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25 November 2004

## Circular to SFC's Licensed Intermediaries

### Telephone Recording Requirements

1. The SFC would like to remind brokers of the importance of complying with the telephone recording requirements in the SFC's *Code of Conduct* and internal control guidelines.
2. During our recent onsite examinations, some brokers were found to have breached the *Code of Conduct* in the following ways:
  - failure to adopt sufficient measures to maintain a reliable record of the time of receipt and details of trade orders that are received by mobile telephones;
  - failure to establish effective procedures to ensure the integrity, reliability and security of the tape recording system and the timely detection of any malfunction;
  - failure to monitor staff who are responsible for recording telephone trade orders and to ensure that they comply with the necessary requirements; and
  - failure to retain relevant telephone recordings even when they are aware of an on-going complaint, inquiry or investigation.
3. Tape recording a client's orders ensures that there is reliable evidence to fall back on when assessing any dispute between a broker and its client concerning the particulars of a trade order. The telephone recording requirements, therefore, protect the interests of both the broker and the client (Note 1).
4. While the Code requires that telephone recordings be kept for a minimum of three months, when a licensed or registered person is aware of any complaint, inquiry or investigation regarding particular telephone trade orders, it should retain the related telephone recordings until the case has been completed. It is because such recordings may provide crucial evidence for the case.
5. The SFC has earlier stressed the importance of the telephone recording requirements in its circular to registered intermediaries dated 13 November 2002. Intermediaries are reminded that continuing non-compliance would cast serious doubt on their fitness and properness, given that these requirements have now been in force for more than three years. Further, failing to retain telephone recordings related to an on-going complaint, inquiry or investigation would fall short of the standards of internal controls required of licensed or registered persons (Note 2).



6. To brokers who were previously found to have breached the requirements, the SFC stresses the importance of corrective action and future compliance. Non-compliance cases in the future will be handled strictly and subject to disciplinary action.
7. The SFC takes compliance with the telephone recording requirements very seriously and encourages all licensed intermediaries to do the same. A theme inspection on intermediaries' compliance with the telephone recording requirements will be conducted in the near future. Those who still fail to comply would likely be subject to enforcement action. Intermediaries are advised to take immediate steps to ensure that they meet the requirements.
8. If you have any queries on the above, please contact Ms Madonna Yip of the SFC's Intermediaries Supervision Department at 2842-7618.

Intermediaries & Investment Products  
Securities and Futures Commission

Notes:

1. A licensed or registered person is required under paragraph 3.9 of the *Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission*, where trade orders are received from clients through the telephone, to use a telephone recording system to record the orders and maintain telephone recordings as part of its records for at least three months. The telephone recording requirements have been in force since 1 October 2001.
2. A licensed or registered person is required under paragraph 6 of Part IV of the *Management, Supervision and Internal Control Guidelines for Persons Licensed by or Registered with the Securities and Futures Commission* to establish and maintain effective record retention policies which, among other things, enable the licensed or registered firm, its auditors and other interested parties, e.g. exchanges, clearing houses and the Commission, to carry out routine and ad hoc comprehensive reviews or investigations.