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RECORDING OF TELEPHONE CONVERSATIONS AND OTHER ELECTRONIC COMMUNICATIONS

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Important Note: *This article has been written for general information purposes only and should not be used as definitive professional advice. Readers must, where necessary, seek proper professional advice before deciding on any particular course of action.*

Introduction

One of the FSA's statutory objectives is the reduction of financial crime. Preventing, detecting and deterring market abuse is one of the key priorities under this objective. Unfortunately for the FSA, market abuse is one of the most difficult areas to investigate and in particular, finding the "smoking gun". The disastrous case of The Plumber bears testimony to this difficulty.

In an attempt to make it easier to find the "smoking gun", the FSA has announced that from 6 March 2009 (this date is hidden away in FSA Policy Statement 08/1 on page 76), firms will have to record all telephone conversations and electronic communications relating to client orders and the conclusion of transactions in the equity, bond, and derivatives markets. This new requirement will also help firms in deterring market abuse if staff know that their conversations are going to be recorded. However, there is a loophole which potentially can be exploited by the "bad boys" – see "The main loophole" below.

These requirements applies only with respect to a firm's activities carried on from offices maintained by the firm in the United Kingdom. Potentially, this is yet another loophole that the "bad boys" can exploit. In addition, firms such as service companies are not caught by these requirements.

Outline of requirements

The FSA requires firms to take reasonable steps to record relevant telephone conversations, and keep a copy of relevant electronic communications, made with, sent from or received on equipment provided by the firm to an employee or contractor, or the use of which has been approved by the firm.

The main loophole

The above requirement does not apply to telephone conversations and electronic communications (except e-mails) made with, sent from or received on a mobile telephone or other mobile hand held electronic device. Any person who is up to no good will obviously exploit this loophole – it is an absolute “no brainer”. Granted there are difficulties with trying to record mobile communications and let us hope that the exemption does not open the flood gates!

Exemptions for discretionary fund managers

Discretionary fund managers have been given two exemptions.

Firstly, they are not required to record telephone conversations, or keep a copies of relevant electronic communications from firms where the discretionary fund manager reasonably believes that the other firm is subject to the recording obligations in respect of that conversation or communication.

Secondly, where a discretionary fund manager deals with a person who is not subject to the recording obligations and such business is on an infrequent basis, and represents a small proportion of the total telephone conversations and electronic communications, then record keeping requirements are not required. The term “small proportion” has not been defined and is open to interpretation – firms and their compliance officers need to exercise their professional judgement.

In the context of the above, the FSA would not usually expect conversations or communications made by investment analysts, retail financial advisers, and persons carrying out back office functions to be caught by the above requirements.

Record Keeping

A firm must take reasonable steps to retain all records made by it for a period of at least six months and in a medium that permits the FSA to access the records readily. Where corrections or amendments are required to such records then the situation prior to these changes should also be easily ascertained from the records – i.e an audit trail needs to be maintained of the changes made.

Conclusion

These new requirements have been introduced by the FSA in order to help bolster its efforts to stamp out market abuse. Obviously, FSA needs to have a Plan B in terms of the potential loopholes. Wrong doing cannot be condoned and we hope FSA’s laudable initiative will be effective.

Notes for editors and readers

1. This article is based on the information available on 29 May 2008 and was written with the kind assistance of Peter Szeremeta who is a compliance consultant with Financial Services Compliance (EU) Limited.
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