings can not only be employed to support internal market abuse and fraud control requirements, but could also in theory be connected to big data technology systems in order to more accurately analyse client interactions, trends, and behaviours. Such multi-channel analytics would have the potential to create new marketing and selling opportunities for firms that would in theory allow them to 'recoup' the current sunk costs of MiFID II compliance..

CONCLUSION

It is clear that the new MiFID II regulatory compliance framework will provide a tough challenge for investment firms operating in the EU in terms of achieving full regulatory compliance. One of the inherent difficulties is the sheer range of new obligations for firms, another is the difficulty that firms face when interpreting new 'proportionality' requirements, as it requires firms to make crucial but difficult judgment calls. The new recording of communications obligations under MiFID II will certainly prove to be highly challenging for firms to implement in practice. This is in part due to their complexity, but also in part due to the proportional and risk-based approach firms are required to take in practice in order to fully comply. Moreover, as has been seen, firms also have a range of other moderating factors to take into account when putting in place compliance solutions. What can certainly be said is that investment firms can now choose from a broad range of recording technology solutions offered by highly experienced technology firms that can help firms achieve MiFID II recording compliance in a timely and cost-effective manner.

Storm-7 Consulting

is an international consultancy company that provides premier financial intelligence and knowledge to leading financial institutions around the world. We deliver premium quality events on cutting-edge legal and financial issues, and strive to provide access to crucial insight by leading global experts on the latest complex regulatory developments.



COMPANY SPECIALIST AREAS

Our company products and services include conferences, training events, training forums, conferences, in-house training programmes, company technical training programmes, technical consulting services, industry reports, industry briefings, whitepapers, technical blogs, technical research, technical analysis, industry analysis, and forecasting. Our highly unique and innovative sales and marketing products and services include media partnerships, promotional marketing, social media marketing, integrated active sales and marketing campaigns, lead generation services, client referral agreements, company and solution brochures and marketing materials, industry surveys, marketing and promotional videos, specialist infographic services, business development and conversion services.

- MiFID II
- MiFIR
- FATCA AND THE OECD CRS
- CRD IV
- OTC DERIVATIVES DOCUMENTATION AND NEGOTIATION
- CCP CLEARING, RISK, RECOVERY AND RESOLUTION
- ISLAMIC BANKING AND FINANCE
- REPURCHASE AGREEMENTS
- ADVANCED STRESS TESTING
- MARKET ABUSE: OPERATIONAL COMPLIANCE
- FOURTH ANTI MONEY LAUNDERING DIRECTIVE
- CREDIT RATINGS AGENCIES
- ISDA 2016 VARIATION MARGIN PROTOCOL
- CYBER SECURITY
- SENIOR MANAGERS AND CERTIFICATION REGIME
- GENERAL DATA PROTECTION REGULATION (GDPR)
- MiFID II: OPERATIONAL COMPLIANCE
- MAD 2 MAR
- SOLVENCY II
- PRIIPs
- BRIBERY AND CORRUPTION COMPLIANCE
- HEDGE FUNDS
- GLOBAL REGULATORY COMPLIANCE
- SECURITIES LENDING AGREEMENTS
- MiFID II: REGULATORY, RISK AND COMPLIANCE
- PAYMENT SERVICES DIRECTIVE 2 (PSD2)
- AIFMD
- OPERATIONAL RISK
- ADVANCED SWAPS
- BIG DATA
- SCHOOL OF REGULATORY COMPLIANCE
- EMIR

To provide a little context as to the calibre level of clients we train, below are relevant details of our associations:



MIFID II REGULATORY COMPLIANCE TRAINING COURSES

Storm-7 Consulting has created and developed a highly unique and comprehensive modular MiFID II regulatory compliance training course that contains 20 training modules. It is an extended intermediate to advanced level programme that provides attendees with comprehensive training in the latest MiFID II regulatory, risk, compliance and implementation issues. Attendees are guided through the latest MiFID II operational framework in detail, and are provided with a critical and explanatory review of the latest draft Level 2 texts published by the European Securities and Markets Authority (**ESMA**). Attendees can learn how MiFID II will affect financial services firms from legal, financial, operational, technological and strategic perspectives.

MEDIA PARTNERS AND STRATEGIC PARTNER FIRMS



Storm-7 Consulting have worked with a number of leading firms around the world and have in place a broad range of media partnerships and strategic partnerships. This includes firms such as the United Kingdom Financial Conduct Authority, the Central Bank of Ireland, Sopra Steria, SunGard, Capco, JP Morgan Asset Management, Custom House Global Fund Services, Ritrema, Eze Castle Integration, Imperial College London, Cass Business School, Bangor University, Solum Financial, OTC Partners (New York), OTC Space, Heriot Watt University, EurekaHedge, Hedge Fund Alert, WallStreetOasis, Luxurise, Alpha Journal, ATMonitor, Financial IT, HedgeConnection, HF Alert, and CrowdReviews.



BOOKINGS AND ENQUIRIES

Storm-7 Consulting have received bookings and consulting enquiries from firms such as the Central Bank of Russia, Gulf International Bank, Astellon Capital, Cognizant, Accenture, Eversheds, John Hancock, ICBC Standard Bank, NBK Capital, AB Maximus, Lazard Asset Management, Renaissance Capital, GT Bank, Stuart Walker Cayman Law Firm, Garanti, E&I Shipping and Trading, ABN Amro, Moore Stephens, FDIC, Total, Desjardins, Kreab, Deutsche-Boerse, FNO.NO, Barclays Investment, JS Bank, ADM Investor Services, Woodbridge Funds, Enel, Hyannis Port Research, Standard Life, Celdes S.R.L., IFA Global, Raiffeisen Bank International AG, BGC Partners, Fresenius SE & Co. KGaA, Bartonheyman, Lloyds Banking Group, MS Amlin, Islamic Bank, Citadel, and Clearsettle.

The MiFID II modular in-house training course allows firms to choose from a broad range of modules that allows them to specifically tailor the training course to their precise organisational requirements.

MODULE 1

An Introduction to the New MiFID II Operational Framework

MODULE 2

Market Structure, Trade Reporting and Transaction Reporting

MODULE 3

Transparency, Position Limits and Position Reporting

MODULE 4

Organisational Requirements, Conduct of Business Rules and Investor Protection

MODULE 5

The Third Country Firm Framework

MODULE 6

Over-the-counter (OTC) and Commodity Derivatives

MODULE 7

Liquidity, Algorithmic Trading, and Dark Pools

MODULE 8

MiFIR Reporting Framework

MODULE 9

Use of Technology and Software in MiFID II Compliance Programs

MODULE 10

The Operational Impact of MiFID II and Strategic Analysis

MODULE 11

MiFID II Investment Strategies

MODULE 12

Research Unbundling

MODULE 13

Suitability and Appropriateness

MODULE 14

The Recording of Telecommunications

MODULE 15

MiFID II Best Execution

MODULE 16

The MiFID II Approved Reporting Mechanism Framework

MODULE 17

The MiFID II Approved Publication Arrangement Framework

MODULE 18

The MiFID II Consolidated Tape Publication Framework

MODULE 19

Key MiFID II Considerations for MiFID II Third Country Firms

MODULE 20

Using Artificial Intelligence and Machine Learning to Identify and Analyse MiFID II Requirements

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PREMIER FINANCIAL INSIGHT



“ We believe that although certain functionalities are at the employee’s discretion, the firm is responsible for ensuring that, for example, relevant conversations on the firm-issued equipment are either recorded and stored for six months or that conversations that take place on alternative devices are subject to taping. ”
(FSA Policy Statement 10/17, para. 2.46).


“ The rules will still apply under circumstances when the firm has issued the equipment, but the contract for other functionalities is between the employee and service provider, as it is the firm’s responsibility to ensure the device is used in accordance with its internal policies. ”
(FSA Policy Statement 10/17, para. 2.47).

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