Hidden Costs of "Bare Minimum" Audio Supervision

Understanding the high risk of low-cost supervisory approaches

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Introduction

Whether your financial institution (FI) does business in the United States or Europe, chances are your compliance team is tasked with recording, review, and retention of oral communications. That's because the EU's **Markets in Financial Instruments Directive (MiFID II)** and U.S. **Commodity Futures Trading Commission's (CFTC) Dodd-Frank Rules**, among other global regulations, require FIs to record and archive all voice communications related to certain products and services. And, with the popular adoption of collaboration platforms, firms must deal with new content types, like video, that further expand the communication channels that require supervision.

So, what happened when these regulations were introduced?

FIs scrambled for a fast solution to simply get recording up and running. Supervision was, and still is, an afterthought that applies a "dartboard-style" approach to sampling and post-review of recordings. These rudimentary processes gave FIs a quick foothold to put a check box next to the requirement.

As part of the Dodd-Frank reform proposals, SIFMA submitted a series of "No Action" letters, which estimated that the typical large financial services firm would need to record the landlines of between 2,000 to 5,000 employees globally. In addition, these large firms would need to record the mobile phones of certain employees resulting in an additional 2,500 recorded cell phones in both the US and UK.[i]

A firm with **3,500 employees** creates **4.5 million hours per year of recorded audio content**

Using a mean of 3,500 employees for landline recording and a conservative estimate of 5 hours of recorded content per employee per day for 5 days a week results in 87,500 hours of recordings each week. That's 379,166 hours a month and 4,550,000 hours per year. Even at a smaller firm of 200 employees, estimates based on these numbers work out to 260,000 hours of voice recordings per year.

During the implementation of Dodd-Frank, Congress estimated that firms would spend about 24.2 million hours to comply with the regulation each year. According to Compliance Risk, this corresponds to roughly 11,625 new jobs required to comply with the regulation each year. These metrics are staggering, whether your firm is large or small.

However, basic oversight processes that rely solely on resource-intensive and high cost manual reviews have failed to deliver meaningful gains for identifying risks and insights contained in the conversations. Additionally, recent enforcement trends demonstrate that it is imperative for firms to consider the risks in their legacy audio supervision approaches.

This paper takes a look at these converging trends and their hidden costs.

Bare Minimum Supervision Isn't Enough

To understand *why* random sampling and minimal search-for-review approaches pose a high risk, first, we need to take a quick look at *why* it has been a compelling, "good enough" solution for firms.

When the regulations went into effect, they didn't prescribe *how much* or *how often* audio recordings must be supervised. This led to a bare minimum approach. Firms adopted a sampling process where a small percentage of recordings were selected at random and manually reviewed by compliance staff listening to calls in their entirety. FIs could show regulators a minimum best effort was made to review a sampling of the audio communications.

For firms that wanted to dedicate slightly more effort, simple searches of call metadata, such as call times and telephone numbers involved in the conversation, were performed. The most "sophisticated" reviews might analyze the often variable and inaccurate call transcripts pulled directly from recording systems. While transcription was (and remains) flawed, firms attempt to rely on such protocols as demonstrating some modicum of "smart" review and as a justification for compliance and supervision efforts.

Manual compliance review of audio content for a firm with **200 users costs an estimated $268,000 per year** for bare minimum reviews.

The cost of compliance for a small firm of 200 users, simply reviewing two hours of recorded content per user (200 users x 2 hours review per month x $47.40 per hour of compliance review time) would result in an annual cost of $227,520. That excludes review of other types of content like collaboration platforms, email, and instant messaging. Dedicating four supervision hours to each recorded user each month to review all channels of communication (again, a very modest estimate), means a small firm would be spending $455,040 per year on compliance.

It's easy to see that even incremental approaches to reviewing a few hours of recordings each month are both cost-inefficient and fail to address the actual risks in the recorded content. Limited, manual compliance reviews are effectively a sunk cost.

Today, the hidden costs of these approaches require a fresh perspective.

Hidden Cost #1: Skyrocketing Volumes Present More Risk

With the explosion of digital communications, firms now regularly engage with customers through a variety of channels—from traditional voice to video collaboration applications. In fact, 90% of firms are using video collaboration platforms in their organization. [ii]

Firms are using multiple platforms to engage with clients, often concurrently. In a Theta Lake Q4 2019 survey, we found that the top collaboration platforms were from Microsoft (Teams, Skype), followed by Zoom, RingCentral, GoToMeeting, Cisco Webex, and Google Hangouts. These collaboration platforms provide a rich mix of communication functionality, and with a growth in engagement, FIs are seeing increased volumes of recording and supervision data every year.

The rise in recorded content combined with the increased recording supervision requirements from MiFID II and Dodd-Frank means FIs face growing information risks that can't be ignored. With an estimated **1.7MB of data** created **every second for every person** on earth, it's no wonder that **45% of compliance personnel** feel they are **constantly in catch-up mode**. [iii]

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It might seem straightforward to tackle this "volume problem" by throwing more resources at it. However, this significantly increases human capital costs. The cost of hiring a compliance supervisor is an average of $98,647 per year.[iv] Moreover, simply adding warm bodies to the review queue introduces even greater variability in the quality of review, because different people have varying levels of knowledge and sometimes divergent skillsets. If, on the other hand, firms maintain the same, fixed resources to manage ever-increasing recording volumes, it stands to reason that ballooning call volumes will cause review accuracy to suffer. Neither approach is sufficient.

Hidden Cost #2: Manually Spot Check at Your Own Peril

Significant innovations have been made in process automation and artificial intelligence since the days when voice-to-text transcription was considered cutting edge. And, regulators are taking note.

60% of compliance personnel are concerned about **fine-tuning supervision processes to find real risk.** [vii]

Regulators are investing in advanced technologies that allow them to review more content, faster, and with consistent quality.

Some research on legal document reviews, which can be extrapolated to other manual review processes, demonstrates that inconsistency rates among reviewers often hover near 70%.[v] From a practical perspective, this means that a group of compliance officers reviewing the same voice recording dataset would only agree on the relevance of a particular call 30% of the time.

Seen through this lens, starting a compliance review with suboptimal transcribed content and attempting to drive consensus on its relevance through manual reviews is a losing battle.

This takes us back to the lowest common denominator approach to voice recording supervision by transcription and manual spot checks. A compliance effort based on these legacy processes relies on outdated technology and suffers from human error. Ultimately, it's ineffective for identifying and measuring compliance and regulatory risks.

The bottom line: if you aren't using advanced technology and regulators are, they have the advantage in finding your mistakes. And for that, your firm will have no defense.

Hidden Cost #3: Evolving Oversight Standards Introduce Stricter Fines

Whether your firm maintains oral communications as a registered Swap Dealer or Futures Commission Merchant under CFTC Rules or covered UK conversations pursuant to MiFID II, oversight standards for telephone recordings are evolving.

As a result, pressures are increasing on compliance teams to review and analyze voice data. These stresses have been further compounded by accountability regimes for Chief Compliance Officers and their staff under CFTC Rules in the US, as well as the Senior Managers and Certification Regime in the UK.

The potential monetary and conduct sanctions for non-compliance and inadequate oversight related to telephone recording supervision are rising. With increased regulatory scrutiny on communication monitoring and supervision failures, it is no surprise that global fines for this area reached over $150 million in 2019 with the top 5 communication supervision failures averaging over $27.2 million each.[vi]

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The following are a few examples of top line fines for supervision failures in 2019:

- FCA fined Prudential **£25 million** for failures in its annuities recommendation practices, specifically for the conduct of its sales staff during phone calls. (September 2019)
- CFTC collectively fined BGC Financial, LP, and GFI Securities LLC **$25 million** for making false representations about emerging markets foreign exchange options, using their respective voice communications and instant messaging platforms to disseminate and discuss these unlawful trading practices. (October 2019)

This regulatory focus on supervision puts firms on notice that simplistic approaches to voice recording oversight may be inadequate. It reinforces the need for a "paradigm shift" to a compliance strategy focused on a sophisticated analysis of electronic communications content.

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The Theta Lake Approach

At Theta Lake, we developed a modern compliance platform that uses natural language processing and machine learning to analyze voice and video content and identify relevant financial services and insurance-related risks.

For example, the platform can identify derivatives-related conversations, as well as risky behavior that may have occurred during the call. Importantly, Theta Lake does this analysis at scale. Firms can ingest every voice recording for every user to determine which conversations contain potential risks. And, when a potential risk is uncovered, the content is routed to your compliance team for review in our unified, AI-enabled workflow.

Eliminating the hidden costs of voice recording supervision and avoiding future compliance fines requires advanced technology. Theta Lake gives regulated firms the edge by cutting supervision review time and effort by two-thirds while facilitating the review of all content—delivering an ROI in less than a year.

Learn More

To learn more about Theta Lake's AI-enabled approach to audio recording compliance visit:

https://thetalake.com/solutions/call-recording/

i SIFMA. Request for No-Action Relief: Recording Requirements under the Internal Business Conduct Rules.
ii Theta Lake. "Are Your Compliance Practices Keeping Pace With Emerging Video Platforms Survey." 2019
iii Smarsh. Electronic Communications Compliance Survey. 2019.
iv Salary.com
v Theta Lake. "Are Your Compliance Practices Keeping Pace With Emerging Video Platforms Survey." 2019
vi Cole Schotz P.C. E-Discovery is Ruining Litigation Information Age Myths.
vii Smarsh. Electronic Communications Compliance Survey. 2019.

ABOUT THETA LAKE. Theta Lake provides cloud-based compliance for video, audio, and other modern digital communications. Its patent-pending technology uses AI, deep learning, and seamlessly integrates with the leading audio recording, video marketing, and video conferencing platforms to detect compliance risks in what was said or shown in modern digital communications. Using AI to also power insights and automation, Theta Lake provides directed workflow to add consistency, efficiency and scale to the compliance review and supervision process, driving down the cost of compliance.