

# SEC and CFTC Continue Targeting Off-Channel Communications at Financial Institutions

August 10, 2023

On August 8, the SEC and CFTC announced another round of recordkeeping settlements against broker-dealers and one investment adviser regarding off-channel communications.<sup>1</sup> The SEC charged 11 financial institutions for a combined penalty of \$289 million; the CFTC charged four financial institutions for a combined penalty of \$260 million. These settlements follow those announced against 15 broker-dealers and one affiliated investment adviser in 2022 and HSBC and Scotiabank several months ago. Collectively, the resolutions reflect regulators' continued imposition of significant penalties for these violations, including an increasingly aggressive approach by the CFTC, as well as further emphasis by regulators on the importance of self-reporting and cooperation, and a universal requirement for independent compliance consultants. We provide below a brief overview of the recent settlements and their major takeaways.

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## Summary of SEC Settlements

The SEC orders are nearly identical in structure to the orders from the first round and from the HSBC and Scotiabank orders, and they impose the same relief. According to the orders, the SEC's investigations uncovered pervasive and longstanding off-channel communications at all 11 firms. As described in the SEC's orders, the firms admitted that, from at least 2019, their employees often communicated through various messaging platforms on their personal devices, including iMessage, WhatsApp, and

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<sup>1</sup> See Appendix 1 for a chart of all the SEC and CFTC recordkeeping settlement penalty numbers to date. The SEC and CFTC simultaneously announced a first round of recordkeeping settlements on September 27, 2022, involving the following institutions: Barclays Capital Inc.; BofA Securities Inc. together with Merrill Lynch, Pierce, Fenner & Smith Inc.; Citigroup Global Markets Inc.; Credit Suisse Securities (USA) LLC; Deutsche Bank Securities Inc. together with DWS Distributors Inc. and DWS Investment Management Americas, Inc.; Goldman Sachs & Co. LLC; Morgan Stanley & Co. LLC together with Morgan Stanley Smith Barney LLC; UBS Securities LLC together with UBS Financial Services Inc.; Jefferies LLC; Nomura Securities International, Inc.; and Cantor Fitzgerald & Co. The CFTC's settlements were with the FCM and Swap Dealer entities of these firms. On May 11 and May 12, 2023, the SEC and CFTC announced another round of recordkeeping settlements with HSBC and Scotiabank. The SEC settlements were with HSBC Securities (USA) Inc. and Scotia Capital (USA) Inc., and the CFTC settlements were with HSBC Bank USA, N.A., HSBC Securities (USA) Inc., HSBC Bank plc, Bank of Nova Scotia and Scotia Capital (USA) Inc.

Signal, about the business of their employers. The firms further admitted that they did not maintain or preserve the substantial majority of these written communications. The orders found that these failures were firm-wide and involved personnel at all levels of authority. As a result, the firms were found to have violated Section 17(a) of the Securities Exchange Act of 1934 and Rule 17a-4(b)(4) thereunder, and to have failed to reasonably supervise with a view to preventing and detecting those violations. Wedbush Securities Inc., a dually registered broker-dealer and investment adviser, was additionally charged with violating certain recordkeeping provisions of the Investment Advisers Act of 1940 and with failing to reasonably supervise with a view to preventing and detecting those violations. This was the second time that the SEC charged an affiliated investment advisor under the Investment Advisers Act.

In addition to agreeing to pay a substantial penalty, each firm agreed to retain an independent compliance consultant to conduct comprehensive reviews of their policies and procedures relating to the retention of electronic communications, including those found on personal electronic devices. The compliance consultants will also review the firms' respective frameworks for addressing noncompliance by their employees with those policies and procedures.

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## Summary of CFTC Settlements

The CFTC charged the FCM/swap dealer entities of four of the 11 firms – BNP Paribas, Wells Fargo, Société Générale, and Bank of Montreal – for failing to maintain, preserve, or produce records that were required to be kept under CFTC recordkeeping requirements and failing to diligently supervise matters related to their businesses as CFTC registrants. Like the SEC orders, the CFTC orders were generally identical in structure to the orders from the first round and the Scotiabank/HSBC settlements, and they impose the same obligations. Each order finds that the relevant swap dealer and/or FCM, for a period of years, failed to prevent its employees, including those at senior levels, from communicating both internally and externally using unapproved communication methods, including messages sent via personal text or WhatsApp, contrary to its recordkeeping obligations as a CFTC registrant. These written communications generally were not maintained and preserved by the firms, and so the firms generally would not have been able to provide them promptly to the CFTC when requested.

In addition to agreeing to pay a substantial penalty, each firm agreed to conduct a comprehensive review of all policies and procedures, training, surveillance programs, technological solutions, and disciplinary framework related to electronic

communications and to submit a written report with the findings and recommendations from this review.

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## Key Observations

A few key observations and takeaways have emerged from the most recent round of settlements:

### I. Increased CFTC Penalties

One takeaway from this round of settlements is the increased penalty amounts sought by the CFTC. In this round, several firms agreed to settle for higher CFTC penalties than SEC penalties. This represents a departure from the first round of settlements, in which all CFTC settlement amounts were approximately 60% of the SEC settlement amounts.

These increased penalties, along with statements issued by the CFTC accompanying the orders, reflect the CFTC's continued focus on recordkeeping violations.

### II. Self-Reporting and Cooperation

The SEC and CFTC have continued to emphasize the importance of self-reporting and cooperation in relation to off-channel communications and recordkeeping violations. In its May settlements with HSBC and Scotiabank, the SEC specifically recognized self-reporting and self-remediation efforts, and this self-reporting and cooperation appears to have led to reduced penalties. The level of credit that the firms received from that self-reporting was unclear, though, as there were ongoing CFTC investigations at the time of the SEC self-report, and the CFTC-imposed penalties did not appear to reflect any credit for self-reporting.

In this most recent round of settlements, no firm was credited for self-reporting violations. While the SEC orders recognized self-remediation efforts taken by all the firms, it does not appear that any penalties were reduced for these self-remediation efforts. Nonetheless, statements issued by both the SEC and CFTC highlight their continued emphasis on self-reporting and cooperation. SEC Director of Enforcement Gurbir Grewal, in a statement accompanying the orders, stated: "So here are three takeaways for those firms who haven't yet done so: self-report, cooperate and remediate. If you adopt that playbook, you'll have a better outcome than if you wait for us to come calling." Notwithstanding this statement, it remains unclear what level of credit firms will get from self-reporting at this stage.

### III. Independent Compliance Consultants

As in the previous SEC recordkeeping settlements, all of the SEC orders require an independent compliance consultant to conduct a “comprehensive” review of the firm’s policies and procedures and issue a report focused on policies and procedures, trainings, surveillance programs, technological solutions, and disciplinary frameworks related to off-channel communications.

### IV. Waivers of Disqualification

Additionally, as in its previous recordkeeping settlements, the SEC agreed to waive the statutory disqualifications of Regulations A, D, E, and Crowdfunding, assuming the firms comply with the terms of their recordkeeping orders. These statutes provide for disqualification from exemptions to registration for certain offerings if the relevant entity is subject to a Commission order pursuant to Section 15(b) of the Exchange Act that places limits on that entity’s activities, functions, or operations.

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## Best Practices

At this stage, there are several best practices that firms can adopt to strengthen their policy frameworks for retaining electronic communications<sup>2</sup>, including:

- Conducting a risk assessment regarding off-system communications, including the use of particular applications, contacts that employees most frequently interact with via messaging, and the purposes of any such messaging for business purposes;
- Reviewing and assessing policies and procedures on electronic communications to address any inadequacies and strengthen prohibitions on off-channel platforms;
- Incorporating mandatory in-person trainings for all employees on the appropriate use of electronic communications;
- Requiring quarterly certifications that employees understand and will comply with all relevant electronic communications policies;
- Requiring and incentivizing prompt self-reporting of any off-channel communications by employees;

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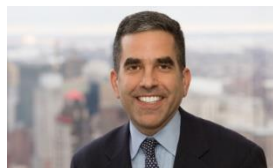
<sup>2</sup> See Andrew M. Levine and Chana Zuckier, *The messaging dilemma: grappling with employees’ off-system communications*, REUTERS (Feb. 3, 2023), <https://www.reuters.com/legal/legalindustry/messaging-dilemma-grappling-with-employees-off-system-communications-2023-02-03>.

- Enhancing disciplinary frameworks to address instances of noncompliance with electronic communications policies and strengthen discipline for offenders; and
- Staying up to date on available technological solutions and regularly assessing whether new technologies should be implemented.

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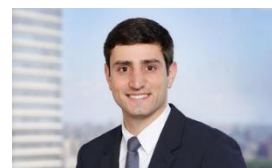
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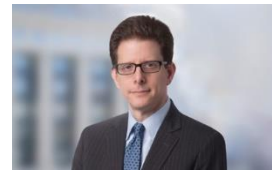
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**Appendix 1 - SEC/CFTC Settlements**

<b>Entity</b>	<b>SEC Penalty</b>	<b>CFTC Penalty</b>
JP Morgan Securities LLC <sup>1</sup>	\$125M	\$75M
Barclays Capital Inc.	\$125M	\$75M
BofA Securities Inc <sup>2</sup>	\$125M	\$100M
Merrill Lynch Pierce, Fenner & Smith Inc. <sup>2</sup>	\$125M	\$100M
Citigroup Global Markets Inc. <sup>3</sup>	\$125M	\$75M
Credit Suisse Securities (USA) LLC	\$125M	\$75M
Deutsche Bank Securities Inc. <sup>4</sup>	\$125M	\$75M
DWS Distributors Inc. <sup>4</sup>	\$125M	N/A
DWS Investment Management Americas, Inc. <sup>4</sup>	\$125M	N/A
Goldman Sachs & Co. LLC	\$125M	\$75M
Morgan Stanley & Co. LLC <sup>5</sup>	\$125M	\$75M
Morgan Stanley Smith Barney LLC <sup>5</sup>	\$125M	N/A
UBS Securities LLC <sup>6</sup>	\$125M	\$75M
UBS Financial Services Inc. <sup>6</sup>	\$125M	\$75M
Jefferies LLC <sup>7</sup>	\$50M	\$30M

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- <sup>1</sup> J.P. Morgan Securities LLC together with JPMorgan Chase Bank, N.A. and J.P. Morgan Securities plc jointly settled with the CFTC.
- <sup>2</sup> BofA Securities Inc. together with Merrill Lynch, Pierce, Fenner & Smith Inc. jointly settled with the SEC and the CFTC.
- <sup>3</sup> Citigroup Global Markets Inc. together with Citibank, N.A. and Citigroup Energy Inc. jointly settled with the CFTC.
- <sup>4</sup> Deutsche Bank Securities Inc. together with DWS Distributors Inc. and DWS Investment Management Americas, Inc. jointly settled with the SEC. Deutsche Bank Securities Inc. together with Deutsche Bank AG jointly settled with the CFTC.
- <sup>5</sup> Morgan Stanley & Co. LLC together with Morgan Stanley Smith Barney LLC jointly settled with the SEC. Morgan Stanley & Co. LLC together with Morgan Stanley Capital Services LLC, Morgan Stanley Capital Group Inc., and Morgan Stanley Bank, N.A. jointly settled with the CFTC.
- <sup>6</sup> UBS Securities LLC together with UBS Financial Services Inc. jointly settled with the SEC. UBS Financial Services, Inc. together with UBS Securities LLC and UBS AG jointly settled with the CFTC.
- <sup>7</sup> Jefferies Financial Services, Inc. together with Jefferies LLC jointly settled with the CFTC.

<b>Entity</b>	<b>SEC Penalty</b>	<b>CFTC Penalty</b>
Nomura Securities International Inc. <sup>8</sup>	\$50M	\$50M
Cantor Fitzgerald & Co.	\$10M	\$6M
HSBC Securities (USA) Inc. <sup>9</sup>	\$15M*	\$30M
Scotia Capital (USA) Inc. <sup>10</sup>	\$7.5M*	\$15M
Wells Fargo Securities, LLC <sup>11</sup>	\$125M	\$75M
Wells Fargo Clearing Services, LLC <sup>11</sup>	\$125M	N/A
Wells Fargo Advisors Financial Network, LLC <sup>11</sup>	\$125M	N/A
BNP Paribas Securities Corp. <sup>12</sup>	\$35M	\$75M
SG Americas Securities, LLC <sup>13</sup>	\$35M	\$75M
BMO Capital Markets Corp.	\$25M	N/A
Bank of Montreal	N/A	\$35M
Mizuho Securities USA LLC	\$25M	N/A
Houlihan Lokey Capital, Inc.	\$15M	N/A
Moelis & Company LLC	\$10M	N/A
Wedbush Securities Inc.	\$10M	N/A
SMBC Nikko Securities America, Inc.	\$9M	N/A

<sup>8</sup> Nomura Securities International, Inc. together with Nomura Global Financial Products Inc. and Nomura International PLC jointly settled with the CFTC.

<sup>9</sup> HSBC Securities (USA) Inc. together with HSBC Bank USA, N.A. and HSBC Bank plc jointly settled with the CFTC.

<sup>10</sup> Scotia Capital USA Inc. together with the Bank of Nova Scotia jointly settled with the CFTC.

<sup>11</sup> Wells Fargo Securities, LLC together with Wells Fargo Clearing Services LLC and Wells Fargo Advisors Financial Network, LLC jointly settled with the SEC. Wells Fargo Bank NA and Wells Fargo Securities, LLC jointly settled with the CFTC.

<sup>12</sup> BNP Paribas S.A. and BNP Paribas Securities Corp. jointly settled with the CFTC.

<sup>13</sup> Société Générale SA and SG Americas Securities, LLC jointly settled with the CFTC.

\* The SEC noted that penalties for HSBC Securities (USA) Inc. and Scotia Capital USA Inc. were reduced because the firms self-reported recordkeeping violations.