NZX Participant Guidance Note

Client Communication Recording

December 2020

Contents

This Guidance Note has been issued by NZX Limited (**NZX**) to promote market certainty and assist Market Participants. This Guidance Note sets out NZX's general approach to the subject, but is not to be regarded as a definitive statement of the application of the Participant Rules (**Rules**) in every situation. Examples set out in this Guidance Note are limited and are not designed to cover all eventualities. NZX may replace Guidance Notes and Practice Notes at any time and a Market Participant should ensure it has the most recent versions of these documents. Guidance Notes do not constitute legal advice. NZX recommends that Market Participants take advice from qualified persons.

1. Introduction

The purpose of this Guidance Note is to provide information for Market Participants in respect of the client communication recording requirements, including:

- the key principles relating to recording client instructions and communications;
- the scope of the requirements relating to mandatory voice recording for Relevant Employee Communications;
- the nature of acceptable market practices, and best practice, relevant to the client communication recording requirements (including the voice recording requirements) in Rule 15.11, including:
    - how to manage face to face discussions or other situations where it is impracticable to directly voice-record Relevant Employee Communications;
    - the features of an appropriate recording system;
    - how long client communication records should be kept; and
- the types of conduct or behaviour that may potentially breach the client communication recording requirements set out in the Rules.

1.1 Scope of this Guidance Note

Where relevant, examples of conduct are set out in this Guidance Note. Please note that the examples set out have been provided for illustrative purposes. They are limited and are not designed to cover all eventualities. All investigations by NZX into the recording of client communications will be considered on a case by case basis, and determined based on their particular facts.

Capitalised terms which are not defined in this Guidance Note have the same meanings given to them in the Rules.

Under Rule 21.4.1, NZX may act by and through NZX Regulation Limited (**NZ RegCo**) in performing any function or discharging any power set out in the Rules. References in this Guidance Note to NZX therefore also include NZ RegCo in relation to any regulatory activity or discretion.

2. Key principles

Appropriate recording of client communications aids market transparency, and provides certainty to enable the detection and deterrence of market misconduct. This increases public confidence in the operation of NZX's markets. Public confidence in turn enhances market liquidity and efficiency.

The key principles relating to recording client communications are:

- adequate information should be recorded, and maintained in a manner that both ensures the integrity and security of the information, and enables appropriate access by clients and regulators;
- NZX's markets should be fair, orderly and transparent;
- Market Participants should have systems and controls in place in order to meet their obligations under the Rules; and
- Market Participants should follow Good Broking Practice.

Section 314 of the Financial Markets Conduct Act (**FMCA**) requires that NZX, as a licensed market operator, "*to the extent that is reasonably practicable, do all things necessary to ensure that each of its licensed markets is a fair, orderly, and transparent market*."

A transparent market is supported by Market Participants maintaining appropriate systems to record client communications. This includes the voice recording of certain communications, to enable records to be maintained that can be used to detect market abuse.

In 2019, NZX amended the Rules to introduce mandatory voice recording for certain client communications (effective 1 January 2020). Guidance in respect of these requirements, is set out in section 3 of this Guidance Note. NZX and the Financial Markets Authority (**FMA**) considered that these requirements were appropriate, noting that similar telephone recording and electronic monitoring requirements exist for certain markets in the United Kingdom, Australia and Singapore, and for certain brokers in the United States.

3. Mandatory recording requirements

Rule 15.11 sets out requirements for certain Market Participants in relation to the recording of client communications.

In particular, Rules 15.11.1 and 15.11.2 include mandatory voice recording requirements for Trading Participants. These requirements are supported by Rule 15.11.3, which includes requirements for Client Advising Participants.

'*15.11.1 In addition to Rules 15.11.3 to 15.11.13, a Trading Participant must record Relevant Employee Communications using an appropriate recording system. Such records must include the records derived by voice recording of telephone conversations and records of electronic communication, as relevant. This record must be retained for 6 months, unless it is an Order record. Where any issue arises in relation to that client Order during that 6 month period, the record must be kept for as long as the issue in relation to that client Order remains active and unresolved.*

15.11.2 Where Relevant Employee Communications cannot be recorded or are impracticable to record directly, such as face to face conversations, encrypted messaging or those that are undertaken on a mobile phone, a contemporaneous record must be made of the contents and time of the instructions or discussion relating to the Relevant Employee Communication, even if no Order eventuates. This must be in a retrievable form which can include written, video or audio form. This record must be retained for 6 months, unless it is an Order record. Where any issue arises in relation to that client Order during that 6 month period, the record must be kept for as long as the issue in relation to that client Order remains active and unresolved. This Rule 15.11.2 may not be used as a basis to avoid compliance with the mandatory recording requirement in Rule 15.11.1.

15.11.3 Each Client Advising Participant must establish policies and procedures regarding recording its client's instructions where voice recording is used, which must include policies and procedures regarding voice recording and behaviour in respect of the use of electronic communication and personal devices where there may be discussions regarding and taking client orders. The Compliance Manager of a Client Advising Participant is responsible for ensuring that such policies and procedures are put in place and are, to the best of the Compliance Manager's ability, adhered to by that Client Advising Participant's Employees.'

3.1 What are Relevant Employee Communications?

'Relevant Employee Communications' are defined as:

' "***Relevant Employee Communications***" *means communications by or with the Market Participant's institutional sales and trading desk and/or principal desk (including both proprietary and facilitation trading) and includes conversations, communications and instructions, in relation to receiving, arranging, negotiating or executing Orders on NZSX either as Principal or on behalf of Institutional Clients;*'

The definition covers communications in relation to Orders for Institutional Clients, along with communications relating to Orders by a Trading Participant Acting as Principal (including in respect of proprietary or facilitation trading).

NZX notes the definition of an Institutional Client is a person, whose principal business is the investment of money, or who, in the course of and for the purpose of their business, habitually invests money. This definition does not capture clients merely because they are sophisticated investors, or entities such as charitable trusts and limited partnerships, unless their principal business is investment, or the primary focus of their undertaking is the habitual investment of money. For example: it is anticipated that a charitable trust's principal business will be the operation of a charity and the investment of money will be incidental to its charitable purposes, whereas a fund manager or an institutional investor's principal business is clearly investment. Trading Participants may wish to engage with NZX, if they are uncertain as to the manner in which this definition should be interpreted, particularly in the context of commercial entities who routinely invest for charitable purposes.

A Relevant Employee Communication includes, communications by or with the Participant's institutional sales and trading desk in relation to Orders on the NZSX on behalf of an Institutional Client. NZX considers a wholesale equities desk to be an institutional sales and trading desk, along with any alternative mechanism utilised by the Trading Participant to facilitate orders for Institutional Clients. Where a Trading Participant does not separate its retail and institutional desks it will be necessary for the entire desk to be treated as an institutional sales and trading desk for the purposes of the Rule.

A Relevant Employee Communication also includes communications by or with the Participant's principal desk. Where a Trading Participant does not separate its principal desk, it will be necessary for any Employees who conduct principal trading on behalf of the Participant (including in respect of proprietary or facilitation trading and in respect of any category of client) to be treated as a principal desk for the purposes of the Rule.

As noted in section 3.3 below, where Relevant Employee Communications must be facilitated through other means or in places away from the institutional or principal desk, it may be impracticable to voice record the communication and a contemporaneous record must instead be made.

The definition extends to include conversations relating to the execution of an Order, which is broader that a simple execution instruction. It includes communications in relation to a transaction, even if ultimately an Order is not executed as a result of the conversation. NZX does not consider that all communications conducted in an institutional dealing room will fall within the definition, for example: conversations relating to social and personal matters will not be Relevant Employee Communications. NZX also does not expect conversations or communications to be recorded, in respect of Employees who are: conducting Investment Banking or Research Services; retail financial advisors; or carrying on back office functions.

The definition does not cover communications relating to Orders for Retail Clients, unless they are relevant to Orders as Principal. Communications relating to Orders entered on the NZDX are also not Relevant Employee Communications. In addition, where a Trading Participant only trades Acting as Principal solely to manage error positions, NZX considers that communications in relation to such trading would not be captured as Relevant Employee Communications.

Example 1:

Maria works on the institutional sales and trading desk employed by a Trading Participant. Maria receives a call from an Institutional Client in relation to an Order to purchase SPK ordinary shares. Maria has a general discussion with Nathan, who is an analyst in the Trading Participant's Markets and Research team, about SPK's recent performance and an upcoming off-site client golf event.

Maria's conversation with the Institutional Client is a Relevant Employee Conversation and must be voice recorded. Maria does not have to record the conversation with Nathan regarding SPK's recent performance or the upcoming client entertainment event, as this conversation does not directly relate to Maria's execution of the Institutional Client's order.

3.2 Use of an appropriate recording system

Rule 15.11.1 requires a Trading Participant to use an appropriate recording system for recording Relevant Employee Communications.

An appropriate recording system, for a Trading Participant should as a minimum, include:

- voice recording technology to enable all phone landlines for institutional sales and trading desks and principal trading desks to be recorded;
- a system to ensure that records of electronic communications containing Relevant Employee Communications are securely stored in a non-editable form.; and
- a system that securely stores non-editable records of Relevant Employee Communications that are impracticable to record directly.

An application that converts a conversation conducted via telephone to text, would not be an appropriate voice-recording system for directly recording communications, for the purposes of Rule 15.11.1. Such applications may be appropriate for the purposes of Rule 15.11.2, to create records where it is impracticable to directly record a Relevant Employee Communication, for example: a contemporaneous record of a conversation conducted on a mobile phone.

3.3 Direct recording of electronic communications

Where Relevant Employee Communications are conducted electronically rather than verbally, the Rules require copies of "electronic communications" containing Relevant Employee Communications to be maintained (unless it is impossible or impracticable for the Trading Participant to do so).

NZX has not defined the scope of "electronic communications" in the Rules, because of the continuing innovation and advancement in technology. NZX considers that "electronic communications" currently include, but are not limited to, communications conducted via: fax; email; Bloomberg mail (or similar); video conferencing facilities; SMS; business to business devices; chat; and instant messaging. Participants should consider whether any new communication technologies that arise, also fall within "electronic communications".

NZX expects Trading Participants to exercise judgement in determining whether a communication is an “electronic communication” by considering the principles of the client communication recording requirements described in this Guidance Note, and Good Broking Practice. Trading Participants may wish to engage with NZX, if they are uncertain as to the manner in which these requirements should be interpreted.

Records of electronic communications could include copies of faxes, emails, chat, and instant messaging correspondence (for example pdf copies). Records of electronic communications could also include video or audio recordings of communications conducted via video conferencing facilities or screen-shots of communications sent through SMS and business to business devices. Further requirements for record keeping are set out in section 3.5 of this guidance note.

Example 2:

Aaron works on the institutional sales and trading desk of a Trading Participant who texts an SMS to Belinda (who is an Institutional Client). Belinda texts back with an Order. Aaron screenshots both the text messages, sending these as an attachment to his own email. He then converts the email and the attachment into a PDF file and stores it in accordance with the Trading Participant’s record keeping procedures. Aaron has fulfilled his obligation under the Rules.

3.4 When is it impracticable to directly record Relevant Employee Communications?

NZX expects Trading Participants to maintain policies and procedures that require Relevant Employee Communications to be directly recorded whenever possible.

Rule 15.11.2 establishes requirements in the situation where it is impracticable to directly record a Relevant Employee Communication. In this context NZX considers that “impracticable” should be interpreted as being not reasonably practicable, rather than impossible. The Rule requires that, in those circumstances, a contemporaneous record must be made of the contents and time of the instructions or discussion relating to the Relevant Employee Communication, even if no Order eventuates.

Trading Participants are able to determine when it is impracticable to directly record a Relevant Employee Communication, however NZX expects Trading Participants to consider the principles of Good Broking Practice, and to be reasonable and consistent when making such a determination. In particular, a Trading Participant must not determine that it is impracticable to directly record a Relevant Employee Communication for the purpose of avoiding the mandatory voice recording requirements set out in new Rule 15.11.1.

NZX considers that it may be impracticable for a Trading Participant to use voice-recording technology to record communications conducted face-to-face, or where the Employee receives a call on a mobile phone because the Employee is out of the office (where this is permitted by the Trading Participant’s policies and procedures). There may also be other circumstances when it is impracticable to use voice-recording technology.

Although NZX requires that Trading Participants’ client agreements permit direct voice-recording of Relevant Employee Communications, there may be rare circumstances in which the privacy principles contained in the Privacy Act 1993 prevent the direct recording of such communications. NZX emphasizes that these principles must not be relied upon as a means of avoiding compliance with the Rules.

The use of mobile phones for client conversations is at the discretion of the Trading Participant and subject to its internal policies and procedures. NZX expects Trading Participants to consider their obligations to voice-record Relevant Employee Communications when designing these policies and procedures, and to include appropriate anti-avoidance provisions. NZX Trading Participants should also implement appropriate controls to monitor the usage of mobile phones by their relevant Employees, to detect non-compliance with the Rules.

While Trading Participants may determine their own individual requirements in respect of office mobile device usage, NZX expects Trading Participants to discourage employees from receiving client communications through mobile phones while in the trading room, or in the Trading Participant's usual place of business. NZX does not consider that it would be adequate for a Trading Participant to record a transcript of a Relevant Employee Communication from an Institutional Client that was received in these circumstances.

Example 3:

Cathy works on the institutional sales and trading desk at a Trading Participant. Donald is Cathy's Institutional Client. Donald calls Cathy while she is at her desk, on Cathy's work mobile phone to discuss a potential sell down that Donald is considering undertaking. Cathy asks Donald to call her back on her office land-line to discuss the potential transaction. Cathy is acting in accordance with her employer's obligations under the Rules, as this allows Cathy and Donald's conversation to be voice-recorded.

Example 4:

Enoha works on the institutional sales and trading desk at a Trading Participant. Frances is Enoha's Institutional Client, who is travelling overseas for business and doesn't have easy access to email. Enoha receives an encrypted mobile message from Frances, relating to a potential order in an NZSX quoted financial product. Enoha screenshots the message because it is impracticable for Enoha to speak to Frances on the institutional trading desk landline. Enoha knows he is acting within his firm's internal policy and has fulfilled his obligation under the Rules.

Example 5:

Hussein works on the institutional sales and trading desk at a Trading Participant. Hussein is out at lunch when he runs into his Institutional Client (Ieremia) who provides him with background relating to a potential order. Ieremia subsequently calls Hussein in the afternoon on Hussein's landline desk phone, which is directly recorded, to follow up in respect of their conversation.

Hussein makes a file note of the key matters relating to the Order discussed in his lunchtime conversation with Ieremia, other than those discussed in the subsequent telephone call (as the land-line conversation is recorded through voice-recording technology). Hussein will be acting in compliance with the Rules if he arranges for the file note to be stored in accordance with his firm's internal policies which reflect the requirements of the Rules.

Example 6:

Jacqui works on the institutional sales and trading desk at a Trading Participant. Jacqui has a conversation with an Institutional Client in relation to an Order which is directly voice recorded in accordance with her firm's policies.

Jacqui wishes the firm to undertake a trade Acting as Principal to facilitate the Institutional Client's Order. Kano is also a Dealer at the same Trading Participant who is authorised to undertake trading Acting as Principal for the firm. Jacqui discusses this trade with Kano face to face while in the NZX Trading Participant's offices.

Jacqui and Kano will be acting in compliance with the Rules, if Jacqui takes notes during her conversation with Kano of key matters that were not directly recorded in the conversation with the Institutional Client, shares those notes with Kano and arranges for the notes to be stored in accordance with her firm's internal policies which reflect the requirements of the Rules. Kano does not need to additionally make a record of the conversation that has been recorded by Jacqui.

Example 7:

Leilani is an NZX Adviser at a Trading Participant. James is a Dealer on the retail sales and trading desk, who is authorised to undertake trading Acting as Principal for the firm. Leilani contacts James to request that James facilitate a large Order from a client on behalf of the Trading Participant, Acting as Principal. Leilani calls James to discuss the potential Order on James's office landline.

James will be acting in compliance with the Rules because the conversation between Leilani and James will be voice-recorded through the Trading Participant's voice recording service.

3.5 What are the content requirements for mandatory client communication records?

Rules 15.11.1 and 15.11.2, require that Relevant Employee Communication records must include (as appropriate):

- records derived by voice recording of telephone conversations;
- records of electronic communications; and
- written, video or audio forms of contemporaneous records (i.e. transcripts) of Relevant Employee Communications that are impracticable to record directly.

As noted in section 3.1 above, the definition of Relevant Employee Communications is broader than instructions relating to execution of an Order, and therefore records should be retained of all material communications in relation to the transaction to execute the Order.

Where a record of a Relevant Employee Communication is made in reliance on Rule 15.11.2, it must include details of the key aspects of the discussion (the financial products, volumes and values that were discussed), along with the date and time of the instructions or discussion.

The record must be made contemporaneously with the Relevant Employee Communication, for example by using written minutes or notes. Transcripts made in these circumstances may be recorded in video, audio or written form. It is permissible to complete transcript records immediately after the Relevant Employee Communication (for example: by making a voice recording transcript or written transcript of the key matters discussed, immediately after a face to face meeting).

3.6 In what manner should mandatory client communication records be stored?

NZX expects that records that are maintained in accordance with the requirements of section 15 of the Rules should be stored in a durable medium which allows them to be replayed or copied, and retained in a format that does not allow the original record to be altered or deleted. Records should also be maintained in a manner that is easily searchable to enable appropriate access for clients and regulators.

Records of Relevant Employee Communications must be kept for a minimum of 6 months, unless:

- the record is an Order, or forms part of the Order's audit trail as described in Rule 15.12 (in which case it must be retained for 2 years); or
- an issue arises in relation to the Order (whether the Order is for an Institutional Client or for the Trading Participant Acting as Principal).

Where any issue arises in relation to that Order (for example: NZX or the FMA wishes to query the Order, or a complaint is received) during that 6 month period, the Relevant Employee Communication records must be kept for as long as the issue in relation to that Order remains active and unresolved.

Voice-recording records (whether required under Rule 15.11.1 or maintained voluntarily as discussed in section 4 of this Guidance Note) must not be edited. A Market Participant's compliance manager (or delegate) must be present when access is provided to any editable voice-recording, and is the only person authorised to make a copy of a voice recording. Voice-recording records are required to be stored in a secure area, which may include a secure area in an off-shore jurisdiction, so long as access to the records is restricted in the manner contemplated by the Rules.

3.7 Policies and procedures for recording client communications

A good internal policy and supporting procedures, as required by Rule 15.11.3, will help Employees of Trading Participants understand the firm's internal practices in respect of recording communications with clients, and communications relating to Orders to be undertaken while Acting as Principal.

These policies and procedures should be consistent with NZX's expectations set out in this Guidance Note, and should explain:

- what sort of communications are captured;
- which Employees are required to have their phones recorded;
- how to approach different forms of communication to ensure that they are appropriately recorded in accordance with the requirements in the Rules, including:
  - establishing an expectation that where reasonably practicable, Relevant Employee Communications should be conducted in a manner that allows for direct recording, to ensure compliance with Rule 15.11.1;
  - describing when it is acceptable to use electronic communication and personal devices when communicating with clients; and
  - setting record keeping requirements in respect of communications relating to a Trading Participant undertaking an Order when Acting as Principal.

- the recording systems used at that particular organisation and practical information such as who to contact if there is a practical problem with the use of voice-recording technology;
- the process relating to the storage of client communications (including those where the Trading Participant is Acting as Principal), and the controls that apply to accessing those records; and
- the consequences of breaching the communication recording policy and procedures.

A Trading Participant may also wish to consider the following information in its policy:

- identifying what avoidance looks like and the organisation's anti-avoidance measures;
- practical examples to illustrate behaviour that is in the scope of the internal policy;
- how to correctly make transcripts recording discussions (i.e. the appropriate level of detail, where these are saved); and
- how the organisation treats non-mandatory recordings of communications – see also section 4.

NZX considers that Trading Participants should also implement appropriate controls to identify non-compliance with the client communication recording requirements, as set out in both the Rules and its internal policies. The nature of these controls will depend on the scale and nature of the Trading Participant's operations. Appropriate controls may include processes to determine changes in the manner by which a Trading Participant receives communications relating to Order instructions (e.g. a break-down of those received through email/ mobile phone etc.).

NZX considers that Trading Participants should also implement appropriate compliance monitoring procedures that are designed to identify instances of avoidance of the recording requirements, to support these controls.

NZX intends to provide ongoing monitoring oversight of Trading Participants' compliance with the new client communication recording requirements, including in respect of adherence to internal policies and procedures.

3.8 Client Agreement requirements

Trading Participants must ensure that their Client Agreements include an acknowledgement by the client that the Participant may record telephone conversations between the client and the Participant, noting that in the event of a dispute or anticipated dispute between the client and the Participant, the client has the right to listen to any recording of those conversations. This acknowledgement may be included in the standard terms and conditions of the Client Agreement and does not need to be separately acknowledged by the client.

4. Voluntary voice-recording requirements

In addition to the mandatory requirements for Trading Participants to record Relevant Employee Communications, a number of requirements exist in respect of Client Advising Participants who elect to voice-record client instructions.

Voluntary voice-recording could arise where a Client Advising Participant elects to voice-record client communications or Order instructions.

4.1 Policies and procedures for voluntary voice-recording

Under Rule 15.11.3, each Client Advising Participant must establish policies and procedures for recording its client's instructions where it elects to use voice recording. Client Advising Participants who elect to voice-record client communications should consider the guidance set out in section 3.7 of this Guidance Note when determining the contents of its policies and procedures.

The policies and procedures must address voice recording and behaviour in respect of the use of electronic communication and personal devices, where there may be discussions regarding client Orders. The policy should describe when conversations should be conducted on a landline to enable compliance with the Client Advising Participant's voluntary decision to voice record client communications.

4.2 In what manner should voluntary client communication records be stored?

Records of client communications that have been voluntarily voice-recorded by the Client Advising Participant should be maintained in a manner that is easily searchable to enable appropriate access for clients and regulators.

Under Rule 15.11.7, voice-recording records must be stored in a secure area, which may include a secure area in an off-shore jurisdiction, so long as access to the records is restricted in the manner contemplated by the Rules. A Client Advising Participant's compliance manager (or delegate) must be present when access is provided to any editable voice-recording and is the only person authorised to make a copy of a voice recording.

Under Rule 15.11.11, voluntarily made voice-recordings of Orders must be labelled, and must usually be retained by the Client Advising Participant for a period of 10 Business Days from the time of the client Order being submitted. If any issue arises in relation to that client Order during that 10 Business Day period, the record must be kept for as long as the issue in relation to that client Order remains active and unresolved. Where the record is, or forms part of, an Order record, it must be retained for 2 years in accordance with Rule 15.11.2.

4.3 Client Agreement requirements

A Client Agreement must include an acknowledgement by the client that the Client Advising Participant may record telephone conversations between the client and the Participant, where the Client Advising Participant elects to use voice-recording. This acknowledgement may be included in the standard terms and conditions of the Client Agreement and does not need to be separately acknowledged by the client.