

**MESSAGE RECEIVED:
GOVERNMENT AGENCIES ZERO
IN ON OFF-CHANNEL
COMMUNICATION**

Hayley Trahan-Liptak and Christopher Warner
April 6, 2023

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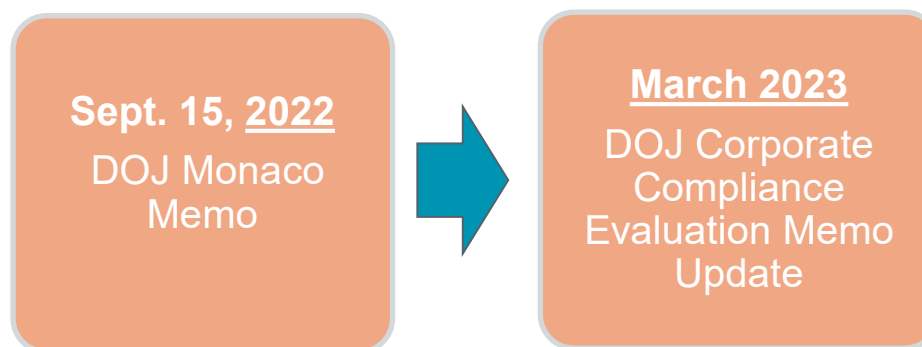
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Setting the Scene: Timeline of Key Events





Relevant Agency Rules

Relevant Agency Rules: The Exchange Act

Securities and Exchange Act of 1934

§ 17 & Rule 17a-4

- Among other things, Rule 17a-4 requires broker-dealers to preserve **for a period of three years** “originals of all communications received and copies of all communications sent... **relating to its business as such.**”

Relevant Agency Rules: The Investment Advisers Act

The Investment Advisers Act of 1940

§ 204 & Rule 204-2

- Rule 204-2 obligates registered investment adviser to “make and keep **true, accurate and current** ... books and records relating to its advisory business.”

In its recent orders, the SEC noted the rule requires, in relevant part, investment advisers to:

*“preserve in an easily accessible place originals of all communications received and copies of all written communications **sent relating to, among other things, any recommendation made or proposed to be made and any advice given or proposed to be given.**”*

Relevant Agency Rules: Other Considerations

Failure to Supervise Employees

- Regulated entities must also be aware of the requirement to supervise their employees to prevent or detect violations of applicable laws and regulations
- Failure to do so can result in additional violations, including:
 - § 15(b)(4)(E) of the Exchange Act;
 - § 203(e)(6) of the Advisers Act





Communication at Issue

Communication at Issue: Relevant Communication

- Regulators are focused on ensuring all business-related communication is preserved.
- This includes communication between:
 - Colleagues;
 - Clients;
 - Broker-dealers customers; and
 - Other persons connected to the securities, commodities, or swaps – related businesses.
- Mediums at issue include:
 - Text messages;
 - WhatsApp;
 - Signal; and
 - Personal email.

UNITED STATES OF AMERICA Before the SECURITIES AND EXCHANGE COMMISSION	
SECURITIES EXCHANGE ACT OF 1934 Release No. 95925 / September 27, 2022	
ADMINISTRATIVE PROCEEDING File No. 3-21170	
In the Matter of Nomura Securities International, Inc. Respondent.	ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, PURSUANT TO SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER
I.	
The Securities and Exchange Commission (“Commission”) deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 (“Exchange Act”) against Nomura Securities International, Inc. (“Respondent” or “NSI”).	

NSI’s Recordkeeping Failures Across Its Brokerage Business

17. In September 2021, Commission staff commenced a risk-based initiative to investigate whether broker-dealers were properly retaining business-related messages sent and received on personal devices. NSI cooperated with the investigation by gathering communications from the personal devices of a broad array of senior and other broker-dealer personnel. These personnel included senior leadership, investment bankers, and debt and equity traders.

Communication at Issue: “Business-Related”

- SEC has not specifically defined “business-related.”
- SEC has applied the term to communication involving the following:
 - Investment strategies;
 - Client meetings; and
 - Market, analysis, activity trends, or events.
- However, content of communication will likely be the determining factor
 - In an adopting release of Rule 17a-4 (Feb. 1997), SEC noted that “the content of the electronic communication is determinative[.]”

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SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 240

[Release No. 34-38245; File No. S7-21-93]

RIN 3235-AF91

REPORTING REQUIREMENTS FOR BROKERS OR DEALERS UNDER THE
SECURITIES EXCHANGE ACT OF 1934

AGENCY: Securities and Exchange Commission.

unrelated to the business of the broker-dealer. Consistent with the Commission's recommendation to the SROs regarding the appropriate standard for prior supervisory review for electronic communications, the Commission believes that for record retention purposes under Rule 17a-4, the content of the electronic communication is determinative, and therefore broker-dealers must retain only those e-mail and Internet communications (including inter-office communications) which relate to the broker-dealer's "business as such."

preservation rule relating to the retention of electronically

generated communications.

EFFECTIVE DATE: The amendments become effective [Insert 60 days after publication in the Federal Register.]

FOR FURTHER INFORMATION CONTACT: Michael A. Macchiaroli,
Associate Director (202/942-0132), Peter R. Geraghty, Assistant

Communication at Issue: “Business-Related”

Rules Applicable to Broker- Dealers

§ 17 & Rule 17a-4

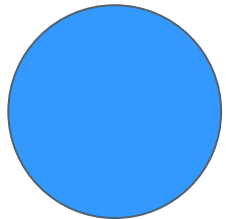
- “all communications ... relating to its business as such.”

Rules Applicable to Investment Advisers

The Investment Advisers Act: § 204 & Rule 204-2

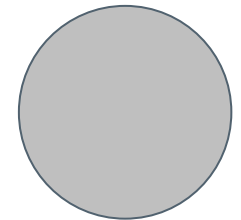
- “communications received ... [or] sent ... relating to **advice given or proposed... receipt, disbursement, or delivery of funds or securities... placing or execution of any order to purchase or sell...[or] predecessor performance.**”

Communication at Issue: Examples

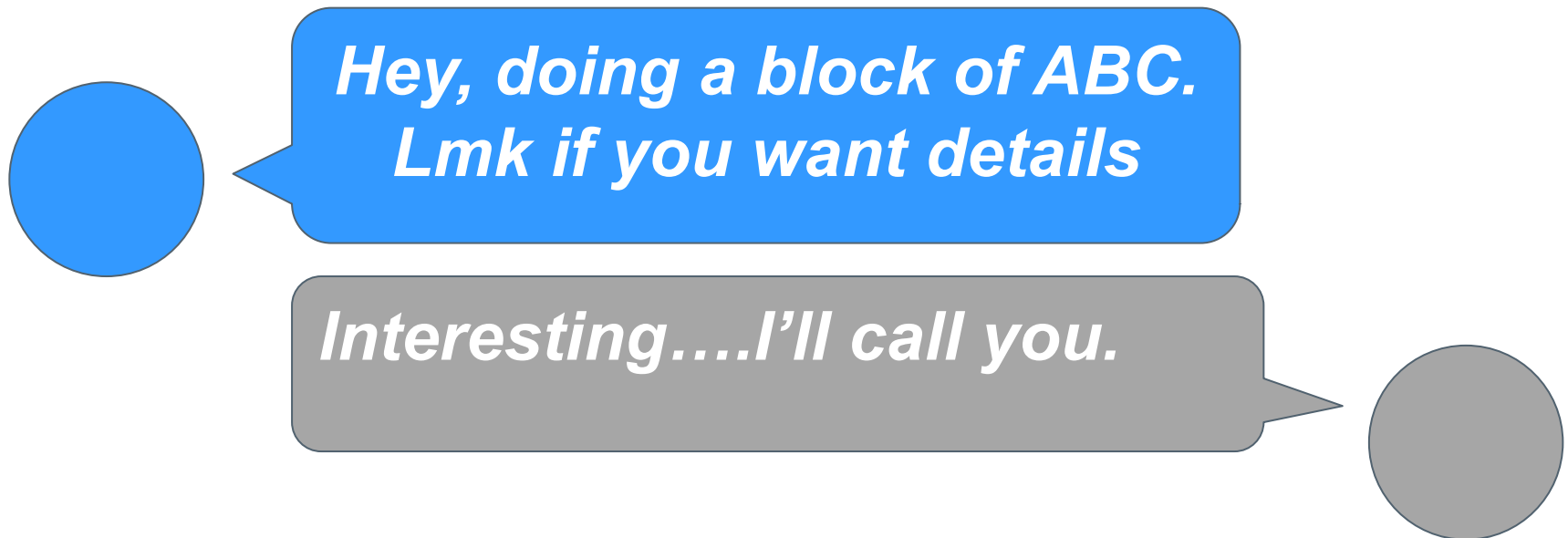


*Have you been watching
ABC today?*

*It's wild! Think it'll keep
going up?*



Communication at Issue: Examples (cont.)



Communication at Issue: Examples of Relevant Communication

SEC Order: Sept. 27, 2022.

- Investment banker received text messages concerning “investment strategy; discussions of investment banking client meetings; and communications about market color, analysis, activity trends or events in the technology industry.”
- Managing director exchanged off-channel business related communication with colleagues, clients, and industry participants



Enforcement Actions & Exams

Enforcement Actions & Exams: December 2021 Efforts

December 2021: SEC and CFTC Enforcement Actions

- SEC and CFTC resolved charges against a major Wall Street firm resulting in a combined penalty of US \$200 million.
- The firm was charged with “widespread and longstanding failures by the firm and its employees to maintain and preserve” business-related communication.
- Platforms at issue included:
 - Text messages;
 - WhatsApp; and
 - Personal email.

“As technology changes, it’s even more important that registrants ensure that their communications are appropriately recorded and are not conducted outside of official channels in order to avoid market oversight[.]”

SEC Chair Gary Gensler

Enforcement Actions & Exams: September 2022 Efforts

- SEC and CFTC announced a group of settled enforcement actions
- Charges against 15 high-profile broker-dealers and 1 investment adviser.
- Centered on failures to monitor and retain business-related communication conducted over “off-channel” mediums.
- Penalties:
 - Collectively \$1.1 billion in monetary penalties;
 - Hiring an independent consultant to review and report (to the SEC) on policies, procedures, training;
 - Adopt independent consultant’s recommendations (unless unduly burdensome); and
 - Consultant reviews preservation programs one year after submitting its initial report to the SEC.

Press Release

SEC Charges 16 Wall Street Firms with Widespread Recordkeeping Failures

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Office of Proceedings

UNITED STATES OF AMERICA
Before the
COMMODITY FUTURES TRADING COMMISSION

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 95927 / September 27, 2022

ADMINISTRATIVE PROCEEDING
File No. 3-21172

In the Matter of

Cantor Fitzgerald & Co.

Respondent.

ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, PURSUANT TO SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER

I.

The Securities and Exchange Commission (“Commission”) deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 (“Exchange Act”) against Cantor Fitzgerald & Co. (“Respondent” or “Cantor”).

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (“Offer”) that the Commission has determined to accept. Respondent admits the facts set forth in Section III below, acknowledges that its conduct violated the federal securities laws, admits the Commission’s jurisdiction over it and the subject matter of these proceedings, and consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order (“Order”), as set forth below.

III.

On the basis of this Order and Respondent’s Offer, the Commission finds¹ that

¹ The findings herein are made pursuant to Respondent’s Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

Enforcement Actions & Exams: September 2022 Efforts

September 2022: Takeaways

“These actions deliver a straightforward message to registrants: You are expected to abide by the Commission’s recordkeeping rules[.]”

Sanjay Wadhwa

In 2021 and 2022 Orders, SEC focused on the following facts:

- Record Keeping Failures: Widespread and pervasive use of unrecorded business-related communication conducted through off-channel mediums.
 - Use of text messages, WhatsApp, Signal, and personal email.
- Policy Failures: Existence of record retention policies and procedures that were not followed or enforced; and
 - Management and supervisors tasked with enforcing policies and procedures related to record retention and off-channel communication also violated such policies and procedures.

Enforcement Actions & Exams: Additional Inquiries

- November 2022:
 - Three large private equity firms disclosed in quarterly filings they were responding to SEC inquiries into their business-related messaging.
- February 2023:
 - Two hedge funds disclosed the SEC had asked to review mobile phones for potential off-channel communication.
 - A French bank announced the SEC requested information related to compliance with recordkeeping requirements in connection with business-related communications on unapproved messaging platforms



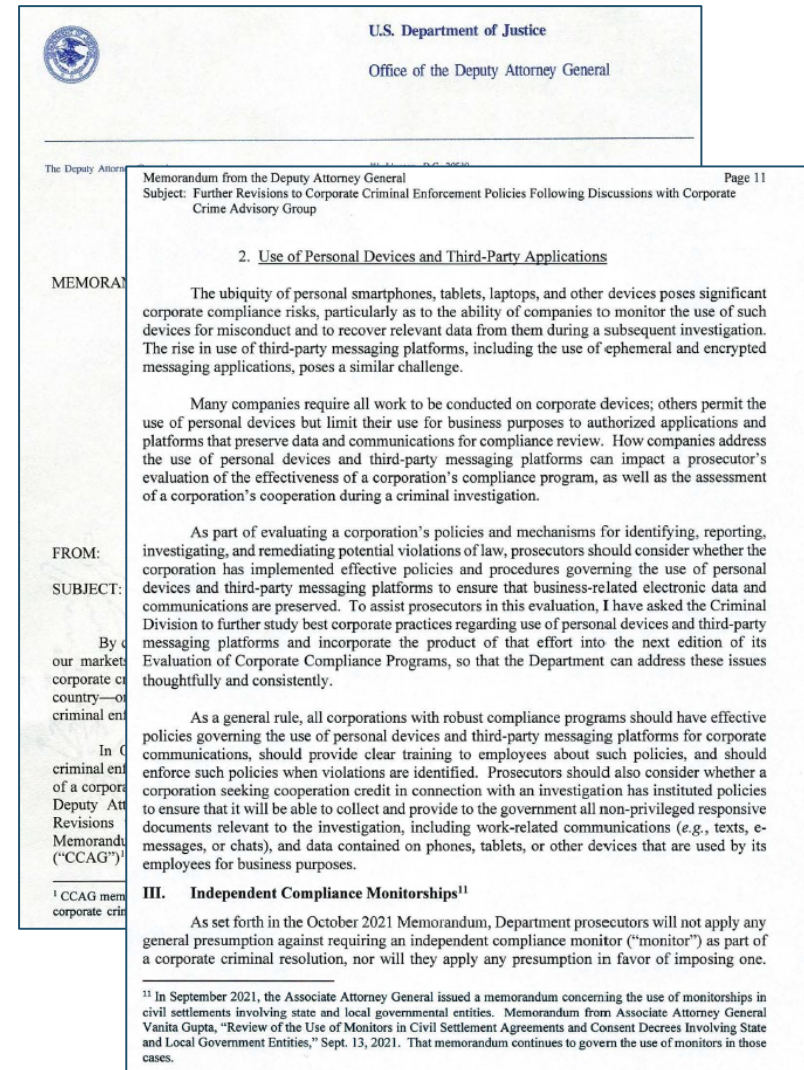
A blue speech bubble graphic with a white outline, pointing to the right. It contains the text "Department of Justice Guidance" in white, sans-serif font.

Department of Justice
Guidance

DOJ Guidance: Prior Guidance

Assessing Corporate Compliance Programs

- September 2022: Monaco Memo
 - Management of third-party messaging platforms impacts cooperation assessment, including information retention and availability;
 - Prosecutors urged to consider how use of third-party messaging platforms are policed; and
 - Corporations expected to have policies and training related to third-party messaging platforms.
- November 2022: DOJ Comments
 - Emphasize importance of employee training;
 - Third-party messaging platforms are risky; and
 - Adopt a risk-based approach.



DOJ Guidance: March 2023 Guidance

Assessing Corporate Compliance Programs

- Communication Channel
 - What types of channels are used?
 - Preservation mechanisms in place?
 - Are deletion settings available?
- Policy Environment
 - What is in place to ensure communication is preserved?
 - Are policies enforced? Are they effective?
 - How do companies with a “bring your own device” program manage?
- Risk Management
 - Consequences for violations or refusal to comply?
 - Has disciplinary action occurred?
 - Has use of third-messaging negatively impacted the company in responding to government inquiry?

U.S. Department of Justice
Criminal Division
Evaluation of Corporate Compliance Programs
(Updated March 2023)

Introduction

The “Principles of Federal Prosecution of Business Organizations” in the Justice Manual describe specific factors that prosecutors should consider in conducting an investigation of a corporation, determining whether to bring charges, and negotiating plea or other agreements. JM 9-28.300. These factors include “the adequacy and effectiveness of the corporation’s compliance program at the time of the offense, as well as at the time of a charging decision” and the

- **Communication Channels** – What electronic communication channels do the company and its employees use, or allow to be used, to conduct business? How does that practice vary by jurisdiction and business function, and why? What mechanisms has the company put in place to manage and preserve information contained within each of the electronic communication channels? What preservation or deletion settings are available to each employee under each communication channel, and what do the company’s policies require with respect to each? What is the rationale for the company’s approach to determining which communication channels and settings are permitted?
- **Policy Environment** – What policies and procedures are in place to ensure that communications and other data is preserved from devices that are replaced? What are the relevant code of conduct, privacy, security, and employment laws or policies that govern the organization’s ability to ensure security or monitor/access business-related communications? If the company has a “bring your own device” (BYOD) program, what are its policies governing preservation of and access to corporate data and communications stored on personal devices—including data contained within messaging platforms—and what is the rationale behind those policies? How have the company’s data retention and business conduct policies been applied and enforced with respect to personal devices and messaging applications? Do the organization’s policies permit the company to review business communications on BYOD and/or messaging applications? What exceptions or limitations to these policies have been permitted by

individualized determination. As the Justice Manual notes, there are three fundamental questions⁴ a prosecutor should ask:

1. Is the corporation’s compliance program well designed?
2. Is the program being applied earnestly and in good faith? In other words, is the program adequately resourced and empowered to function effectively?



How to Prepare?

How to Prepare: Start Now

Speech

"This Law and Its Effective Administration":
Remarks Before the Practising Law Institute's
54th Annual Institute on Securities Regulation



Chair Gary Gensler

Washington D.C.

Nov. 2, 2022

My thanks to the Practising Law Institute and the 54th Annual Institute on Securities Regulation. I like to note that my views are my own, and I am not speaking on behalf of my fellow Commissioners.

On May 27, 1933, when he signed the first of the federal securities laws, President Franklin D. Roosevelt said, "This law and its effective administration are steps in a program to restore some measure of public rectitude."¹

For nearly 90 years since, Congress has tasked the Securities and Exchange Commission and our dedicated staff with this "effective administration."

We do this through overseeing markets, registering entities, enacting rules, examining against the rules, and enforcing those rules.

Today, I am going to focus on that final pillar: enforcement.

In the fiscal year that just ended on September 30, 2022, we filed more than 700 actions. We obtained judgments and

We then did a sweep for similar violations. In October, we charged 16 additional financial entities for similar recordkeeping failures, all of whom admitted their misconduct, in a combined settlement of \$1.1 billion.^[12] We ordered undertakings against the 16 firms designed to remediate past failures and prevent future misconduct, and our investigation is ongoing.

I hope this sends a message to other registrants. Books and records matter. We will strive to ensure that penalties are not seen as the cost of doing business. We will use sweeps, initiatives, and undertakings to shape market behavior.

Second, high-impact cases aren't just the ones that have a high profile or high penalties. They also can be cases where we reward good behavior.

Press Release

SEC Announces Enforcement Results for FY22

Commission filed 760 enforcement actions and recovered record \$6.4 billion in penalties and disgorgement on behalf of investing public

Penalties, Undertakings, and Admissions

To deter future misconduct and enhance public accountability, the SEC in a number of actions recalibrated penalties for certain violations, included prophylactic remedies, and required admissions where appropriate. For example, the \$1.235 billion in cumulative penalties paid in connection with the recordkeeping violations made clear that the fines were not just a cost of doing business. The undertakings in those cases included retention of compliance consultants to, among other things, conduct comprehensive reviews of the firms' policies and procedures relating to the retention of electronic communications found on personal devices. In addition, the firms admitted their conduct and acknowledged that their conduct violated recordkeeping provisions of the federal securities laws.

"I continue to be impressed with our Division of Enforcement. These numbers, though, tell only part of the story," said SEC Chair Gary Gensler. "Enforcement results change from year to year. What stays the same is the staff's commitment to follow the facts wherever they lead."

"As reflected in these results, the Enforcement Division is working with a sense of urgency to protect investors, hold wrongdoers accountable and deter future misconduct in our financial markets," said Gurbir S. Grewal, Director of the Division of Enforcement. "A centerpiece of those efforts is ensuring that we are using every tool in

our arsenal to have a deterrent effect and are viewed as more than the cost of doing business. The total amount of penalties and disgorgement in this past fiscal year for total money ordered at \$6.4 billion, including a record \$1.1 billion in settlements, is expected to break these records and set new ones each year because we expect compliance."

Last year's actions amply demonstrates Enforcement staff's skill in uncovering and deterring misconduct by employing the right investigative tools and case strategy, and, above all, its commitment to protecting investors and obtaining remedies that promote market integrity while helping to protect the public interest. As Deputy Director of the Division of Enforcement, "From investigative attorneys and analysts, investigators, and support staff, each member of Enforcement contributed to the success of the Division in the past fiscal year, and it is a great privilege to serve alongside them in

How to Prepare: Practices and Procedures

- Institute and/or evaluate current and prior policies pertaining to electronic records preservation and the use of communication channels.
 - Policies should clearly state violations can result in disciplinary action.
- Conduct routine trainings on the firm's policies and procedures regarding electronic communication and off-channel mediums.



How to Prepare: Practices and Procedures

- Institute technological measures that preserve and flag off-channel communication, or prohibit the download or use of certain applications where message retention is not possible.
- Issue company-owned phones or company-managed phones.
- Conduct periodic audits of electronic communication storage and use of messaging applications.



Questions?



K&L GATES