The Think Tank for EU Driven IT
Change in Financial Services

CiFER Solving real business problems for financial institutions through understanding records

Dott. Carlo Comporti
Secretary General
Committee of European Securities Regulators
11-13 Avenue de Friedland
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FRANCE

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Dear Dott. Comporti,

CESR's Consultation on Proposals for the Review Panel Work Plan

Thank you for the invitation to comment on the proposals for the Review Panel Work Plan issued on 10 March. We welcome the inclusion of a record keeping workstream and fundamentally agree that this needs to be given a higher profile across the regulatory community.

JWG-IT, the neutral FS industry think-tank, and the Centre for the Investigation of Financial Electronic Records (CiFER), directed by Dr. Victoria Lemieux, Professor of Archival Studies at the University of British Columbia, are offering a joint view on the importance of, and issues involved in, workstream number 10, CESR recommendations on Article 51 (3) Implementing Directive. We have conducted over three years of collaborative research on the impact of new record keeping obligations in the securities industry and have authored numerous publications, including JWG-IT's analysis reports "*MiFID Record Keeping: Raising the Heat*", "*Record keeping: How high should you jump?*", "*Winning the RegTech data war*", plus contributions to Springer's "*MiFID Kompendium*", and the forthcoming Facet publication, "*Managing Records in Global Financial Markets - ensuring compliance and mitigating risk*".

Far from a low priority, we believe that, in this difficult time for the capital markets, record keeping is perhaps the single most important review that CESR could conduct. In summary, we note that:

- CESR is committed to the goals of customer protection, transparency and robust systems and controls
- The G20 summit resolution of November 2008 called for a strengthening of transparency, standards and accountability
- Many research studies show that effective management of records and information is a critical precursor to achieving the goals of transparency, accountability, customer protection and effective systems and controls.

On this basis, we believe:

- Record keeping is fundamental to achieving the noble aims of MiFID
- Increasingly, the common market is challenged by different levels of regulatory commitment to Article 51
- CESR's help in creating a level playing field with common regulatory standards will go a long way towards controlling risks, lowering costs to investors and restoring global financial stability.

We are pleased to be able to summarise the views on record keeping of a number of firms and their suppliers.

Record keeping context

Investment firms have always tracked information about the world within their control (i.e., the products and services offered to their clients) and information about the world around them (i.e., the state of the client, the market, the product, etc.). The firms have put in place technologies and processes to collect the data required to make informed business decisions and comply with legal and regulatory requirements. Yet, there remain many record keeping challenges.

Today, investment firms have some of the most digitally intensive business models of all industries. As a percentage of revenue, their IT budgets are many times those of organisations in industries that are tied to the physical production of materials. The environmental impact of this warrants review.

Since the commercialisation of the internet in 1993, the complexity, velocity and size of the information infrastructure has grown exponentially. The number of players in the value chain has risen substantially. Following the introduction of MiFID, there now exist over 260 venues to execute a trade; in addition to the traditional exchanges, we now have multilateral trading facilities (MTFs) and systematic internalisers (SIs). The raised number of market participants increases the complexity of capital markets and poses a potential challenge to the objectives of transparency, customer protection and transaction control. A review of how regulators have met the Article 51 requirements would help to certify that they do not thwart CESR's aims and objectives.

New financial products and types of financial transactions also present a challenge. There has been and, despite the global financial crisis, will likely continue to be constant innovation in financial products. Financial products, such as asset-based securities and OTC derivatives, call for a review of the records and information that will ensure proper control, customer protection and transparency.

The record keeping challenge is not just contained to the transparency of transactions and products. As an example, we ask you to consider the challenges with respect to reference data. When a customer reorganises seven existing banks into five new banks and a holding company, and keeps some of the original names and addresses across multiple jurisdictions, the risk that the value chain will be unable to track the changes correctly increases. Without up-to-date knowledge of the current state of reference information, firms could unknowingly breach financial crime, money laundering or suitability and appropriateness laws.

MiFID imposes demanding data management requirements

MiFID raised record keeping requirements to new levels for financial institutions in Europe with Article 51. Firms must prove that their actions conformed to what they said they would do, and that they were unable to manipulate any of the information around the trade – for five years. Furthermore, it says that customer records that set out rights and obligations shall be retained for the lifetime of the relationship with the client.

To answer even the simplest of questions will require access to data that will be historical in nature. This could span timeframes from a few days to multiple years. As the trading and information about the customer, products and reports changes, any data will need to have the amendments logged, with the corresponding audit trails showing details of access, to ensure authenticity and integrity have not been compromised. Moreover, efforts will have to be made to enable data accessibility in the face of technological obsolescence.

JWG-IT have built a reference framework for MiFID's 1,000+ detailed data and technology requirements and, since 2005, have used this to establish the appropriate policies and reference operating models by collaboration with firms and their suppliers. At our 2008 FORUMS, which were attended by representatives from the European Commission including David Wright (Deputy Director General, DG Internal Market and Services) and Maria Velentza (Head of Unit, Financial Services Policy and Financial Markets, DG Internal Market and Services), feedback from 300 financial services participants showed that a key priority for firms was to get the basics right to mitigate risk in a principles-based regulatory environment. The top priority, as ranked by 55% of attendees, was improving poor quality product and customer data.

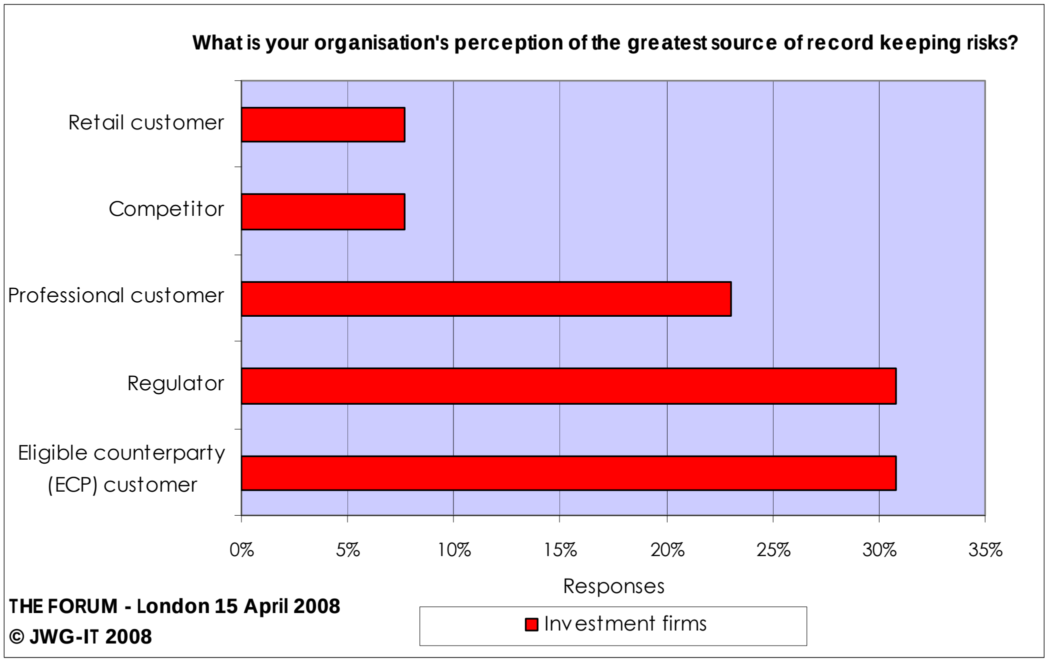
***Figure 1**: What is your organisation's perception of the most likely source of trading risk as a result of data issues?*

	Average	UK	DE	IT
Initial and ongoing costs of trading and data infrastructures	21%	30%	33%	0%
Poor quality product/instrument reference data	35%	30%	20%	55%
Poor quality client data	20%	10%	33%	18%
Ability to identify new liquidity venues before business impact	17%	10%	13%	27%
Length of time required to add instrument or venues	7%	20%	0%	0%

Source: 300+ delegates at the FORUMs 2008

As the delegates at JWG-IT's industry FORUM in April 2008 highlighted (see *Figure 2*), the real challenges are expected to come from customers.

***Figure 2**:* Investment firms' risk perception



Source: JWG-IT April 2008 UK FORUM interactive survey

62% of investment firms rate customer threats for recording that deals were done 'with their best interests at heart' as the main source of record keeping risk – double the number that feared the regulator. However, it is not just the customers and regulators that need watching. Société Générale's loss of €6.4 billion, in January 2008, was attributed to alleged fraudulent activity carried out by an employee.

European adoption of MiFID record keeping requirements

Following receipt of the CESR workplan, we organised a seminar at a financial institution in London on 30 March to prioritise the need for MiFID standards in the current environment. Given the brevity of the timeframe for this consultation we were only able to register 8 financial institutions to attend, but we had over 20 that have expressed interest in following the discussion and attending future discussions.

Unsurprisingly, the fundamental change signalled by the Turner Review and discussed at length in Discussion Paper DP 09/2 was a topic of high interest. There is an urgent need to understand the impact on minimum record keeping requirements given the shift in policy noted in 11.14: "*In the future the FSA's supervisors will seek to make judgments on the judgments of senior management and take action if in they view those actions will lead to risks to the FSA's statutory. ... It is effectively moving from regulation based on facts to regulation based on judgements on the future.*" The industry would welcome the chance to review the changes and their impact on the current minimum list.

Attendees felt that jurisdictional differences on record keeping made harmonising policies and infrastructures difficult, costly and prone to risk. Concerns were also raised about which specific jurisdictions obligate records to be kept within their legislative boundaries, i.e., within the country and not offshore. There are other cross-jurisdictional legal issues which could also be considered. In particular, a review of the impact of banking secrecy laws would be useful, particularly in light of the G20's call for promoting integrity in financial markets.

The group also discussed additional record keeping obligations for certain products (e.g., energy products, as outlined by ERGEG/CESR) and situations (e.g. telephone recording for market abuse/ insider dealing in the UK) which add complexity to defining and meeting the minimum regulatory obligations for all firms.

It is clear that differences in the requirements will test firms who conduct cross-border business, and challenge their mode of operation. Common commitment and more detailed standards from regulators will be required.

The community notes that real standards are required to formalise record keeping requirements. Record keeping is not just a 'tick the box' exercise. There are a number of key risks that need to be mitigated which are not addressed by CESR's current 'legalistic' approach of assigning record types to article numbers. We have not found any firm that was able to implement a record keeping policy using this framework. A substantial effort is required to develop a policy which covers the MiFID scope and further guidance in this area would be helpful. Some suggest record management standards, such as ISO 15489:2001[1] Information and documentation, will need to be followed to provide a risk-based approach to managing the firm's data. The EU's Model Requirements (MoReq)[2], for the management of electronic records, could also be applied to the record keeping operating model for capture, classification, access, appraisal, storage, use and tracking and disposal.

It is clearly beyond the scope of this letter to suggest how to manage these issues in the course of a consultation process, however, we would be more than willing to spend time with you to devise an approach that would help the regulatory community.

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We hope that this feedback has been helpful in clarifying the importance of the record keeping workstream. Should any of the points require clarification we would be most happy to provide more detail.

Yours sincerely

PJ Di Giammarino
CEO of JWG-IT

Vicki Lemieux
Director of CiFER

[1] Defined as "The field of management responsible for the efficient and systematic control of the creation, receipt, maintenance, use and disposition of records, including the processes for capturing and maintaining evidence of and information about business activities and transactions in the form of records"

[2] The Model Requirements for the management of electronic records were originally produced in 2001 in the framework of the IDA programme as a comprehensive specification of the functional requirements for the management of electronic records.