Recent SEC Enforcement Actions of Note

October 18, 2024

The SEC and CFTC Continue Enforcement Actions Against Off-Channel Communications

In the latest wave of enforcement actions involving the use of personal devices to communicate by text messages and/or other unapproved written communication platforms ("off-channel communications"), the Securities and Exchange Commission (the "SEC") announced on September 24, 2024, the settlement of enforcement actions against eleven financial firms (the "Respondents") and the imposition of more than $88 million in aggregate civil monetary penalties against the Respondents. The SEC found that the Respondents, comprised of broker-dealers, investment advisers, and one dually-registered broker-dealer/investment adviser, violated recordkeeping requirements under the federal securities laws and failed to implement a system to ensure compliance with firm policies and procedures. In many instances, the use of off-channel communications was widespread among firm personnel, including senior level personnel with supervisory responsibilities.

In addition to any civil money penalty, the settlements included:

(i) cease-and-desist orders from future violations of the recordkeeping requirements;

(ii) censures; and

(iii) certain undertakings, including the retention of an independent compliance consultant ("Compliance Consultant"), a one-year evaluation by the Compliance Consultant to be submitted to the SEC staff, an internal audit of its progress on the undertakings, and a written certification of compliance with the undertakings.

On the same day, the Commodity Futures Trading Commission (the "CFTC") also announced a settlement order against Canadian Imperial Bank of Commerce ("CIBC"), a registered swap dealer, for widespread and long-term use of off-channel communications to engage in firm business, including relating to trading in CFTC regulated derivatives markets, in violation of the Commodity Exchange Act (the "CEA") and regulations thereunder. The CFTC found that such off-channel communications violated CIBC's own policies and procedures, which prohibited such communications, and CIBC failed to maintain adequate internal controls with respect to business-related off-channel communications.

Pursuant to the settlement, the CFTC ordered CIBC to:

(i) cease and desist from future violations of the recordkeeping and supervision provisions of the CEA and rules thereunder;

(ii) pay a civil monetary penalty of $30 million; and

(iii) comply with those conditions and undertakings consented to by CIBC.

With more than $2 billion in civil penalties assessed by the SEC and CFTC in enforcement actions over the last three years, each of the SEC and CFTC appear to have adopted a "take no prisoners" approach when it comes to off-channel communications. Specifically, any use of off-channel communications that results in recordkeeping violations, even if discovered pursuant to a robust compliance program, could result in an enforcement action. For example, Qatalyst Partners LP ("Qatalyst"), a registered broker-dealer, self-reported its recordkeeping violations, cooperated with the SEC staff investigation, and "demonstrated substantial efforts at compliance with the recordkeeping requirements." While spared civil monetary penalties, Qatalyst was still subject to an enforcement proceeding. In a joint statement dissenting from the Qatalyst settlement, SEC Commissioners Peirce and Uyeda

expressed concern that firms are not provided an achievable path to compliance. "Under the standard applied in this case, even well-intentioned firms could find themselves in the Commission's enforcement queue time and again."[1] The "culture of compliance" once touted by the SEC and SEC staff may not be enough when it comes to off-channel communications.

Key Takeaways

The continuing wave of enforcement actions reveal the sustained focus on off-channel communications by the SEC and CFTC. While full compliance with the recordkeeping requirements may be a daunting task, SEC and CFTC registrants should nonetheless take steps to enhance their recordkeeping compliance policies and procedures. Registrants may consider, among other things:

- **Gap analysis** – Review and revise recordkeeping policies and procedures to ensure that there are no gaps in the scope of coverage in terms of personnel involved and forms of communication contemplated.
- **Training** – Conduct regular training of both supervisory and non-supervisory personnel on the importance of complying with recordkeeping policies and procedures that prohibit the use of off-channel communications. Such training should involve raising awareness that communications on certain apps may not be retained and lead to violations of the recordkeeping policies and that only firm approved modes of communications should be used.
- **Review of personal devices** – There have been reports that regulators' investigations included the review of personal devices for a sample pool of personnel. Registrants should inform its registered personnel of this possibility and consider the appropriateness of conducting their own review of personal devices of select personnel to monitor compliance.
- **Disciplinary actions** – In light of the severe penalties levied by regulators for violations of the recordkeeping requirements, registrants should consider imposing strong disciplinary actions against personnel who are found to have engaged in off-channel communications so as to send a strong message of the consequences of such violations.
- **Remedial actions** – Where the use of off-channel communication is discovered, registrants should take immediate steps to preserve the communication on the firm's recordkeeping systems.
- **Self-reporting** – While self-reporting of violations may not necessarily avoid enforcement action, the regulators have reduced or eliminated civil penalties and undertakings in light of a firm's self-reporting and remediation efforts.

SEC Fraud Settlement with Macquarie Investment Management Business Trust

In a settled administrative proceeding, the SEC issued an order (the "Order") assessing disgorgement and civil monetary penalties of nearly $80 million against Macquarie Investment Management Business Trust ("MIMBT"), a registered investment adviser, for violations of the antifraud provisions of the Investment Advisers Act of 1940 (the "Advisers Act") and rules thereunder, and for causing registered investment companies advised by MIMBT to violate the Investment Company Act of 1940 (the "1940 Act") and various rules thereunder. MIMBT, a business trust comprised of eight series with more than $190 billion in assets under management, provides advisory services to registered investment companies ("RICs"), large institutional clients located in the U.S. and abroad, Undertakings for Collective Investments in Transferable Securities ("UCITS"), pension plans, endowments, foundations, and alternative investment portfolios, including private funds and products.

According to the Order, from January 2017 through April 2021, MIMBT managed the Absolute Return Mortgage-Backed Securities strategy (the "Strategy"), a fixed-income strategy primarily invested in U.S. agency mortgage-backed securities ("MBS"), treasury futures, and agency collateralized mortgage obligations ("CMOs"). During the relevant time period, MIMBT had twenty advisory clients, including RICs, unregistered investment vehicles, and private funds utilizing the Strategy ("Strategy Accounts"). The Strategy included investments in thousands of smaller-sized "odd lot" CMO positions that traded at a discount to institutional, larger-sized positions.

However, MIMBT valued the odd lot positions using prices obtained from a third-party pricing service that were intended for valuing institutional lots only. As a result, thousands of odd lot CMO positions were found to have been marked at inflated prices and overstated MIMBT's performance of client accounts holding such positions.

In addition, in order to meet redemption requests from certain investors in an unregistered investment vehicle ("Unregistered Vehicle"), MIMBT executed numerous internal cross trades of CMO positions with the RICs to avoid or minimize losses to the selling Unregistered Vehicle. Such cross trades resulted in the RICs absorbing the trading losses that otherwise would have been borne by the selling Unregistered Vehicle. MIMBT also arranged for dealer-interposed cross trades to satisfy redemption requests from investors in certain Unregistered Vehicles in which MIMBT temporarily sold odd lot CMO positions to third-party broker-dealers and then repurchased the same positions for allocation to one or more Strategy Accounts. The execution of the cross trades created undisclosed conflicts of interest and benefited certain advisory clients over others and violated certain affiliated transaction prohibitions of the 1940 Act.

The Order found that, as a result of its conduct, MIMBT violated:

(i) the antifraud provisions of Sections 206(1), (2), and (4) of the Advisers Act;

(ii) Rule 206(4)-7 requiring advisers to adopt compliance policies and procedures reasonably designed to prevent violations of the Advisers Act and rules thereunder; and

(iii) Rule 206(4)-8 which makes it unlawful for any adviser to a pooled investment vehicle to defraud any investor or prospective investor.

The Order also found that:

(i) MIMBT itself violated and caused the RICs to violate the Section 17 affiliated transaction provisions of the 1940 Act; and

(ii) MIMBT caused the RICs to violate Rules 22c-1 and 38a-1 under the 1940 Act.

Pursuant to the Order, MIMBT was censured and ordered to:

(i) cease and desist from committing or causing any violations of the provisions referenced above;

(ii) pay disgorgement and prejudgment interest of nearly $10 million; and

(iii) pay civil monetary penalties of $70 million.

Key Takeaways

The SEC's action against MIMBT serves as a reminder for investment advisers of their fiduciary obligations to all clients and that actions to minimize losses to certain clients to the detriment of its other clients is a violation of such fiduciary obligations. In addition, advisers are reminded that "[u]tilizing a third-party pricing service does not negate an investment adviser's obligation to value assets accurately."[2]

For More Information

We are available at any time to answer questions, discuss scenarios, and provide guidance. If you would like further information concerning the matters discussed in this article, please contact a member of the Investment Management Practice Group or visit us online at chapman.com.

1 Commissioner Hester M. Peirce and Commissioner Mark T. Uyeda, *A Catalyst: Statement on Qatalyst Partners LP* (Sept. 24, 2024) at https://www.sec.gov/newsroom/speeches-statements/statement-peirce-uyeda-qatalyst-09242024.

2 Statement of Eric I. Bustillo, Director of the SEC's Miami Regional Office (https://www.sec.gov/newsroom/press-releases/2024-140).