

Regulators Hit Jackpot: Off-Channel Communications

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Several years before announcing the first “off-channel” communications enforcement action, the SEC and FINRA cautioned broker-dealers and investment advisers about problematic record-keeping practices involving the use of texting, messaging, and social media applications — such as WhatsApp, WeChat, Facebook, and Slack — for business-related communication. For example: In 2017, FINRA provided guidance on how FINRA and SEC record-keeping rules applied to digital communications “in light of emerging technologies and communications innovations.” In 2018, the SEC noted its examination observations about the use of electronic messaging by investment advisers. In 2019, FINRA examinations uncovered that some broker-dealers did not maintain a process to reasonably identify and respond to “red flags that registered representatives were using impermissible personal digital channel communications in connection with firm business.”

Apparently, these admonitions proved ineffective because, in September 2021, the SEC’s Division of Enforcement commenced an initiative to investigate record preservation practices at financial firms. The division encouraged firms whose record preservation practices do not comply with the securities laws to contact the SEC. In December 2021, the SEC and the Commodity Futures Trading Commission announced settled actions against the same firm for “widespread and longstanding failures” to maintain and preserve written communications. Since that time, a steady stream of settled actions has continued. By August 8, 2023, when the SEC and the CFTC announced more settled actions involving off-channel communications, the SEC had brought over 30 enforcement actions and imposed over \$1.5 billion in penalties against broker-dealers and investment advisers. The CFTC had brought over 18 enforcement actions against swap dealers and futures commission merchants and imposed more than \$1 billion in penalties. To add to the mix, earlier this year, a group of 10 financial industry trade associations, including the Investment Company Institute and the Securities Industry and Financial Markets Association, wrote to SEC Chair Gary Gensler addressing investment adviser record-keeping requirements. The letter noted that, unlike broker-dealers, investment advisers are not required to retain all business communications. These trade associations expressed concern that “the SEC is attempting to exceed its authority under the Advisers Act and engaging in rulemaking by enforcement through its current sweep regarding off-channel communications.” For its part, FINRA has brought enforcement actions against both firms

and individuals for failing to retain business-related off-channel communications, including:

- A \$1.5 million fine against a firm that did not preserve or reasonably supervise its employees' business-related text messages (even though firm written supervisory procedures prohibited employees from using text messaging for business-related communications, the procedures were not followed).
- A \$10,000 penalty and a three-month suspension against an individual who guaranteed a customer against loss using text messages via his personal cellphone, rather than a firm-approved application (FINRA tacked on a books and records charge to allegations of prohibited messaging via off-channel communication).

With billions in penalties imposed to date, it is no surprise that both the SEC and FINRA have included in their 2023 examination priorities the inspection of broker-dealer compliance and supervisory programs for electronic communications related to firm business and the record-keeping for those electronic communications. To the extent the amount of penalties imposed is a measure of success of an examination program, regulators have struck gold. With such apparently favorable odds, regulators are likely to keep mining for registered personnel who engage in business-related digital communications with firm customers through channels not approved and controlled by the firm.

Authored By



Ann Began Furman

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