



# Taping: Removing the mobile phone exemption

This Paper has been prepared by Research In Motion® based on advice from Hogan Lovells, the international law firm



## Contents

1. Executive Summary .....	3
2. The current position .....	4
3. Why the FSA is considering removing the exemption .....	5
4. The FSA's proposed changes .....	6
5. Technology Solutions .....	7
6. Business Benefits .....	9
7. Conclusion .....	10
Appendix. The taping rules - Conduct of Business Sourcebook 11.8 .....	11

# 1. Executive Summary

**In March 2008 the Financial Services Authority (“FSA”) published new rules requiring firms to record telephone conversations and electronic communications relating to client orders and to the conclusion of transactions in the equities, bond, and derivatives markets.** These taping rules apply to all FSA authorised firms that carry out such activities, including banks, stockbrokers and investment managers. The records must be kept for at least six months, and they must be readily available for inspection by the FSA.<sup>1</sup>

The FSA introduced these additional rules to enhance their ability to monitor, investigate and prosecute market abuse offences. The FSA have wide ranging disciplinary and enforcement powers for non-compliance with the rules, including the ability to fine and publically censure firms and individuals, and prohibit them from carrying out regulated activities in the future.

**There is a specific exemption for communications to and from mobile phones and in respect of other mobile communications (with the exception of emails).** This was introduced due to the cost of, and technical difficulties with, recording mobile communications.

The FSA is currently reconsidering this exemption, in a Consultation Paper published in March 2010. The consultation period ends on 14 June 2010. The basis for the proposed removal of the exemption is that technology has advanced sufficiently since March 2008 that it is now technically feasible, at reasonable cost, to record mobile communications and to store them as required.

As firms should now be able to comply with the proposed FSA requirements to record and store mobile communications at reasonable cost, they should not need to ban such communications. This should improve operational efficiency and allow firms’ employees to transact on the most timely basis. We believe that firms will therefore welcome these proposals.

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1. The rules for the recording of telephone conversations and electronic communications can be found in the FSA’s Conduct of Business Sourcebook (“COBS”) at <http://fsahandbook.info/FSA/html/handbook/COBS/11/8>.

## 2. The current position

Currently each member state of the European Union has its own taping requirements and the regimes vary significantly between member states.<sup>2</sup> The UK's taping rules were published by the FSA in March 2008, and came into effect a year later. The rules require firms to take reasonable steps to record 'relevant communications', which are voice and electronic communications that involve the receipt of client orders and negotiating, agreeing and arranging transactions in the equity, bond and financial and commodity derivatives markets (COBS 11.8.8). The rules are summarised in the Appendix.

Mobile phone conversations and other mobile communications (except emails) were exempted from the rules (COBS 11.8.6). **The FSA was advised that, at the time, the technology to record and retain copies of these communications was insufficiently developed to provide a feasible technical solution at reasonable cost.**

Some firms have been concerned that their employees might misuse firm-issued mobile phones and other mobile communication devices. As suitable technical methods did not exist at reasonable cost until fairly recently, a number of those firms chose to ban the use of mobile communication devices for transacting the firms' business. This would reduce the prospect of the firms being exposed to reputational risk as a result of their employees misusing firm-issued equipment.

In its Policy Statement PS08/1, published in March 2008, the FSA noted that it would review the mobile phone exclusion towards the end of 2009. The FSA met with various interested parties - technology suppliers, trade associations and economic consultants - to test the feasibility of extending the taping rules to mobile communication devices. After reviewing the feedback from these parties, **the FSA published a Consultation Paper (CP10/7) in March 2010, in which it outlines its plans to remove the mobile phone exemption.**

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2. Although taping requirements are derived from the same European legislative sources (Article 12(1) of the Market Abuse Directive and Article 51(4) of the Markets in Financial Instruments Implementing Directive), these give member states a wide discretion as to how and what to implement.

## 3. Why the FSA is considering removing the exemption

### The FSA's reasons

In its Consultation Paper (CP 10/7), the FSA explained the purposes for removing the mobile communications exemption. The FSA gave two key reasons for this:

- a. To close a loophole and enhance enforcement of the taping rules: Individuals can currently divert fixed line traffic onto an un-taped mobile line.
- b. Technological advances: The technology to record, store and retrieve mobile communications has advanced. Firms now have a choice of 'hosted' or 'in-house-integrated' solutions and a wide range of suppliers to capture relevant mobile communications.

### Background to the FSA's reasons

Preventing market abuse is one of the FSA's key priorities. Removing the mobile communications exemption would produce an additional source of voice conversation and electronic communication evidence that would allow the FSA to improve its monitoring, investigation and enforcement in relation to alleged market abuse offences.

The removal of the exemption would result in consistent regulatory treatment of all electronic communication media operated by a firm.

When the FSA introduced transaction recording rules in March 2008, the evidence before them was that it would be overly burdensome on firms to record and store communications to and from mobile phones and other electronic communication devices. This was due to the state of technical advancement at the time and the cost of technical solutions. The FSA is reconsidering the position now, in the light of technical developments that have been made over the past two years.

## 4. The FSA's proposed changes

**The FSA proposes to extend the current taping obligations to include the recording and storage by firms of all 'relevant communications' that are made with, sent from, or received on mobile phones** (and other mobile communication devices).

**The extension will apply only to mobile phones that are issued by firms for business purposes.** Applying the taping rules to private mobile devices would increase the scope for capturing non-relevant (non-business) conversations. This could infringe privacy laws. Accordingly the FSA plans to introduce an additional rule requiring firms to take reasonable steps to ensure that relevant communications do not take place on private communication equipment. Private communication equipment includes private mobile phones, private handheld mobile electronic communication devices and private non-mobile electronic communication devices. **The FSA proposes that should any relevant conversation be received or commenced on private communication equipment, the conversation must be terminated immediately and diverted to a recorded business line.**

**The FSA expects to make the changes to the taping rules towards the end of 2010. The FSA would then allow a transition period of one year for firms to implement.**

## 5. Technology Solutions

The FSA commissioned a study from Europe Economics to review the practicalities of extending the taping rules to cover mobile communications. Following the study, the FSA is satisfied that there is an adequate choice of technology and suppliers for firms.

There are currently two primary technology solutions that allow incoming and outgoing relevant communications made on mobile phones to be recorded. These are:

- a. by recording the relevant communications on the handset; or
- b. by recording the relevant communications on a remote server.

Two further solutions allow relevant communications to be stored and retrieved:

- a. by storing the communications on an in-house server, managed by the firm and located on the firm's premises; or
- b. by storing the communications on a hosted server, managed by a third party or the technology provider on other premises.

To meet the FSA's objectives the technology solution needs to ensure that calls are reliably recorded wherever the calls are made or received, and that the recordings are stored securely but accessibly. To avoid the potential for market abuse the technology should make certain that users cannot bypass or delete the recordings. The FSA highlighted a potential disadvantage with recording communications on the handset, since following the end of the call and prior to the establishment of a successful data connection with the server the only place the recording exists is on the handset. If the handset is switched off, the battery runs out or coverage is lost during or immediately after a call and the handset is then destroyed or reconfigured any recordings will be lost. The FSA also indicated that larger firms in particular may prefer to integrate the storage of mobile calls with their fixed line recording, making search and retrieval easier.

According to Europe Economics, the average cost per line to implement a solution is estimated at £700 as a one-off payment (for, amongst other things, the purchase of software and installation of the software) and £1,200 per annum on-going payments. On-going payments would include payments for maintaining the recording equipment, storing records and retrieval of records. The study suggests that prices

should not rise as a result of the removal of the current exemption; indeed, it is possible that, owing to greater demand, unit prices will fall.

In a survey of relevant firms, Europe Economics found that around 60 per cent of firms would ban the use of mobile phones should the mobile communications exemption be removed. These firms accounted for approximately 30 per cent of mobile phones in the sample.

Taking into account those firms who would ban the use of mobile phones should the exemption be removed, Europe Economics estimates that the total one-off incremental cost to the industry would be £11 million.<sup>3</sup> Total on-going incremental costs would be around £18 million.

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3. For the reasons given in paragraph 6.2 below, it may be the case that firms are less likely to ban mobile phone use than might have been thought.

## 6. Business Benefits

**Removing this exemption** might appear to be another headache for compliance officers, especially for small-sized firms, but the firms should welcome these recording rules as they **would make it more difficult for individuals to commit offences and it will allow the firms to provide evidence required for successful prosecution.**

It will also help firms avoid the prospect of FSA sanctions. Misuse of mobile phones to facilitate market abuse has already led to enforcement action by the FSA. **The FSA recently imposed fines of £4.25 million, publicised as the largest ever penalty for a financial firm, on Winterflood Securities and two of its traders.** Among other improper actions, the traders communicated with their broker by mobile phone in order to avoid trading discussions being taped. Winterflood itself were disciplined for failing to recognise and react to the wrongdoing.

Overall, the proposed changes should also benefit firms in the following ways:

- a. Firms which ban mobile communications which would be covered by the new rules are currently likely to be suffering a reduction in operational efficiency and some loss of business.
- b. In view of the necessary technology becoming available [at reasonable cost] [with cost reductions due to technological innovation and scale], these and other firms can now make a virtue out of necessity, implement a compliant solution and realise the benefits of operating a recorded mobile communications network.
- c. The FSA has also identified that in market terms, there should be increased market confidence and greater price efficiency as a result of the revised rules.

## 7. Conclusion

We believe that firms should embrace the new requirements, which should improve operational efficiency, avoid loss of business and allow firms' employees to transact on the most timely basis. **The requirements should reduce the risk that mobile phones are used to facilitate market abuse and improve firms' and the FSA's ability to investigate such offences;** therefore increasing market confidence and avoiding cases such as Winterflood. With the necessary technology, that ensures that recording systems cannot be bypassed, firms will be able to comply with the requirements and realise the benefits.

It is important that firms consider how they will respond to the new requirements within the anticipated timescale (by around Q4 2011). **Firms need to take the necessary steps to ensure they can implement their chosen technology solution in good time** by ascertaining the key requirements, reviewing the available options and identifying the most suitable solution.

**There are several software solutions available which offer banks an easy way to comply with forthcoming regulations and empower their staff to trade on their smartphone, knowing that the conversation is being recorded and so can be easily retrieved if required.** These solutions leverage the BlackBerry platform's inherent security architecture to keep recorded calls safe. The BlackBerry platform's in-built flexibility also ensures that these applications can be easily rolled out over-the-air to end users' BlackBerry smartphones.

## Appendix

### The Taping Rules - Conduct of Business Sourcebook 11.8

#### 1. The taping rules

The FSA's rules on recording telephone conversations and electronic communications ("the taping rules") are outlined in the Conduct of Business Sourcebook 11.8 ("COBS 11.8").

#### 2. Application - who

Under COBS 11.8.1, the taping rules apply to all FSA-authorized firms that carry out the following activities:

- a. receiving client orders;
- b. executing client orders;
- c. arranging for client orders to be executed;
- d. carrying out transactions on behalf of the firm, or another person in the firm's group, and which are part of the firm's trading activities or the trading activities of another person in the firm's group;
- e. executing orders that result from decisions by the firm to deal on behalf of its clients; and/or
- f. placing orders with other entities for execution that result from decisions by the firm to deal on behalf of its client.

The taping rules will only apply if the activities listed above relate to certain "qualifying investments".

#### 3. COBS 11.8.2 Application - where?

COBS 11.8 only applies to a firm's activities carried on from an establishment maintained by the firm in the UK.

## Appendix

### The Taping Rules - Conduct of Business Sourcebook 11.8

#### 4. Recording telephone conversations

Under the taping rules, firms must 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 to enable that employee or contractor to carry out any of the activities referred to in paragraph 2 above.

There are certain exemptions, in particular, under COBS 11.8.5 this obligation does not currently apply to telephone conversations and electronic communications (except emails) made with, sent from or received on a mobile telephone or other mobile handheld electronic communication device.

#### 5. Relevant communications

A relevant communication is any one of the following:

- a. a conversation or communication between an employee or contractor of the firm with a client, which concludes an agreement by the firm to carry out the activities referred to in paragraph 2.1 above as principal or as agent;
- b. a conversation or communication between an employee or contractor of the firm with a professional client or an eligible counterparty, or when acting on behalf of a professional client or an eligible counterparty, with another person, which is carried on with a view to the conclusion of an agreement referred to in (a) above, and whether or not it is part of the same conversation or communication as in (a).

This includes conversations and communications relating to specific transactions which are intended to lead to the conclusion of an agreement by the firm to deal with or on behalf of the client as principal or agent, even if those conversations or communications do not lead to the conclusion of such an agreement. It does not include conversations or communications which are not intended to lead to the conclusion of such an agreement, such as general conversations or communications about market conditions.

## Appendix

### The Taping Rules - Conduct of Business Sourcebook 11.8

The FSA would not usually expect firms to record conversations or communications made by investment analysts, retail financial advisers, and persons carrying on back office functions, as such persons will not normally make relevant conversations or communications when acting in those capacities.

#### 6. Retention

Firms must take reasonable steps to retain all records of relevant communications for a period of at least six (6) months from the date the record was created. The records must be readily accessible for future reference by the FSA, and any corrections or other amendments must be clearly marked. Firms must ensure they have adequate systems in place to prevent the records being altered or manipulated.

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