Managed Funds Association

January 31, 2023

Via Electronic Mail

The Hon. Gary Gensler
Chair
U.S. Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

Re: Investment Adviser Recordkeeping Requirements

Dear Chair Gensler:

The undersigned trade associations (the "**Associations**") respectfully submit this letter to the Securities and Exchange Commission (the "**SEC**" or the "**Commission**") concerning the scope and application of the recordkeeping provisions of the Investment Advisers Act of 1940 (the "**Advisers Act**") to text messaging and other electronic communications.

Our members support SEC market oversight and share the view that the preservation of books and records in compliance with the SEC's rules is critically important. As Chair Gensler recently acknowledged in public statements, the SEC's recordkeeping rules have been an essential part of market integrity since the 1930s, and as technology changes, it is "even more

important" that registrants maintain and preserve communications."[1] However, we are strongly concerned that the SEC is attempting to exceed its authority under the Advisers Act and engaging in rulemaking by enforcement through its current sweep regarding off-channel communications,[2] which has been widely covered in the press.[3] Further, in interpreting the Advisers Act rules overbroadly, we are concerned that the SEC action here will have the unintended consequence of discouraging advisers from setting standards and practices that are above and beyond legal and regulatory requirements.

In connection with this Enforcement sweep, we understand that the SEC has asked each of the investment advisers involved in the sweep to have the personal phones of several employees imaged and reviewed, and that the SEC seeks evidence of *any* off-channel business communication, regardless of its nature. As set forth in greater detail below, this approach exceeds the scope of the recordkeeping provisions in the Advisers Act, raises concerns that the SEC will seek to shoehorn instances of non-compliance by employees of firms with reasonably designed policies and procedures into enforcement violations, and gives rise to serious privacy implications.

Accordingly, for these reasons and as discussed further below, we respectfully request that the SEC apply the recordkeeping rule of the Advisers Act as written, and, if necessary, issue guidance after industry input clarifying the SEC's interpretation of those rules.

A. The statutory and regulatory framework for investment advisers is narrower than the framework for broker-dealers with respect to electronic communications.

We are concerned that the SEC is exceeding its statutory authority under the Advisers Act by seeking evidence from investment advisers of *any* off-channel business communications, applying an overly broad interpretation of the narrow recordkeeping requirements, and looking for instances of non-compliance with an adviser's policies and procedures that are generally designed to be broader than the statutory requirements. As described below, that approach is inconsistent with the statutory requirements under the Advisers Act, raises policy concerns for advisers' compliance programs, and discourages good governance practices by advisers.

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[1] *See* SEC Charges 16 Wall Street Firms with Widespread Recordkeeping Failures, Rel. No. 2022-174 (Sept. 27, 2022), available at https://www.sec.gov/news/press-release/2022-174.

[2] As used herein, "**off-channel communications**" refers to communications sent by text or other messaging applications on platforms or devices that were not authorized or preserved by the adviser.

[3] *See, e.g.*, Chris Prentice, *SEC Scrutiny into Wall Street Communications Shifts to Investment Funds – Sources*, Reuters (Oct. 11, 2022), https://www.reuters.com/business/sec-scrutiny-into-wall-street-communications-widens-investment-funds-sources-2022-10-11/; Lydia Beyoud, *SEC WhatsApp Probe Digs Deeper Into Asset Managers' Personnel*, Bloomberg (Oct. 13, 2022), https://www.bloomberg.com/news/articles/2022-10-13/sec-whatsapp-probe-digs-deeper-into-asset-managers-personnel.

1. Investment Advisers are not required to preserve all business communications.

We are particularly concerned that the SEC apparently intends to hold investment advisers to the broad recordkeeping requirements applicable to broker-dealers notwithstanding the narrower statutory requirements of the Advisers Act.

For background, it is important to understand the differences in the statutory framework applicable to investment advisers and broker-dealers. Advisers Act Rule 204-2(a)(7) requires registered investment advisers to maintain four narrow enumerated categories of written communications; specifically, communications "received and . . . sent by such investment adviser" relating to (i) recommendations made or proposed to be made and advice given or proposed to be given; (ii) receipt, disbursement or delivery of funds or securities; (iii) placing or execution of orders to purchase or sell securities; and (iv) predecessor performance.[4] Rule 204-2(a)(7) was initially introduced in 1961, at which time the adopting release stated in part, "Paragraph (a) of the rule specifies the books and records which all investment advisers are required to keep. These include . . . originals or copies of *certain communications* received or sent by the investment adviser."[5] This language reflects that the rule was intended to enumerate specific categories of records required to be kept and does not encompass all communications. The SEC has since revisited and amended Rule 204-2(a)(7) on multiple occasions.[6] Notwithstanding its repeated, careful attention to this rule, at no point has the SEC sought to implement a broad requirement to retain all communications related to an adviser's business.

By contrast, the recordkeeping rule for broker-dealers is much broader. Rule 17a-4(b)(4) of the U.S. Securities Exchange Act of 1934 (the "**Exchange Act**") contains a broad provision requiring a broker-dealer to retain "all communications. . . (including inter-office memoranda and communications) relating to its business as such."[7] The same phraseology—"business as such"—appears in several other places throughout Rule 17a-4.[8] For example, Rule 17a-4(b)(3) requires broker-dealers to preserve "[a]ll bills receivable or payable . . . relating to the . . . broker or dealer's business as such."[9]

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[4] 17 C.F.R. § 275.204-2(a)(7).

[5] 26 Fed. Reg. 5002 (June 6, 1961), available at https://www.govinfo.gov/content/pkg/FR-1961-06-06/pdf/FR-1961-06-06.pdf#page=1 (emphasis added).

[6] *See, e.g.*, 81 Fed. Reg. 60,417 (Aug. 25, 2016), available at https://www.federalregister.gov/documents/2016/09/01/2016-20832/form-adv-and-investment-advisers-act-rules; 86 Fed. Reg. 13,024 (Dec. 22, 2020), available at https://www.federalregister.gov/documents/2021/03/05/2020-28868/investment-adviser-marketing.

[7] 17 C.F.R. § 240.17a-4(b)(4).

[8] *See, e.g.*, 17 C.F.R. §§ 240.17a-4(b)(3), (b)(5), (b)(7).

[9] 17 C.F.R. § 240.17a-4(b)(3).

The SEC knows how to draft broad books and records requirements when it wants to. Indeed, Advisers Act Rule 204-2 utilizes "business as such" language similar to the broker-dealer rule in multiple places. For example, Advisers Act Rule 204-2(a)(5) contains nearly identical language to Exchange Act Rule 17a-4(b)(3), requiring investment advisers to retain "[a]ll bills or statements . . . relating to the business of the investment adviser as such."[10] However, this language is notably *missing* from the communications prong of the Advisers Act recordkeeping rule.

Similarly, while Exchange Act Rule 17a-4(b)(4) explicitly states that the communications a broker-dealer must maintain include "inter-office memoranda and communications," the SEC did not include any such requirement in Advisers Act Rule 204-2(a)(7). Rather, the Advisers Act recordkeeping rule is limited to certain communications "received and . . . sent by such investment adviser," reflecting that it requires preservation of certain categories of *external* communications—not those that are purely internal.[11] Indeed, we are not aware of any instance in which the SEC has explicitly stated that the Advisers Act recordkeeping rule extends to purely internal communications.

In an apparent effort to bridge these gaps, we understand that the SEC may be interpreting the first category of the Advisers Act recordkeeping rule (*i.e.,* recommendations made or proposed to be made and advice given or proposed to be given) to encompass most, if not all, of an investment adviser's business communications. Doing so would require the SEC to leverage the phrase "relating to" in a manner inconsistent with the plain language of the rule. However, the first category of the Advisers Act recordkeeping rule very narrowly prescribes the preservation of communications related to "[a]ny recommendation made or proposed to be made" or "any advice given or proposed to be given."[12] Had the SEC intended to require investment advisers to preserve all communications concerning the overall business of advising clients, the SEC could have added the "relating to the business of the investment adviser as such" language that appears elsewhere in the Advisers Act (and in substantially similar form in the Exchange Act). It also could have added language explicitly stating that the preservation of internal communications was required. It did neither.

The SEC Staff itself has acknowledged the limited nature of the Advisers Act recordkeeping rule. In a January 2011 Study on Investment Advisers and Broker-Dealers (the "**Study**"), the SEC Staff described the requirements of the Advisers Act recordkeeping rule, stating that the rule requires investment advisers to maintain "[o]riginal[s] or copies of certain communications *sent to or received by* the adviser," again suggesting that the Advisers Act rule is limited to communications sent externally and not those exchanged among employees of the

[10] 17 C.F.R. § 275.204-2(a)(5).

[11] 17 C.F.R. § 275.204-2(a)(7).
[12] 17 C.F.R. § 275.204-2(a)(7)(i).

investment adviser.[13] The Study also explicitly described the difference in scope between the Advisers Act recordkeeping rule and the recordkeeping requirements for broker-dealers, stating in part:

> Differences also exist in the books and records requirements applicable to broker-dealers and investment advisers. While many differences reflect distinctions in their overall business activities, others do not. More generally, the rules for broker-dealers require the retention of all communications received and sent, as well as all written agreements (or copies thereof), relating to a firm's "business as such," whereas the rules for advisers require only the retention of materials falling in specific enumerated categories . . .[14]

The Study further described the potential implications of the different requirements for investment advisers compared to broker-dealers and recommended that the Commission "consider whether to modify the Advisers Act books and records requirements, including considering a general requirement to retain all communications . . . related to an adviser's 'business as such.'"[15] Notably, the SEC did not modify the Advisers Act recordkeeping rule in response to this recommendation or otherwise.

Notwithstanding this history and the plain language of the rule, the SEC appears to be reaching beyond the limits of the regulatory framework governing investment advisers by seeking evidence of any off-channel business communications.

Accordingly, the SEC should not hold investment advisers to the broad recordkeeping requirements applicable to broker-dealers because the regulations, as written, do not require investment advisers to preserve all business communications.[16]

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[13] "Study on Investment Advisers and Broker-Dealers" (Jan. 2011), available at https://www.sec.gov/news/studies/2011/913studyfinal.pdf (emphasis added).

[14] *Id.*

[15] *Id.*

[16] Moreover, with regard to internal communications, the language of Advisers Act Rule 204-2(a)(7) strongly supports the conclusion that they are not covered by that rule. As a preliminary matter, the language of Rule 204-2(a)(7) suggests it covers only external communications, as it expressly focuses on communications "by the investment adviser" rather than "supervised persons." An internal communication would not be "sent" or "received" by the "investment adviser" as those terms are commonly understood. If an employee communicates with a fellow employee, one would not normally construe that to be a communication of the "adviser" but rather of the supervised person. Further, the focus on the distinction between "originals" and "copies" in Rule 204-2(a)(7) also supports the conclusion that the rule was intended to cover external communications only. Under Rule 204-2(a)(7), advisers are only required to maintain "copies" of communications sent, because the adviser would no longer have the original sent to an external party—this difference is irrelevant for internal communications where the adviser would have the original that was sent. Because private fund advisers make discretionary investment decisions on behalf of their private fund clients, there is no "communication" of advice or recommendations to a third party.

2. Non-compliance with an investment adviser's broader compliance policies and procedures should not give rise to a Compliance Rule violation.

We are also concerned that the SEC will attempt to transform instances of non-compliance by employees with internal policies and procedures into violations of Advisers Act Rule 206(4)-7 (the "**Compliance Rule**"), absent a recordkeeping violation, and notwithstanding reasonably designed compliance policies and procedures.[17]

Many investment advisers have adopted electronic communications policies that are broader than the statutory requirement. Those policies typically require employees to use approved devices and platforms for all business communications, regardless of whether those communications fall into one of the categories enumerated in Advisers Act Rule 204-2(a)(7). While not statutorily required, a broader policy takes judgment concerning whether a communication falls under one of the narrow prongs of Rule 204-2(a)(7) out of the hands of individual employees. Moreover, a broad electronic communications policy can be part of a robust control environment for a number of reasons unrelated to the securities laws, such as protecting trade secrets, monitoring employee productivity, and/or helping to ensure adherence to expectations and standards relating to culture and interactions with colleagues or direct reports.

As a practical matter, recasting employee policy exceptions as Compliance Rule violations of the investment adviser will have unintended policy consequences. It will penalize advisers' good faith efforts to promote compliance by adopting a broader internal requirement and will incentivize firms to adopt policies that narrowly circumscribe recordkeeping obligations consistent with the statutory requirements, which will introduce subjectivity in interpreting enumerated categories under the rule. It also ignores the plain text of the Compliance Rule, which requires that investment advisers adopt and implement written policies and procedures *reasonably designed* to prevent violations of the Advisers Act.[18] Investment advisers are not required, by statute or any other source, to ensure perfect compliance by every single employee. It is simply not possible to eliminate human error. Such a reading of the Compliance Rule would be contrary to the plain text of the rule and would impose an unattainable standard.

Accordingly, non-compliance with an investment adviser's broader compliance policies and procedures should not give rise to a Compliance Rule violation—that is simply not what the

[17] *See* 17 C.F.R. § 275.206(4)-7(a) (requiring investment advisers to "[a]dopt and implement written policies and procedures reasonably designed to prevent violation. . .of the Act and the rules that the Commission has adopted under the Act").

[18] Moreover, equating all non-compliance with adviser policies and procedures to violations of federal regulation could lead to outrageous and unreasonable outcomes. For example, if an adviser prohibited employees from sending emails after 8 pm on Fridays only, surely, such a policy violation should not equate to violation of a federal regulation.

Compliance Rule requires, nor is it good policy for the SEC to advocate for such an interpretation.

B. **The Commission's approach to off-channel communications must take into account privacy considerations.**

The SEC's use of enforcement tools to seek access to off-channel communications on personal devices implicates privacy considerations. The process of collecting communications from personal devices is extremely invasive and typically requires the imaging of the entirety of the individual's personal device and a comprehensive review of the individual's communications on the device. This process can result in the imaging and collection of sensitive personal data, such as medical information, passwords, or financial information. In some circumstances, it can also create complications under state or foreign data privacy laws, such as the European Union's General Data Protection Regulation. For all of these reasons, imaging personal devices is often a burdensome process that may involve the retention of individual counsel for each potential custodian and a third-party vendor to complete forensic imaging of the device. Even with these precautions, individuals being subjected to imaging as a result of the SEC's overly broad reading of the recordkeeping requirements may have a heightened risk of breach of sensitive personal data as third parties necessarily need to have access to the entirety of the information on their personal devices.

The use of an enforcement sweep calling for the imaging and review of personal phones of several employees is both unnecessary and inappropriate in light of the narrow recordkeeping requirement for investment advisers, especially in the absence of any indications of wrongdoing. The SEC has many less blunt tools to address what it has described as industry-wide conduct, including tools to (i) detect failures to produce responsive records during the course of investigations[19] and (ii) address compliance deficiencies or weaknesses through registrant examinations. The use of a costly enforcement sweep that implicates serious privacy issues in the hope of finding a violation of a narrow statutory requirement is an unwise use of the SEC's investigative authority.

The SEC's approach to off-channel communications has not given the appropriate consideration to privacy considerations, and for that additional reason the SEC should reconsider its approach.

C. **Conclusion**

For all of these reasons, we are deeply concerned that the SEC is prepared to engage in rulemaking by enforcement with respect to the recordkeeping rule under the Advisers Act. The Administrative Procedure Act was designed precisely to prevent unilateral rulemaking of this nature and to allow for public participation in the rulemaking process, including through the

[19] *See, e.g.*, In the Matter of JonesTrading Institutional Services LLC, Exch. Act Rel. No. 89975 (Sept. 23, 2020), available at https://www.sec.gov/litigation/admin/2020/34-89975.pdf (charging broker-dealer with recordkeeping violations based on references to text messages reflected in other records produced by the firm).

provision of public notice and comment.[20] The SEC has not pursued this avenue to date, and we do not believe there is a reason for it to do so now. In the same vein, to the extent the SEC intends to apply existing rules differently than currently interpreted by the industry, it would be appropriate to provide written guidance after input from industry participants. Such guidance would both put investment advisers on notice as to how the SEC interprets the rule and allow industry participants time to adjust their practices as needed. It would also be consistent with the SEC's goal of working collaboratively with legal and compliance professionals.

For all of the reasons discussed herein, we respectfully urge that the SEC:

- Apply Rule 204-2(a)(7) as written;
- Properly interpret and apply the Compliance Rule, so as not to disincentivize investment advisers from best practices when developing prophylactic internal policies;
- Utilize existing tools, such as registrant examinations, to address recordkeeping requirements rather than utilizing invasive, costly and overly broad enforcement sweeps; and
- If the SEC determines to interpret Rule 204-2(a)(7) differently than written and interpreted by industry, issue guidance after input from industry participants.

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We appreciate your consideration, and we would be pleased to meet with the SEC to discuss our comments. If you have any questions about these comments, please do not hesitate to contact David Lourie, Managed Funds Association Vice President & Senior Counsel, at (202) 730-2600.

[20] *See, e.g.*, 5 U.S.C. § 553(b)-(c) (requiring "[g]eneral notice of proposed rule making" to be published in the Federal Register and requiring agencies to "give interested persons an opportunity to participate in the rule making through submission of written data, views, or arguments . . .").

Very truly yours,

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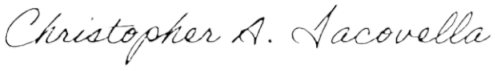

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