

The background features a dark blue and teal color palette with various financial data visualizations. On the left, there is a bar chart with several vertical bars of varying heights. In the center and right, there are line graphs with multiple colored lines (red, orange, green) and a grid. Binary code (0s and 1s) is scattered throughout the background, particularly on the right side. The overall aesthetic is high-tech and data-driven.

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# IMPACT OF SEC'S EXPANDED INVESTIGATIONS INTO OFF- PLATFORM MESSAGING

March 2, 2023

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# Private Funds Landscape Overview

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# How Did We Get Here?

## Increased SEC Focus on Private Fund Managers



# How Does This Issue Arise?

## Enforcement Investigations

- Direct from enforcement sweeps
- Investor complaints
- Unrelated products and services
- Unrelated events such as cyberattacks

## Examinations: 2023 Priorities

- RIAs to Private Funds are a “Notable New and Significant Focus Area”
- RIA Examinations: “Examinations will review RIA policies and procedures for retaining and monitoring electronic communications”
- Never Before Examined RIAs: “As in previous years, the Division prioritizes RIAs that have never been examined, including recently registered firms, and those that have not been examined for a number of years”

# **SEC Investigations of Business Communications via Personal Messaging Platforms**

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# Initial Broker-Dealer Probe into Off-Channel Communications

- In September 2022, the SEC fined 16 financial firms a combined **\$1.8 billion** for failing to monitor and preserve business communications made on employees' personal devices and apps such as WhatsApp, in violation of federal securities laws.
- The SEC investigation uncovered "pervasive off-channel communications" by employees at multiple levels of authority.
  - The SEC issued a statement noting that, "as technology changes, it's even more important that registrants appropriately conduct their communications about business matters within only official channels, and they must maintain and preserve those channels."
  - Describing recordkeeping requirements as "sacrosanct," the SEC urged broker-dealers and asset managers subject to the federal securities laws to "self-report and self-remediate any deficiencies."

# Initial Broker-Dealer Probe into Off-Channel Communications

- The SEC conducted its investigation by requesting the review of communications from personal devices of junior and senior bankers and traders at the firms, finding violations at all levels.
  - The probe found examples of employees talking often about “business matters” through texts on personal devices.
- In addition to the significant penalties, the firms:
  - Admitted wrongdoing;
  - Were ordered to cease and desist from future violations of the relevant recordkeeping provisions and were censured; and
  - Agreed to retain compliance consultants to conduct a comprehensive **review of policies and procedures** related to retention of electronic communications on personal devices and for **addressing noncompliance** by employees.



# Expansion in Scope to Investment Funds and Advisors

- The SEC thereafter broadened the probe to include investment advisers and major hedge fund and private equity firms, several of which disclosed the inquiries in quarterly filings.
- Multiple firms were contacted by the SEC in October 2022 to provide information and documents related to their record-retention policies for certain types of “off-channel” electronic business communications, including text messages and messages on WhatsApp, WeChat, and similar applications.

# Recent Inquiries

Requests have expanded to seeking information on:

- Details about reviews of policies and procedures, including those who are responsible for overseeing them; training programs; disciplinary action; and remediation efforts
- Documentation of how firms' organizations are set up, including information about individuals in each business unit who are responsible for communicating with investors

# **Regulatory Requirements & Objections to Scope of SEC Inquiries**

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# Investment Advisers Act of 1940

- **Rule 204-2(a)(7)** requires investment advisers to keep originals of all written communications received and copies of all written communications relating to:
  - (i) Any recommendations or advice provided;
  - (ii) Receipt, disbursement, or delivery of funds or securities;
  - (iii) The placement or execution of any order to purchase or sell any security; and
  - (iv) Performance of any and all managed accounts.

# Investment Advisers Act of 1940

- **Rule 204-2(e)(1)** requires investment advisers to preserve communications in an easily accessible locations for at least five years.
- **Rule 206(4)-7** requires investment advisers to:
  - (i) Adopt and implement written policies and procedures to ensure compliance with the Investment Advisers Act;
  - (ii) Review these policies and procedures for adequacy and effectiveness on at least an annual basis and;
  - (iii) Designate a supervised chief compliance officer who is responsible for administering these policies and procedures.

# Objections to the Scope of SEC Inquiries

- On January 31, 2023, trade associations, including the Managed Funds Association (MFA) and SIFMA, sent a letter to the SEC Chair Gary Gensler objecting that the Commission's investigation implicates serious privacy concerns and raised questions regarding the scope and application of the recordkeeping provisions of the Investment Advisers Act.
- The letter argues that:
  - The Investment Advisers Act's recordkeeping requirements are narrower than those applicable to broker-dealers under the Securities Exchange Act of 1934 because the Investment Advisers Act enumerates certain categories of communications required to be retained, whereas the Exchange Act has no similar limitations and reflects broader catch-all language.
  - The SEC itself has previously recognized that there are differences in books-and-records requirements applicable to broker dealers and investment advisers.

# Objections to the Scope of SEC Inquiries

- The letter also urged the SEC to avoid equating employee noncompliance with policies regarding retention with firm violations.
  - Many firms' policies already require employees to only use approved channels for communications; penalizing firms for noncompliance is unfair and overbroad.
- Finally, the letter also objected to the SEC's request for review of personal devices as "extremely invasive," including because it would lead to collection of sensitive personal information unrelated to business communications such as medical information and passwords.
  - It pointed to potential violations of stringent international privacy requirements, including the EU's General Data Protection Regulation (GDPR).
- The MFA letter requested formal guidance including a notice-and-comment process.

# **Best Practices & Key Policies**

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# Key Policies to Implement and/or Review

- Record-retention policies should be reviewed to ensure compliance with SEC rules. Policies should also include sufficient enforcement mechanisms and appropriate disciplinary procedures.
- Firm policies should remind employees not to conduct business on WhatsApp or Facebook Messenger, or through personal text-messaging and email that are not retained.
- Conduct recurring training on record-retention and communication policies and consider requiring employees to attest monthly or quarterly that they are in compliance.
- Policies should inform employees that personal devices used to conduct company business are subject to monitoring and search.
  - An amendment to New York law effective May 2022 requires all employers to provide employees with and post publicly written notice that emails, phone calls, and other electronic communications can be monitored.

# Key Policies to Implement and/or Review

## Remote-work policies

- Monitoring of employee communications, including on work and personal devices, took on new challenges during the COVID pandemic, some of which remain as certain employee populations continue to work remotely some or all of the time.
- Employees, as well as clients, may have become accustomed to speaking through texts or apps that are viewed as convenient and quick.
- Remote-work policies should reinforce that employees may not communicate via unauthorized channels, that communications must be retained, and that employee communications are subject to monitoring.
- Training should include information on how to navigate client communication-preference issues (both when working remotely and in the office).

## Whistleblower/reporting policies

- The SEC has also been focused recently on preventing companies from using confidentiality and other policies to deter reporting to the SEC.
- Firms should be mindful of this enforcement priority as they communicate with employees and develop and enforce policies, including policies regarding reporting of potential retention and off-channel communication violations.
  - ✓ Ensure that appropriate IT safeguards are in place such that business-related communications can be produced for an audit or investigation if necessary.

# What's Next?

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