

# SEC sued over broker-dealer texting fines data

By Emile Hallez | June 6, 2024



Amy Greer, a partner at K&L Gates, and Sander Ressler, managing director of Essential Edge Compliance Outsourcing Services.

‘Extraordinarily large’ sums prompt American Securities Association’s lawsuit, which asks commission to turn over documents showing how those amounts were reached.

A lawsuit filed today against the SEC seeks information about how the agency has calculated billions of dollars in fines against broker-dealers for off-channel communications record keeping failures.

Since 2021, the Securities and Exchange Commission has been on an enforcement blitz with broker-dealers and RIAs over that issue. Many large firms, including JPMorgan, Bank of America, Barclay’s, Citigroup, Credit Suisse, Deutsche, Goldman Sachs, and Morgan Stanley have agreed to pay \$125 million each to settle SEC charges, though smaller ones have had penalties of less than half that amount. In its lawsuit filed in US District Court in Florida, the American Securities Association is trying to force the SEC to provide documents showing how those amounts were reached. That group earlier this year filed three Freedom of Information Act requests with SEC that were subsequently denied.

“In the Fall of 2021, the SEC began to investigate certain broker-dealers’ retention of ‘off-channel’ communications, such as text messages on personal devices. The SEC demanded scores of documents from numerous companies without any suspicion that they violated the commission’s rules,” the lawsuit stated.

“There appears to be no rhyme or reason for how the SEC imposed these penalties, and the SEC has provided little explanation into its decision making. The regulated community thus is left with many questions.”

A spokesperson for the SEC said the commission has no comment on the case.

“The amounts are extraordinarily large in comparison to anything

else that's happened historically," said Sander Ressler, managing director of Essential Edge Compliance Outsourcing Services. "The other concern from the industry point of view is there is no real understanding of how these fines have been determined... The fines just seem to be arbitrary. I think firms would expect there is some formula on how to determine fines and have that formula communicated in some way shape or form. And that hasn't been the case."

However, Ressler said he disagrees with the assertion that the SEC had not reason to suspect firms were running afoul of record-keeping requirements, as text messaging from personal devices was a totally overlooking subject for over a decade.

The enforcement blitz "was a clear, concise, and powerful attempt to get firms to comply ASAP," he said. "This was a known issue, but we went from 0-100 in about half a second. There weren't any intermediate steps."

Amy Greer, a partner at K&L Gates who had worked as chief litigation counsel at the SEC's Philadelphia office until 2008, said that the commission's recent fines over off-channel communications record keeping are unrivaled by anything she saw when she was there.

At that time, settlements of \$10 million were considered large, she noted. However, \$125 million can still be seen as a good deal for very large firms in cases where there was the potential for real harm to investors, she said.

The ASA's lawsuit is quick to mention the high cost of complying with SEC records requests, although that isn't necessarily a bad thing, she said.

"The SEC has attempted to streamline the investigations by putting the onus on the entity that is being investigated. And that is usually deemed beneficial. You really don't want your regulator rooting around in your emails, or in this case, your off-channel communications," she said.

The size of the fines the SEC has imposed through settlements appears to reflect the size of the firms charged with violations rather than the statutory per-violation calculation it would otherwise use, she said. However, at more than \$115,000 per violation, that could quickly exceed the amounts in the settlements, and the firms that agreed to the terms have had the benefit of doing their own investigations, she noted.

For smaller firms, that is less likely to be the case, she said.

"It's certainly not how these laws and regulations were intended to work," she said.

Further, the ongoing pace of the cases the SEC has pursued brings into question its role as a regulatory agency as opposed to an enforcement agency like the Justice Department, she said.

"If the issue here was regulation, certainly this first group of cases would have been sufficient – the message would have gotten across," she said. "Instead, they just keep shooting fish in barrels looking backward, not asking, 'What are you doing today?'"

The SEC's enforcement activity reminds her of its efforts 20 years ago around marketing timing and late trading by mutual funds, in that the agency shot wide-ranging inquiries at many firms. While that exposed bad practices by numerous companies, the SEC later had to later comply with an administrative law judge's order to provide discovery documents.

As with the more recent sweep, "that sort of omnibus request has gotten the SEC enforcement division in some trouble in the past," she said. Because the broker-dealers and RIAs involved in the sweep will be able to reject having their documents provided part of FOIA requests, all of the documentation provided will almost certainly be the SEC's alone, she said.

"It's potentially quite a mess that has been created by these broad omnibus request and sweep matters."