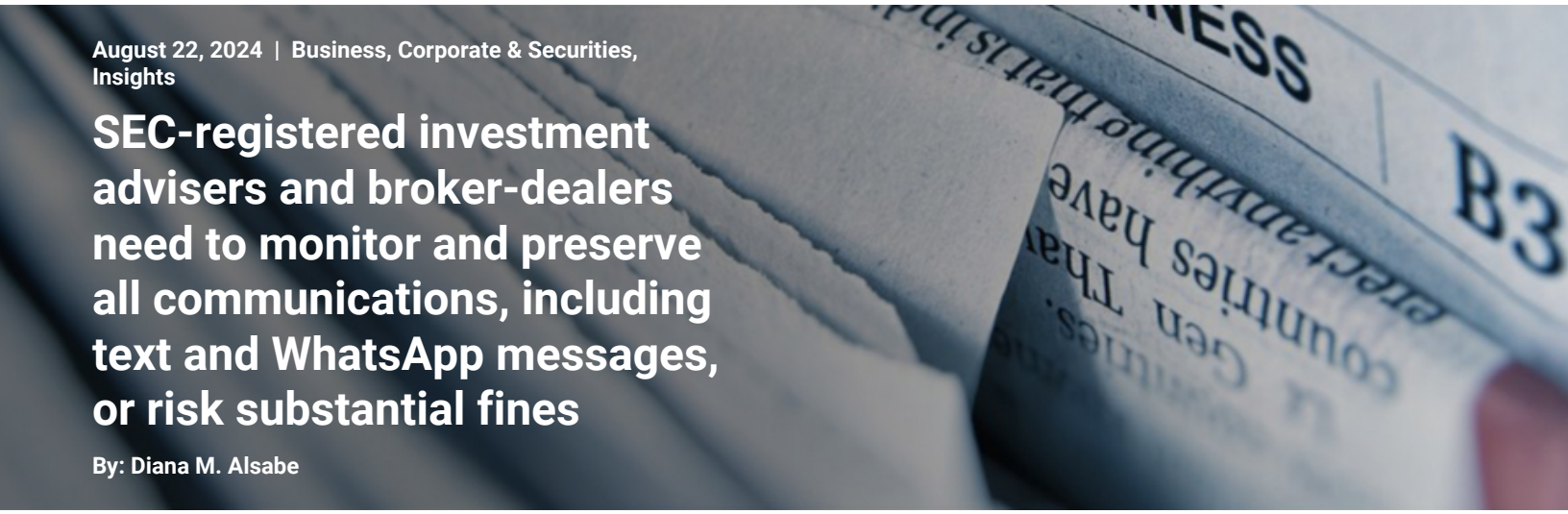

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SEC-registered investment advisers and broker-dealers need to monitor and preserve all communications, including text and WhatsApp messages, or risk substantial fines

By: Diana M. Alsabe

On August 14, 2024, the Securities and Exchange Commission (the "SEC") announced charges against 25 total entities: 11 broker-dealers, 3 SEC-registered investment advisers and 11 dually-registered broker-dealers and investment advisers (collectively, the "Firms") for compliance failures. The Firms were charged with failure to maintain and preserve electronic communications under applicable federal securities laws, in a total amount of over $392 million in combined civil penalties.

The SEC's sweep was pursuant to the Initiative to Investigate Off-Channel Communications at Registered Entities (the "Off-Channel Communications Initiative"), led by the SEC's Division of Enforcement. The SEC issued an Order on August 14, 2024 (the "Order"), and separate individual orders (the "Recordkeeping Orders") instituting administrative cease-and-desist proceedings against each of the Firms affected by the SEC's sweep.

The Firms admitted that their personnel relied on unapproved channels to send and receive communications for which records were required to be maintained under the Securities Exchange Act of 1933 (the "Securities Act"), the Investment Advisers Act of 1940 (the "Advisers Act"), or both. These off-channel communications included text messages that were delivered on personal devices that were not approved written communications platforms. More importantly, the Firms failed to keep for prescribed periods, and furnish copies of, such business-related records as necessary or appropriate in the public interest or for the protection of investors. This failure to maintain records was in direct contravention of Section 17(a) of the Exchange Act and Rule 17a-4(b)(4) thereunder, and/or Section 204 of the Advisers Act and Rule 204-2(a)(7) thereunder and would deprive the SEC of those communications in its investigations.

This is not the SEC's first crackdown into recordkeeping practices in the investment adviser and broker-dealer spaces this year. As early as February 2024, the SEC penalized 16 broker-dealers and dually-registered investment advisers for failure to maintain electronic communications, resulting in civil penalties in excess of $81 million. In that February 2024 sweep, the SEC uncovered longstanding uses of unapproved



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communication methods (the "off-channel communications") in which employees communicated about their business matters through personal text messages. The firms did not maintain or preserve the majority of these off-channel communications, thus triggering a violation of the Securities Act and Advisers Act. Similar to the previous SEC sweep, the actions taken by the SEC in February 2024 led to a cease and desist order against each firm for future violations of relevant recordkeeping rules and included censures.

More recently, on April 3, 2024, the SEC brought its first enforcement action against an SEC-registered investment adviser, for violation of the Advisers Act through such off-channel communications. The regulatory proceeding, In the Matter of Senvest Management, LLC, identified that during 2019-2021, Senvest Management's employees exchanged business-related messages through personal messaging platforms like WhatsApp and other unaffiliated communication services. The SEC discovered that the firm's inability to produce such employee communications in response to record requests and subpoenas burdened the SEC's investigative efforts. Consequently, Senvest faced a penalty of $6.5 million due to non-compliance with certain documentation and ethics requirements under the Advisers Act, including insufficient oversight aimed at preventing such infractions.

The SEC's Off-Channel Communications Initiative advocates for industry professionals within investment advisory and brokerage services to use on-channel platforms for communication and ensure proper documentation of all relevant conversations. Should you need more details about recordkeeping responsibilities for SEC-registered investment advisers and broker-dealers, or the initiative's impact on your enterprise, don't hesitate to get in touch with us.

Disclaimer: This summary is provided for educational and informational purposes only and is not legal advice. Any specific questions about these topics should be directed to attorneys Thomas Bilodeau III, Scott Stokes or Diana Alsabe.

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