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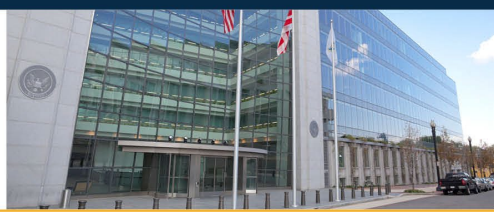
April 10, 2024

Client Alert | Investment Management and Securities Litigation & Enforcement



SEC Settles First Off-Channel Communications Enforcement Action with Standalone Investment Adviser

On April 3, 2024, the U.S. Securities and Exchange Commission (SEC) settled an administrative action against Senvest Management LLC (Senvest) for alleged recordkeeping, policies and procedures, and failure to supervise violations related to off-channel communications (the use of text messaging and other electronic communication services that fall outside of the adviser's official recordkeeping channels).[1] Although the SEC has previously settled actions against investment advisers who were dually registered as, or affiliated with, a broker-dealer, this is the first action against a standalone investment adviser brought pursuant to the Investment Advisers Act of 1940 (IAA).

This is also the first time the SEC has charged an investment adviser for failing to adopt and implement written policies and procedures reasonably designed to prevent violations of the IAA concerning off-channel communications. In settling the matter, Senvest admitted to the facts of the violation and agreed to pay a $6.5 million civil penalty, cease and desist from further violations, a censure, and to implement improvements to its compliance policies and procedures.

SEC Finds Violations of IAA and Senvest Policies

The books and records provisions of the IAA, including Rule 204-2(a)(7), are more limited than the books and records provisions applicable to broker-dealers. Investment advisers are required to preserve all communications received and copies of all written communications sent relating to specified records, including recommendations made or proposed to be made and any advice given or proposed to be given; any receipt, disbursement or delivery of funds or securities; or the placing or execution of any order to purchase or sell any security. Pursuant to Rule 17a-4(b)(4), promulgated under Section 17(a)(1) of the Securities Exchange Act of 1934, broker-dealers are required to maintain books and records relating to their "business as such."

Despite the more limited requirements of the IAA, Senvest's compliance manual provided that the firm would "retain all electronic communications that it sends and receives" (not merely

[1] *In the Matter of Senvest Management*, Release No. IA-6581 (April 3, 2024). The order also notes that certain Senvest employees failed to adhere to the firm's code of ethics provisions in violation of Section 204A of the IAA and Rule 204A-1 promulgated thereunder. Senvest's code of ethics requires employees to obtain pre-clearance for all securities transactions in their personal accounts. According to the order, Senvest failed to implement this requirement and thus failed to detect pre-clearance failures.

those that were records that were required to be kept under Rule 204-2(a)(7)) and that employees were "strictly prohibited from using non-Senvest electronic communication services for any business purpose." If employees used an off-channel communication, they were required to report the use and copy those communications to their business email accounts to be properly archived. Senvest's policies also included supervision and training requirements.

The SEC found that, for nearly three years, Senvest employees, including supervisors, sent and received thousands of "business-related messages" between and among senior officers, managing directors, employees, fund investors and other financial-industry participants using personal text messaging platforms and other non-Senvest unofficial electronic communication channels. They did so without copying these communications to their email accounts, and the firm did not conduct surveillance on their personal devices, in violation of the firm's policies and procedures. Unlike firms that have previously settled with the SEC for similar violations, Senvest's policies and procedures explicitly permitted the firm to surveil employees' personal devices to review for off-channel communications.

Although Senvest's policies and procedures required a broader set of records to be maintained than the plain language of Rule 204-2(a)(7), the settled order details that at least some of the off-channel text messages included communications that fell within the scope of the IAA rule because they concerned "recommendations made or proposed to be made and advice given or proposed to be given about securities." In addition, at least three senior employees communicated via personal devices set to automatically delete messages after 30 days, which prevented the SEC from determining the number and subject matter of all off-channel communications at Senvest. The SEC noted that Senvest's failure to maintain and preserve required records also "likely deprived the Commission" of off-channel communications responsive to SEC requests and document subpoenas served on Senvest during the time of these failures.

As a result, the SEC found that Senvest violated Sections 204, 204A and 206(4) of the IAA and Rules 204-2(a)(7), 204A-1 and 206(4)-7 thereunder. In addition, the SEC concluded that Senvest failed to supervise certain of its employees to prevent them from aiding and abetting violations of those provisions within the meaning of Section 203(e)(6) of the IAA.

What Can Investment Advisers Take from the Senvest Matter?

While comprehensive, the firm's policies and procedures that required surveillance of employee personal devices may have actually bolstered the SEC's charges. Senvest did not conduct the stated surveillance and, therefore, committed a wholesale failure to implement its own policies designed to prevent the precise books and records violations that formed the basis of the charges.

Although Senvest did not self-report, the SEC's order notes that the firm made certain undefined revisions to its policies and procedures and remediated by providing employees with firm-issued cellphones that automatically upload communications into Senvest's archiving system for retention. Senvest is not the first firm to remediate in such a way.[2] By recognizing firms that issue mobile devices with archiving and surveilling capabilities in their settled orders, the SEC seems to be signaling that this is an acceptable — although not required — method for complying with recordkeeping requirements under the securities laws.

[2] See, e.g., *In the Matter of Moelis & Company*, Release No. IA-98078 (August 8, 2023) and *In the Matter of Guggenheim Securities*, Release No. IA-6551 (February 9, 2024).

While the Senvest matter involved new policies and procedures charges, the settlement eliminated some of the standard undertakings that the SEC had included in its prior 40 off-channel communications settlements.

Specifically, the Senvest settlement did not require that:

- The independent compliance consultant (ICC) conduct a comprehensive review of the framework adopted by the firm to address instances of past non-compliance by the firm's employees.
- The ICC report the imposition of discipline imposed by the firm concerning any employee found to have violated the firm's policies and procedures concerning the preservation of electronic communications.
- The firm's internal audit function conduct a separate audit assessing the firm's progress in the areas identified for the ICC's review.

In light of the Senvest settlement, investment advisers that have not already reviewed their recordkeeping policies and procedures regarding off-channel communications should consider doing so with a view toward the recordkeeping requirements applicable to standalone investment advisers and with due consideration of the breadth of their policies and procedures. In addition, advisers involved in SEC investigations concerning such communications should consider the legal limitations placed on the SEC's authority to levy civil monetary penalties,[3] as well as the public remarks from SEC Deputy Director of Enforcement Sanjay Wadhwa, made the same day as the Senvest order was issued, outlining the factors the SEC focuses on when making an "individualized assessment" of the penalty appropriate in a specific matter.[4]

[3] See 15 U.S.C. 80b-3(i) (IAA Section 203(i)); 15 U.S.C. 80b-9(e) (IAA Section 209(e)).

[4] Sanjay Wadhwa, Remarks at SEC Speaks 2024 (April 3, 2024). In sum, the factors are:

- The size of the firm (including "the firm's revenues from the regulated parts of its business" and the number of registered professionals at the firm).
- The scope of the violations (including the number of individuals who communicated off-channel and the number of off-channel communications).
- The firm's efforts to comply with its recordkeeping obligations and to prevent off-channel communications.
- Precedent (established through the settled orders issued in these matters since December 2021).
- Self-reporting (the most significant factor).
- Cooperation with the Division of Enforcement staff during its investigation.

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