Proskauer

Messaging Missteps:

SEC's Increasing Focus on Off-Channel Communications

The Capital Commitment on **April 25, 2023**

The SEC's Enforcement Division is conducting a sweep investigation of large investment advisers regarding their employees' use of "off-channel" communications. The sweep, which has been widely reported in the press, focuses on text messages from personal phones, personal email, WhatsApp and other platforms not typically captured or monitored by advisers. The sweep is causing considerable industry concern, following the SEC's announcement of settlements against a number of large broker-dealers for use of off-channel communications, that resulted in $1.235 billion of cumulative penalties.

Private fund advisers have become accustomed to the Exams Division's staff reviewing the use of off-channel communications in recent years. However, given how prevalent text messaging has become in modern business (and everyday life), the SEC is bound to find additional slip-ups as they investigate or conduct exams of private fund advisers. For example, internal text messages among the investment team advising a fund could arguably relate to recommendations or advice to the client (e.g., the fund). If not retained, the SEC staff may have concerns under Section 204 of the Advisers Act and Rule 204-2(a)(7) (the Recordkeeping Rules).

As the SEC presses the issue, smaller asset management firms may face similar scrutiny. Recent actions are a warning to reassess firms' compliance with recordkeeping requirements relating to off channel communications. While this may be anxiety-inducing, firms can take steps to minimize future exposure. Below are some of the key factors asset managers should evaluate:

1. *Policies and Procedures*: Policies should reasonably address off-channel communications and should accurately reflect current practices and exceptions. At a minimum, policies should be tailored to comply with the Recordkeeping Rules under the Advisers Act. Yet having a policy is not enough, firms must ensure that their employees read, understand, and comply with the policies.
2. *Detection and Surveillance*: Firms should take steps to detect off-channel communications that are covered by the Recordkeeping Rules, whether by

managing firm-issued devices or using reasonable detection mechanisms. Options include interviewing key team members, monitoring certain app usage, encouraging self-reporting of policy violations, and scanning work emails for indications of off-channel use (*e.g.,* "please get in touch with me via WhatsApp"). Additionally, once employees exit the firm, if off-channel communications exist, the SEC may expect firms to take steps to obtain and preserve them.

3. *Devices and Platforms*: Considering how difficult it may be to monitor employees' communications on their personal devices, firms may choose to issue devices to their personnel, taking steps to ensure that communications are conducted on approved platforms and retained. Firms also may consider whether unauthorized platforms can be blocked using IT measures.

4. *Violations*: Even with appropriate policies in place, firms must have a cognizable process for handling potential violations. The SEC may expect firms to collect the individual's business-related communications or image devices. The SEC may ask questions about whether disciplinary action has been taken against individuals who violate internal policies.

The sheer magnitude of SEC penalties in the broker-dealer space showcases how seriously the SEC views recordkeeping. It is reasonable to expect that the SEC will eventually turns its attention to additional asset management firms. Working with counsel, asset managers can minimize their risk by preparing a detailed plan to prepare for further scrutiny.

Read more of our Top Ten Regulatory and Litigation Risks for Private Funds in 2023.

View original.

Related Professionals

- **Margaret A. Dale**
  Partner
- **Mike Hackett**
  Partner
- **Timothy W. Mungovan**
  Chairman of the Firm
- **Dorothy Murray**
  Partner

- **Joshua M. Newville**
  Partner
- **Todd J. Ohlms**
  Partner
- **Robert Pommer**
  Partner
- **Seetha Ramachandran**
  Partner
- **Robert H. Sutton**
  Partner
- **John Verwey**
  Partner
- **Jonathan M. Weiss**
  Partner
- **Julia D. Alonzo**
  Litigation Department Legal Director
- **Charles Bishop**
  Associate
- **William D. Dalsen**
  Partner
- **Adam L. Deming**
  Senior Counsel
- **Reut N. Samuels**
  Associate
- **Michael Singh**
  Associate
- **Hena M. Vora**
  Associate