

## **CP16/29: Markets in Financial Instruments Directive II implementation – Consultation Paper III - FCA Practitioner Panel and FCA Smaller Business Practitioner Panel response**

The following comments are the FCA Practitioner Panel and FCA Smaller Business Practitioner Panel response to CP16/29, specifically regarding Chapter 15 on recording of telephone conversations and electronic communications and related questions 54 to 59.

### **MIFID II & Telephone Taping – FCA Practitioner and Smaller Business Practitioner Panel response**

We believe that the proposal requiring all Article 3 firms to tape client telephone conversations is a disproportionate response to the 'analogous' requirements as set out in the MIFID II Consultation paper.

#### **Proportionality**

The proposed rules, in effect, amount to a requirement to tape all calls of advisers, whether on mobile or landlines, as it cannot be known before a call is made whether it is from a client relating to an investment transaction or not. We estimate that this may require storage of between ¼ and ½ billion of landline calls alone (over a 5 year period). This is clearly not proportionate to the market abuse objective as set out by the MIFID II regulation nor the consumer protection objective as set out by the FCA in relation to article 3 firms. Market abuse which tends to be centred around trading of shares listed on recognised exchanges and/or using inside information is broadly irrelevant in a retail financial advisory relationship whilst article 3 firms account for just c170 dispute cases referred to FOS per year and with no evidence to suggest that call recording would have helped in any of these cases nor resulted in a different client outcome.

#### **Cost Benefit Case**

Given the predominance of face to face advice over telephone based advice by Article 3 firms, the consumer protection objective as set out by the FCA will not be enhanced through the taping of telephone conversations and is not commensurate with the costs to the industry both in monetary and non-monetary terms. The industry analysis we have conducted suggests that the costs of taping for article 3 firms would be in the region of £30m-£40m per annum for what appears to be minimum benefit. Further details of the cost benefit analysis can be found in the appendix to this note.

#### **Practicality**

Whilst the FCA acknowledges that a different solution may be possible for smaller firms, the reality is that the largest article 3 firms are, in practice, made up of lots of smaller businesses, individuals, or advisors. APFA and the FCA's register analysis suggests that there are around 15,000 such firms, the majority of whom operate from their own premises despite many being 'associated' with larger organisations. In addition:

- A number of these firms operate out of serviced office premises and may not have a choice of the telephone systems they use.
- Advisers may also be contacted on personal devices, which could result in recording of personal calls. This also raises concerns regarding compliance with the Data Protection Act if calls have to be recorded which are not business calls and are not relevant to investment transactions.
- Implementation of the rules as proposed results in a curiously inconsistent approach to face-to-face versus telephone communication. If an advisor meets with a client in

person, it is acceptable to rely on notes taken from that meeting to record what took place in line with the FCA's agreed response to ESMA's guidance on such meetings. If exactly the same conversation takes place over the phone, the new rules require it to be taped. The regulatory approach does not reflect the way advisers do business in practice. It would also potentially change the relationship the advisor has with their client.

### **Analogous Requirement**

We have sought legal opinion on the requirements of the FCA to implement MIFID II legislation and in particular the definition of 'analogous'. The legal opinion has set out the following:

- *"The word 'analogous' when used as it is in the English text of the MIFID II directive does not mean that exactly the same provisions as under the Directive need to be in place.....If that meaning had been intended, the Directive would have used clear language to indicate that intention."*
- We note that *"at least analogous"* means *"delivering an analogous outcome"*. It does not mean *"identical to"*.

### **Proposed Alternative and "Analogous" Solution**

We believe that an 'analogous outcome' can be achieved by requiring firms to document and retain a written record of any relevant calls (ie those related to an actual trade). This is aligned to the approach set out in MIFID II for face to face advice as set out by the ESMA technical guidance which states that *"the content of relevant face-to-face conversations with a client may be recorded by using written minutes or notes. Such orders shall be considered equivalent to orders received by telephone."*

We believe that the above approach would meet the requirements of the FCA under the MIFID II regulation for article 3 firms whilst being proportionate and appropriate for the nature of financial advisory firms and their relationship with clients.

## Appendix - Cost & Benefit Analysis

This note seeks to provide further details on the cost benefit case for requiring telephone taping for article 3 firms. The FCA consultation (CP16/29) sets out the following:

“We propose to apply a taping regime to all Article 3 firms...This is because based on information from the Financial Ombudsmen Service the majority of complaints about investments centre on the conversations that happened when they are sold. We think taping conversations between firms and their clients is likely to be an effective way of advancing our consumer protection objective.”

This analysis explores likely costs and benefits at an individual firm level as well as a view on the case for implementing across the industry.

### Indicative Costs of Telephone Taping

As it cannot be known before a call is made whether it is from a client relating to an investment transaction or not, the rules amount to taping of all calls to advisers, whether on mobile or landlines. We start, therefore, by estimating the likely cost of implementing telephone taping of all calls at an individual firm level.

- **Individual Firm:**

We have sought to obtain indicative costs from a range of providers across the industry for installing and running the necessary functionality across both fixed lines and mobiles. A typical estimate is set out below albeit there is a wide range of quoted figures both from a cost and level of required storage perspective:

	Ongoing Costs
<b>Fixed Landlines:</b> <ul style="list-style-type: none"> <li>- Recording cost per extension per month<sup>1</sup></li> <li>- Storage cost of recordings per GB per year</li> </ul>	£15-£20 pm £15-£20 pm
<b>Mobile Phone Costs:</b> <ul style="list-style-type: none"> <li>- Recording cost per mobile per month<sup>2</sup></li> </ul>	£25-£50 pm

We have made the following assumptions about a typical small individual financial advisor practice with some admin support which equates to the following approximate annual cost:

Description		Annual Cost
Number of Landlines:	3	~£700
Number of Mobiles:	2	~£900
Call Storage:		
<ul style="list-style-type: none"> <li>- Average number of calls per month<sup>3</sup> (landlines)</li> <li>- Average length of call</li> </ul>	335 5-10 mins	

<sup>1</sup> Provisional costs obtained taken from a technology provider that supports financial advisory firms.

<sup>2</sup> Provisional costs obtained from 2 mainstream telephony providers.

<sup>3</sup> Taken from a financial advisory firm estimate of call volumes.

Description		Annual Cost
- Hours of recording required per year	~500hrs	~£900
- Storage required per year	10GB	
(Based on 1GB required for approx. 50 hours of calls)	50GB	
- Storage required for 5 years of calls		
<b>Total</b>		<b>~£2500</b>

Whilst in practice, these will vary significantly across firms, it does provide a framing point for the likely annual ongoing costs of a typical firm.

Within the consultation paper, the FCA quote the following: *“Based on evidence from suppliers, our assessment is that the technology to tape phone conversations has improved and costs have reduced significantly since the FSA introduced the requirement to tape in 2008. We estimate that the cost of technology has fallen by a third. Data retention costs have also fallen significantly since the development of third party cloud storage and we expect this trend to continue.”*

Within the different FSA papers from 2008 and 2010 requiring telephone taping, the FSA quoted the following:

FSA Paper		Estimated Cost
PS08/01 March 2008	Small firm cost per fixed line per annum <sup>4</sup>	£644
CP10/7 March 2010	Small Firm cost per mobile line per annum <sup>5</sup>	£2,219

For a similar firm of 3 landlines and 2 mobiles, taking these figures would equate to an annual cost of £6,370 and using the FCA's recent estimate that costs have fallen by a third would result in an estimated annual cost of more like ~£4,000-£4,500 which is substantially more than the figure we have estimated using the approach above. It would appear, therefore, that the actual cost for small firms has been underestimated in this latest CP as none of these details are included within any of its cost-benefit analysis. The CP focuses on a more call-centre style model in its cost-estimates to industry as detailed below.

- **Industry Level**

For larger firms, there will be some economies of scale, however, even the larger Article 3 financial advisory firms impacted are, in reality, made up of lots of smaller businesses of 3 to 5 individuals or advisors for which taping of telephone calls is impractical.

Based on a current estimate of c15,000 advice firms and an annual cost of £2500 per firm, the cost to the industry would be c£30m to £40m per annum. This is overly-simplistic given some larger firms will have multiple advisors working for them, however, they will also benefit from economies of scale. An estimate by one large firm which makes up c10% of the advisor population was that the ongoing cost was likely to be of

<sup>4</sup> Taken from Table 3.9 on p.22

<sup>5</sup> Taken from Table 3 p.12.

the order of c£3m per annum. This also feels consistent with the order of magnitude above and reflects the position that large firms which are made up of lots of smaller businesses do not necessarily benefit from significant economies of scale.

In terms of call volumes, using the same estimated number of small firms and calls per month, between ¼ billion and ½ billion landline calls would be recorded and stored over a 5 year period.

It is important to note that the FCA within their consultation paper have set out estimated costs that would apply to Discretionary Investment Managers based on a call-centre approach. The assumptions underpinning this model are quite different to the ones we have set out above but suggestions that it will cost between £2.4m and £4.7m in ongoing costs significantly under play the total industry costs associated with running small advisor practices.

### Benefits of Taping

The FCA acknowledges that *"Estimating the benefits of taping is not reasonably practicable"* however they state the following in relation to the key benefits that taping will bring:

*"We believe there are real benefits in applying a taping requirement to Article 3 firms. There has been an upward trend in the sales of investment products to retail clients over the last number of years. We expect this to continue following changes to the rules governing pensions, ISAs and the Bank of England's base rate. However, we are aware that the majority of complaints that the FOS receives about investments centre around the conversations that happen when they are sold. The existence of tapes will therefore provide a clear audit trail of the intention and understanding of the parties leading up to the conclusion of a transaction, particularly in cases when allegations of misselling arise. We believe that consumers will also benefit from the self- disciplining effect on advisors from recording calls. Other benefits include providing supervisors with an additional tool when undertaking thematic reviews or mystery shopping exercises. Access to tapes will also provide our Enforcement division with an additional source of evidence."*

In looking at the Financial Ombudsmen Service Complaints Data for H1 2016, there are some interesting statistics relating to number of new cases relating to MIFID business.

Total Number of New Cases Received	<b>157,945</b>	
Total Number of Cases related to Investment (MIFID) business	<b>1446</b>	<b>0.9%</b>
Top 10 firms for Investment complaints:	<b>1123</b>	
- Barclays Bank plc	228	16%
- HSBC Bank plc	170	12%
- Lloyds Bank Plc	147	10%
- National Westminster Bank plc	138	10%
- Bank of Scotland plc	130	9%
- The Royal Bank of Scotland plc	87	6%
- Santander UK plc	87	6%
- Nationwide Building Society	50	3%
- Equinity Financial Services Limited	50	3%
- Clydesdale Bank Plc	36	2%
Number of Investment Cases relating to article 3 firms:	<b>86</b>	<b>0.05%</b>

None of the top 10 firms listed here are article 3 exempt firms. In total, there was only 86 cases which related to article 3 firms (0.05% of all complaints and just 5% of investment cases). Of these cases, it is questionable how many would have been related to situations where call recording would have helped resolve the complaint for a better outcome for clients.

### **Benefits of Taping within an individual firm**

One advisory firm conducted its own analysis by taking a sample of complaint cases over a 2-month period to assess whether telephone taping requirements as set out in CP16/29 for article 3 firms would have made a difference to the likely client outcome.

Whilst only a small sample, it does provide an indication of the potential benefits taping may deliver.

Average proportion of total complaints relating to Investment (MIFID) business	15%
Proportion of complaints where there was a material telephone conversation in the last 5 years?	1%
Proportion of cases where client outcomes <i>may</i> have been different as a result of telephone taping	0%

The latter figure of 0% is because often in cases where there is a dispute regarding what was said and wasn't said on a telephone call, the firms approach was generally to settle the claim in favour of the client.

It is also worth noting that across all complaints (investment business or otherwise) received by the firm c40% of cases relate to events that happened more than 5 years ago where telephone taping according to the MIFID rules would clearly not help.

We believe that these figures are likely to be representative across the industry.

### **Summary**

Taking the above analysis into account, the costs to the industry (£30-£40m per annum) versus the likely benefits (c170 FOS cases per year where call recording may or may not have helped) highlight that requiring telephone recording for article 3 firms is clearly not proportional.