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1 What is the MiFID II Directive?

1.1 History

Facilitating economic growth and cooperation among European states has been a prominent goal of the European Union (EU) since it was established. The Investment Services Directive (ISD) was one of the first major attempts towards harmonizing investor protection and capital movement throughout the EU. Adopted in 1993, the ISD sought “to improve the competitiveness of EU financial markets by creating a single market for investment services and activities.” For 14 years, the ISD facilitated the development of harmonized protection for investors in various financial instruments, such as shares, bonds, derivatives and a variety of structured products.

1.2 MiFID

In November 2007, the ISD was replaced with the Markets in Financial Instruments Directive, more commonly known as MiFID. The drafters took substantial steps forward toward a single EU market by evolving the ISD, which focused on “minimum harmonization,” to MiFID, which focused on “very wide harmonization.” Conceptually, ISD aimed at standardizing the “initial authorization and operating requirements for investment firms, including conduct of business rules…” and “some conditions governing the operation of regulated markets.”  MiFID expanded that focus, aiming to ensure “the degree of harmonization needed to offer investors a high level of protection and to allow investment firms to provide services throughout the Community.”

MiFID has contributed to a more competitive and integrated EU financial market. However, the 2008 financial crisis and other market developments demonstrated weaknesses in some of the underlying principles of MiFID. In order to bolster investor confidence and achieve all of MiFID’s original objectives, the European Commission decided to revise the Directive with an emphasis on safety, soundness and transparency.

1.3 MiFID II

Enter the MiFID II Directive. Taking effect on 3 January 2018, MiFID II consists of new rules regarding trade inducements, research, best execution, market transparency, algorithmic trading and communication recording. Arguably the most extensive financial regulation imposed on the EU to date, MiFID II aims to create a more responsible financial system for the economy and society as a whole.

In a FAQ document that in part explained why MiFID II was necessary, the European Commission stated: “Ensuring a more robust regulatory framework will also serve to address the more complex market reality we are now faced with, a reality which is characterized by increasing diversity in financial instruments and new methods of trading.”

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2 Purpose of a Directive?

2.1 Overview

In discussions about MiFID II, this question often gets lost or glanced over entirely. However, it is important to understand some basic information about how the European Union imposes rules upon Member States.

2.2 Explanation

The EU has primarily two methods of rulemaking; regulations and directives.

Regulations are self-executing, which means they automatically take effect as written in every Member State. Directives, such as MiFID II, must be adopted by the individual Member States before they take effect.

This allows the EU to create a broad initiative, but grants the individual Member States some discretion on how to implement it. The distinction is important since many areas of MiFID II indicate actions that *should* be done, as opposed to those that *must* be done.

2.3 Conclusion

By their very nature, Directives can vary widely depending upon how the Member State chooses to implement them. Furthermore, transactions that traverse international boundaries may find themselves subject to adaptation by both countries. This adds additional layers of complexity to an already colossal undertaking.

In response to a Directive, any technology solution implemented by global firms must not only be robust enough to satisfy the requirements of the host nation, but also flexible enough to conform to any cross-border nuisances. Traditionally, financial institutions purchase solutions based on their own regional needs, without any considerations given to boundary crossover. Given the high likelihood of transnational differences, Banks impacted by MiFID II should ensure that any solutions they adopt not only satisfy the requirements of the host country, but also satisfy the requirements of all other countries in which they do business. This approach will reduce operational challenges to implementation, and increases the probability of multinational compliance.
MiFID II and Mobile Recording Requirements

3 Why Mobile Phones Must Be Recorded

3.1 Overview

In the modern world, customers expect round-the-clock, real-time responsiveness – which requires the use of a mobile device. Communications around financial transactions are no exception and the investing public expects that level of service from their preferred financial institution.

MiFID II expands on the current mandate requiring firms to record communications. The recording requirements will now cover all telephone conversations and electronic communications relating to activities intended to result in the conclusion of a transaction or the provision of client order services - even if they in fact do not. In short, MiFID II imposes an obligation to record ALL relevant telephone conversations and electronic communications – including those which take place on mobile phones.

In general, there are three main reasons for imposing a recording requirement on communications related to transactions:

- To ensure evidence exists to resolve disputes between firms and clients;
- To assist those empowered to supervise code of conduct adherence within the firm; and
- To help deter market abuse, through enhanced detection.

When disputes arise between a firm and a client, they can often be resolved in-house without further escalation. Far more frequently, it is difficult for compliance departments, authorities, or regulators to detect market abuse and prove malicious action. “Evidence collected through recording obligations can provide additional material for discovering the facts of a case.”

Regardless of the outcome, recorded evidence is compelling, and can sometimes even refute information presented through documentation or oral testimony.

Recital 144 further illustrates the importance placed upon recordings:

Existing recordings of telephone conversations and data traffic records from investment firms executing and documenting the executions of transactions...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...

3.2 Limiting Potential for Market Abuse

Aside from evidentiary value, recording can prevent market abuse. Consider for a moment how much higher the risk of market abuse would be if your firm only recorded and monitored trading, front-office, and back-office communications, and excluded communications on mobile phones. A few bad actors would instantly have a clandestine tool to perform all manner of untraceable fraud. Given the importance in today society, excluding mobile recording affectively nullifies the directive’s purpose of increasing certainty, investor protection, and deterring market abuse.

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4 CESR/10-859
5 Recital 144, MiFID II
3.3 Explanation

Article 16(7) states, “an investment firm shall take all reasonable steps to record relevant telephone conversations and electronic communications, 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.”

Although some have questioned what is considered “reasonable” under the Directive, the EC went further requiring that “[a]n investment firm shall take all reasonable steps to prevent an employee or contractor from making, sending or receiving relevant telephone conversations and electronic communication on privately-owned equipment which the investment firm is unable to record or copy.” (emphasis added).

Lastly, it is important to note the recording of mobile conversations is not a concept introduced in MiFID II. In July of 2010, the Committee of European Securities Regulators published technical advice on MiFID. Among other things, the CESR indicated that some firms, who currently permit the use of mobile phones but do not currently record relevant conversations, may well choose to ban their use….” The report contains UK mobile recording cost estimates that are substantially higher than today, concluding “ultimately, investment firms will decide whether they wish to use mobile phones to take client orders.” Under MiFID II the query remains the same, although the cost of recording mobile phones has decreased dramatically in the seven years since the report was issued – changing the outcome of ROI analysis for many stakeholders.

3.4 How do Firms Protect Themselves?

Firms often try to rule by policy, and this instance should be no different. Given how mobile devices are so intertwined into our daily lives, and how necessary they are for business today, it would be prudent for firms to provide mobile phones to all employees covered by the Directive.

Mobile devices provided by the firm directly enable the greatest level of control and oversight. Monitoring of mobile devices will therefore be available firm wide, and adherence of company policies and procedures is greatly increased. Any malfeasance detected can thus be attributed to an individual actor, and not an institutional failure to supervise.

3.5 Conclusion

If any of the aforementioned sections existed in a vacuum, a case could be made that an investment firm’s obligation to record is reasonably satisfied by recording solely turret or PBX-based communications. However, when read in totality, it becomes evident that MiFID II imposes an obligation to record ALL relevant telephone conversations and electronic communications, including mobile.

If an exemption for mobile phones is included, it severely weakens the effectiveness of a recording requirement and undermines a fundamental rationale behind the Directive.

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6 Recital 57, MiFID II
4 The Urgency is Clear

4.1 Overview

The European Commission tasked ESMA to evaluate the impact of obligations created as a result of MiFID II. A questionnaire was sent out to 300 investment firms and UCITs management companies proving investment advice in the twelve Member States. Respondents indicated “the recording of telephone conversations” as one of the single most challenging areas to implement. 63% of participants indicated it would be at the very least “challenging,” with the vast majority indicating it would be “very challenging”. Additionally, ESMA reported 80% of firms were not “fully compliant” as of the publication’s date.

Unfortunately, it seems little progress has been made by the industry since the ESMA report was released. This past July, JWG published the results from a survey conducted by their MiFID Implementation Group. Ninety percent of respondents indicated they are “at either high or medium risk of not being fully compliance by 2018.” A majority of the participants continue to rely on manual, resource intensive routes to comply with the Directive. Continuous reliance on traditional manual processes will only perpetuate the compliance burden for institutions of scale. In light of these findings, it is understandable that firms are concerned about their ability to comply with MiFID II. History foreshadows harsh treatment for firms that are out of compliance with the recording mandate.

4.2 Explanation

When first implemented, MiFID required firms to make and retain certain records, but Article 51(4) reserved discretion on phone calls and electronic communications to the individual Member States. In March of 2009, the UK decided to wholly embrace the directive, requiring covered entities to record certain telephonic communications and retain these recordings for a period of at least six months. Over the next several years, communication recordings became a crucial part of high profile regulatory actions in the UK.

In October 2010, the Financial Services Authority (FSA) fined three firms a total of £4.2m for failing to provide accurate and timely transaction reports. In a statement, the FSA claimed “each firm could have prevented the breaches by carrying out regular reviews of its data. Despite repeated reminders from the FSA during the course of 2007 and 2008, none of the firms did this.”

Between 2007 and February 2013, a covered entity failed to properly report 44.8 million transactions. This represented a breach of FSA rules on transaction reporting and its requirements for firms to have adequate management and controls.

In November 2014, the UK, US and Swiss regulators imposed a record $3.9 billion fine on five banks for their G10 spot FX failings. Firms attempted to manipulate G10 spot FX currency rates,

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7 Technical Advice delivered by ESMA to the European Commission, Investor Protection topics, Data Gathering 15/12/2014
9 Conduct of Business (COBS), Rule 11.8 Recording telephone conversations and electronic communications
including in collusion with traders at other firms, in a way that could disadvantage those clients and the market.

In each instance, and many others, the FSA (now the Financial Conduct Authority and the Prudential Regulation Authority) made clear that audio content brings unique context and value as evidence in enforcement actions. An enhanced review of firm communications could have resulted in the detection and prevention of the actions resulting in hefty penalties.

4.3 Conclusion

MiFID II is far more inclusive and prescriptive than MiFID, and extends to all member states not merely the UK. The recording requirements cover all telephone conversations and electronic communications relating to activities intended to result in the conclusion of a transaction or the provision of client order services – even if they in fact do not.

The time to get ready for MiFID II is now. Taking a “wait and see” approach will result in disastrous consequences, as experience shows that regulators can, and have, made an example of firms that lack appropriate measures to comply with legislation. Heads of Trading, Compliance, and Operations must ensure their firms have sufficient tools to maintain adequate market surveillance. This includes robust analytical insights to reduce multiple forms of abuse and risk, as well as identify and act on potential blind spots.

Ultimately, taking a conservative approach to recording will facilitate compliance with even the strictest of interpretations, and place firms in a strong position to address the unforeseeable challenges ahead. To obtain a strategic competitive advantage throughout the European marketplace, reduce overall risk, and gain peace of mind – embrace the Directive, and the underlying principles by 3 January 2018.
5 Mobile Phone Recording Solutions to Ensure Compliance

5.1 The Challenges Associated with Self-Initiated and In-Network Mobile Recording

There are various options for recording mobile phone communications, but these come with their own set of challenges. For example, some third party recording solutions depend on the regulated employee to initiate recording of his/her business-related mobile phone communications. Additionally there is usually a delay in recording and the quality of the recordings are subpar.

Some mobile network operators also offer basic in-network mobile recording options to record mobile conversations. This approach inherently requires a completely different application from your primary recording solution which means that you’ll need to retrieve, manage and store your firm’s mobile recordings separately from all other recorded communications.

Additionally, complete compliance assurance (easily proving that all types of communications for regulated users are being properly recorded) and quickly producing all recordings for investigations is virtually impossible with these two approaches.

5.2 Capture All Communications in a Single Platform

As the need to monitor more employees and communication channels grows with new regulations such as MiFID II, the NICE Trading Recording (NTR) compliance-focused platform addresses these challenges by capturing, storing and retaining ALL types of communications, including mobile phone calls related to potential transactions. With the NTR solution, your firm is able to:

**Record multiple channels with one solution**

Whether internal or external, inbound or outbound, pre-, during- or post-trade, front- or back-office, fixed or mobile – NTR captures and manages the full spectrum of communications, which means lower cost of ownership and streamlined investigations.

**Benefit from the flexibility of a scalable, distributed architecture**

A scalable, distributed architecture means NTR can easily scale to meet the needs of small branches up to global trading firms, while also adapting to support any type of communication.

**Seamless mobile call recording**

Seamless mobile call recording means foolproof compliance; there are no buttons to push, and no recording delays. NICE’s agile NTR solution integrates with virtually every compliance mobile provider (AT&T, Vodafone, O2, SingTel, PCCW, and more), as well as leading mobile carriers around the world (Truphone, Natterbox, Teleware and others), providing financial institutions with more options to capture traders’ mobile calls and achieve complete compliance.
5.3 Achieve Complete Compliance Assurance

In addition to significantly broadening the scope of employees, asset classes, communication channels and devices that need to be recorded and monitored, MiFID II also mandates proof of compliance. Under MiFID II, it’s no longer sufficient to just record communications; financial institutions must be able to provide proof that recordings are being captured for all regulated users, and properly retained. That is one of the very reasons NICE created NICE COMPASS. The NICE COMPASS compliance assurance solution works alongside the NICE Trade Recording (NTR) system to automate monitoring, testing and reporting to ensure that all aspects of your firm’s communications and recording systems (e.g. network, gateway, PBX, recording, audio quality, archiving and retention of media, metadata and more) are fully operational and working as planned, at every stage of the transaction cycle. Real-time dashboards, alerts and alarms keep you abreast of issues that require attention.

Additionally, MiFID II stipulates that response to regulator requests must be timely. NICE COMPASS’ bulk media download and extraction tools address this requirement and streamline investigations by providing the ability to quickly access and produce large amounts of recordings and associated data. NICE COMPASS also features a centralized search engine which allows compliance managers to search across all modalities from one user interface.

Finally, new regulations are making retention requirements more complex. Different regulations require different retention periods for different types of regulated users. For example, for some users the retention period may be five years, but for Forex traders it can be up to seven – and these varying retention periods need to be managed.

Also keep in mind that most financial firms are global businesses. Even if a firm is based in the U.S., if they conduct business with banks in EMEA they also have to comply with European regulations (such as MiFID II). It’s worth noting that on top of the broader regulations, different countries also have their own retention requirements and this further adds to the complexity.

NICE COMPASS makes it easier for firms to comply with these increasingly complex retention requirements. A centralized web-based portal allows you to configure retention periods for different asset classes, lines of business, and regulated user groups (to align with specific global and/or regional regulations).

5.4 Conclusion

When investing in a recording solution to comply with MiFID II and other evolving regulations, it’s important to choose a flexible, adaptable platform that supports unified recording and monitoring of all current and future communication modalities including mobile phone recording. This is one of the many reasons that more than 90% of the largest financial institutions in the world trust NICE for compliance solutions. NICE is a global organization with an extensive R&D and support team fully dedicated to helping firms achieve total financial communication compliance. Let us help you achieve compliance too.
ABOUT NICE FINANCIAL COMMUNICATION COMPLIANCE

NICE is the world’s leading financial trading communication compliance solution provider, serving more than 90% of the largest financial services organizations globally. NICE’s comprehensive communication compliance platform integrates compliance recording, compliance assurance and communication surveillance solutions to help banks reliably capture and analyze omnichannel communications to ensure compliance with increasing regulatory requirements including MiFID II, MAR, Dodd-Frank and future directives. Learn more at www.HolisticSurveillance.com.

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