

# SEC Cracks Down on Recordkeeping Provisions

In recent years, the Securities and Exchange Commission (SEC) has made major changes to broker-dealer recordkeeping rules.

Historically, the SEC's broker-dealer recordkeeping rule was that firms were required to preserve electronic records exclusively in a non-rewriteable, non-erasable format, known as the "write once, read many" format. Amendments to the electronic recordkeeping, prompt production of records, and third-party recordkeeping service requirements applicable to broker-dealers, security-based swap dealers (SBSDs), and major security-based swap participants (MSBSPs) were proposed.

In 2022, the SEC adopted rule amendments designed to:

1. Modernize recordkeeping requirements given technological changes.
2. Make the rule adaptable to new technologies in electronic recordkeeping
3. Facilitate examinations of broker-dealers, SBSDs and MSBSPs.

**Recent cases have proved costly for firms responding to allegations of SEC rules violations. Coverage for legal fees and costs may be available under a broker-dealer professional liability policy and/or a directors and officers/entity liability policy.**

The amendments added an audit trail alternative under which electronic records can be preserved in a manner that permits the recreation of an original record if it is altered, overwritten or erased. The audit trail alternative is designed to provide broker-dealers with greater flexibility in configuring their electronic recordkeeping systems, so they more closely align with current electronic recordkeeping practices while also protecting the authenticity and reliability of original records. The amendments apply the same requirements to nonbank SBSDs and MSBSPs.

Fast forward to 2024 and 16 firms, including five broker-dealers, seven dually registered broker-dealers and investment advisers, and four affiliated investment advisers will combine to pay more than \$81 million in civil penalties to settle charges for widespread recordkeeping failures of the federal securities laws. Eight firms were charged with violating recordkeeping provisions of the Securities Exchange Act of 1934 and with failing to reasonably supervise to prevent and detect these violations. The remaining firms were charged with violating provisions of the Investment Advisers Act of 1940.

The SEC's investigations uncovered extensive and long-standing uses of unapproved communication methods, known as off-channel communications, at all 16 firms. The failures involved employees at multiple levels of authority, including supervisors and senior managers. The firms did not maintain or preserve a majority of these off-channel communications. By failing to maintain and preserve required records, some of the firms likely deprived the SEC of these off-channel communications in various SEC investigations. The penalties ranged from \$16.5 million down to \$1.25 million. The latter being that the firm voluntarily self-reported their violations and cooperated fully with the investigation. Each firm has begun implementing improvements to their compliance policies and procedures to address these violations.

For example, in addition to the significant financial

penalties, each of the firms were ordered to cease and desist from future violations of the relevant recordkeeping provisions and was censured. The firms are also required to:

1. Retain independent compliance consultants.
2. Conduct comprehensive review of their policies and procedures relating to the retention of electronic communications found on personal devices.
3. Review their frameworks for addressing noncompliance by their employees with those policies and procedures.

The Commission believes that the amendments and continued investigations into the firms' recordkeeping will ensure the Commission's goal to preserve market integrity and protect investors is attainable.

### How can NFP help?

Attorney fees incurred in responding to SEC investigations can be costly. Coverage for legal fees and costs may be available under a broker-dealer professional liability policy and/or a directors and officers/entity liability policy. We recommend contacting NFP to discuss your coverages and to discuss the necessary steps to take if any correspondence is received from the SEC or any other government agency.

### Questions?

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