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SEC Collects $390 Million in Latest Crackdown on 'Off-Channel' Communications in the Financial Industry

In the latest installment of its ongoing "off-channel" communications sweep, on Aug. 14, 2024, the Securities and Exchange Commission announced settlements totaling $393 million with 26 investment advisers and brokers-dealers for widespread use of texting, messaging applications, and other off-channel communications by senior executives and other employees.

Although the use of text messaging and other communication channels is not per se unlawful, investment adviser and broker-dealer regulation requires that firms maintain copies of most electronic business communications. Some of these off-channel communication methods by their nature cannot be easily tracked. Others, like texting, can be through use of available technology solutions, but financial firms often face practical challenges implementing the solutions in existing technology stacks.

The SEC's off-channel communications cases, the first of which was in December 2021, have had widespread impacts across the industry and resulted in billions of dollars in fines. Given the large fines assessed, the ubiquity of texting, messaging applications, and other methods of communication available on handheld devices for employees across the financial industry, and the SEC's repeated emphasis on "proactive compliance" in this area, firms should continue to be vigilant in their compliance work related to off-channel communications.

Background

The SEC adopted Rule 17a-4 pursuant to its authority under Section 17(a)(1) of the Exchange Act and Rule 204-2 pursuant to its authority under Section 204 of the Investment Advisers Act, which require that investment advisers and broker-dealers maintain copies of certain electronic business communications among staff, and that they be able to produce all such communications upon request by the SEC.

The SEC previously has stated that these and other recordkeeping requirements "are an integral part of the investor protection function of the Commission, and other securities regulators, in that the preserved records are the primary means of monitoring compliance with applicable securities laws, including antifraud provisions and financial responsibility standards."[1]

The SEC's Aug. 14, 2024 announcement is the latest in a three-year sweep that has expanded from major Wall Street brokerage firms to stand-alone registered investment advisers. In 2021, the SEC's Division of Enforcement brought its first off-channel communications case against a major financial institution, and has continued to consistently file such cases over the past three years. In September 2022, the SEC announced settlements totaling $1.1 billion with 16 Wall Street firms (15 broker-dealers and one affiliated investment adviser) for failure to preserve electronic communications. In 2023, the SEC announced further settlements with more than 20 broker-dealer and associated investment adviser firms related to failure to preserve off-channel communications, including on personal messaging platforms.[2] In April 2024, the SEC announced its first off-channel communications case against a stand-alone registered investment adviser.

The SEC's messaging regarding the off-channel communications sweep has consistently emphasized its expectation that firms across the financial industry will engage in proactive compliance with electronic record-keeping requirements. For example, in his remarks regarding the sweep to the New York City Bar Association Compliance institute in October 2023, the SEC's Director of the Division of Enforcement, Gurbir Grewal, emphasized many of the firms that had been subject to enforcement actions had appropriate policies in place regarding off-channel communications, but allegedly failed to adequately implement and monitor execution of those policies.

Implications for Investment Advisers and Broker-Dealers

This latest chapter in the SEC's ongoing off-channel communications sweep underscores the SEC's continued commitment to ensuring compliance with the rules regarding maintaining records of most electronic business communications. If they have not already, investment advisers and broker-dealers should consider their policies on the subject and how they test and monitor execution of those policies. They may also wish to engage with employment law experts to ensure they are complying with notice and other state law requirements regarding employee privacy.

Given this recent announcement, investment advisers and broker-dealers should consider:

- Reviewing and updating compliance policies to ensure they address the use of off-channel communications.

[1] Commission Guidance to Broker-Dealers on the Use of Electronic Storage Media under the Electronic Signatures in Global and National Commerce Act of 2000 with Respect to Rule 17a-4(f), 17 C.F.R. Part 241, Exchange Act Rel. No. 44238 (May 1, 2001).
[2] "SEC Charges HSBC and Scotia Capital with Widespread Recordkeeping Failures," Securities Exchange Commission, May 11, 2023.

- Deploying existing technology solutions to bring texting and other similar communication methods within their surveillance program to give employees an option through which to communicate besides email.
- Engaging in ongoing training for employees on how to respond to common real-life situations, such as a business contact sending a message unsolicited via a personal messaging application.
- Providing employees with devices if they currently do not, and blocking applications not under surveillance.
- Creating a testing regime to ensure compliance with prohibitions on off-channel communications, and continuously deploying it. Given the potential for negative reaction from staff to what they might view as privacy incursions, collaboration with human resources professionals is equally important.

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