

An hourglass with blue sand is centered in the frame against a solid blue background. The sand is flowing from the top bulb to the bottom bulb. The hourglass is made of clear glass, and the sand is a vibrant blue color. The background is a uniform, light blue color.

This webinar will begin shortly.

FIA



New Frontiers in Recordkeeping and Compliance

Jonathan Flynn, *Senior Counsel*

Gregory Mocek, *Partner*

Anthony Mansfield, *Partner*

Hilary Seo, *Senior Counsel*

Sean Batson, *Associate*

October 13, 2022



Reminders

- The webinar will be recorded and posted to the FIA website within 24 hours of the live webinar.
 - Please use the “question” function on your webinar control panel to ask a question to the moderator or speakers.
-
- *Disclaimer: This webinar is intended for informational purposes only and is not intended to provide investment, tax, business, legal or professional advice. Neither FIA nor its members endorse, approve, recommend, or certify any information, opinion, product, or service referenced in this webinar. FIA makes no representations, warranties, or guarantees as to the webinar's content.*

Please silence your mobile devices

Use of personal phones takes regulatory recordkeeping into uncharted territory

“... a digital record of nearly every aspect of [our] lives – from the mundane to the intimate.”

Riley v. California, 573 U.S. 373, 395 (2014)



Record-breaking recordkeeping cases

Recent settlements mark a significant development in how financial regulators enforce their recordkeeping requirements

Obvious takeaways:

- Many cases and large monetary penalties, therefore, this is a significant enforcement priority for financial regulators
- The cases involve mobile phones and new methods of communicating have not previously been tested from a regulatory or compliance perspective
- The cases cite “widespread and longstanding failures” both within firms and across the market – i.e., this issue is not isolated or new

But:

- Recordkeeping is only a part of the story
- The real issue is **supervision**: what is the standard – what is “reasonable” and “diligent”?

Banks Fined In Probe Of Messages

By DAVE MICHAELS

WASHINGTON—Eleven of the world's largest banks and brokerages will collectively

JPMorgan fined \$200m over personal devices use

STEFANIA PALMA — WASHINGTON
JOSHUA FRANKLIN — NEW YORK

JPMorgan has agreed to pay US regulators a record \$200m for failing to keep records of staff communications on personal devices.

The SEC penalty is almost 10 times larger than the \$15m paid by Morgan Stanley in 2006 to settle allegations that it failed to preserve emails.

Sanjay Wadhwa, deputy director of enforcement at the SEC, said that JPMorgan's actions “hindered several

Inc., Morgan Stanley, UBS Group AG and Nomura Holdings Inc. Brokerage firms Jef-

Roadmap for today

How do we get from confusion to compliance?

- What is a “regulatory record” and why does it matter?
- Overview of recent enforcement actions
 - Key provisions
 - Aggravating factors
 - Outliers
- Broader enforcement implications
- Building and defending a reasonable and diligent compliance program



The slide features a white background with decorative geometric shapes. In the top left corner, there is a small 3D-style graphic composed of overlapping green and blue rectangular planes. On the right side, there are two large, overlapping triangular shapes: a light blue one on top and a light green one on the bottom, both pointing towards the center of the slide.

What is a “regulatory record” and why does it matter?

What are “regulatory records”?

What records are required to be kept varies by regulator and registration status

CFTC recordkeeping requirements focus on “regulatory records”*

- **“Commodity interest and related records”** – full, complete, and systematic records of all transactions relating to its business of dealing in commodity interests and related cash or forward transactions (e.g., orders, confirmations, statements) (CFTC Rule 1.35(a)(1)(i); 23.201(a))
- **“Original source documents”** – all documents on which trade information is originally recorded (CFTC Rule 1.35(a)(1)(ii); 23.202(a))
 - **“Transaction records”** = “Commodity interest and related records” + “original source documents”
- **“Pre-trade communications”** – oral and written communications provided or received concerning quotes, solicitations, bids, offers, instructions, trading, and prices that lead to the execution of a transaction in a commodity interest and any related cash or forward transactions** (CFTC Rule 1.35(a)(1)(iii); 23.202(a))

* - Other recordkeeping requirements apply, particularly to certain categories of registrants.

** - But not oral communications that lead solely to the execution of a related cash or forward transaction.

*** - Gilbert v. Lind-Waldock & Co. et al, U.S. Commodity Futures Trading Commission, P26,720 (jun. 17, 1996).

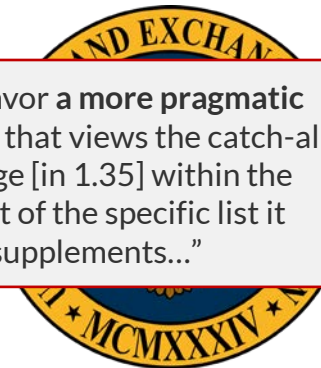
8

SEC recordkeeping requirements are arguably broader

- Broker-dealers must preserve in an easily accessible place originals of all communications received and copies of all communications sent **related to the firm’s “business as such”** (SEC Exchange Act Rule 17 a-4(b)(4))
- Minimum recordkeeping standards are based on standards a prudent broker-dealer should follow in the normal course of business. (SEC Exchange Act Rule 17 a-4(b)(4))

Lind-
Waldock

... we favor a more pragmatic approach that views the catch-all language [in 1.35] within the context of the specific list it supplements...”



What are “regulatory records”?

What records are required to be kept varies by regulator and registration status

CFTC recordkeeping requirements focus on “regulatory records”*

- **“Commodity interest and related records”** – full, complete, and systematic records of all transactions relating to its business of dealing in commodity interests and related cash or forward transactions (e.g., orders, confirmations, statements) (CFTC Rule 1.35(a)(1)(i); 23.201(a))
- **“Original source documents”** – all documents on which trade information is originally recorded (CFTC Rule 1.35(a)(1)(ii); 23.202(a))
 - **“Transaction records”** = “Commodity interest and related records” + “original source documents”
- **“Pre-trade communications”** – oral and written communications provided or received concerning quotes, solicitations, bids, offers, instructions, trading, and prices that lead to the execution of a transaction in a commodity interest and any related cash or forward transactions** (CFTC Rule 1.35(a)(1)(iii); 23.202(a))

SEC recordkeeping requirements are arguably broader

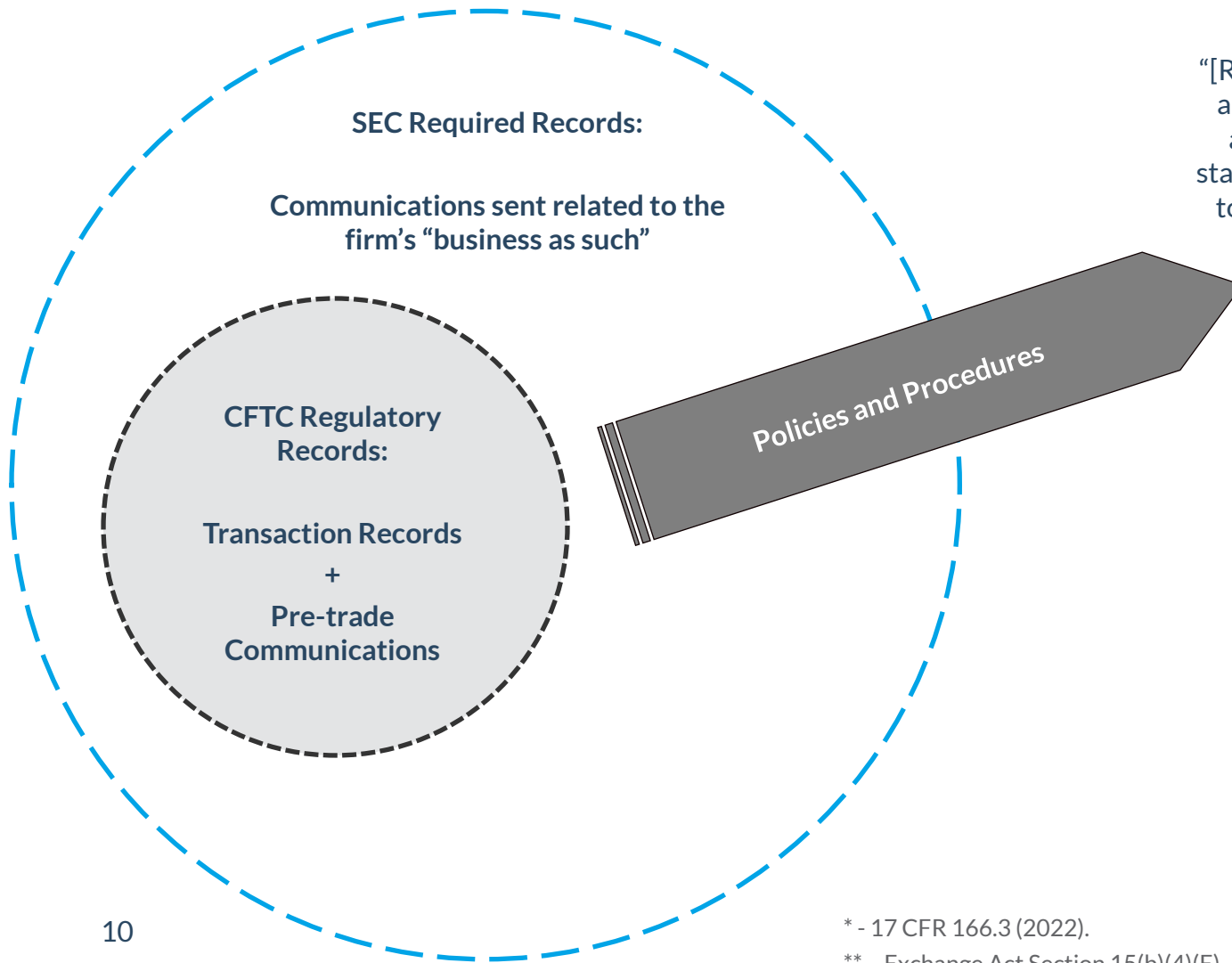
- Broker-dealers must preserve in an easily accessible place originals of all communications received and copies of all communications sent **related to the firm’s “business as such”** (SEC Rule 17a-4(b)(4))
- Minimum recordkeeping standards are based on standards a prudent broker-dealer should follow in the normal course of business. (SEC Rule 17a-4(b)(4))

Regulatory records must be **“readily accessible”** and produced **“promptly”** upon request. CFTC Rule 1.31(b)(4) and (d).

* - Other recordkeeping requirements apply, particularly to certain categories of registrants.

** - But not oral communications that lead solely to the execution of a related cash or forward transaction.

What are “regulatory records”?



CFTC Supervision Requirements:

“[Registrants] must **diligently supervise** ... all ... activities of its partners, officers, employees and agents (or persons occupying a similar status or performing a similar function) relating to its business as a Commission registrant.” *

SEC Supervision Requirements:

... duty to “**reasonably**” supervise...

"no person shall be deemed to have failed reasonably to supervise any other person, if— (i) there have been established procedures, and a system for applying such procedures, which would **reasonably** be expected to prevent and detect, insofar as practicable, any such violation by such other person, and (ii) such person has **reasonably** discharged the duties and obligations incumbent upon him by reason of such procedures and system without **reasonable** cause to believe that such procedures and system were not being complied with.” **

* - 17 CFR 166.3 (2022).

** - Exchange Act Section 15(b)(4)(E).

“Reasonable” and “diligent” supervision

Recordkeeping reconsidered in the context of compliance

Supervisory requirements (and related policies and procedures) may have the effect of expanding recordkeeping requirements...

... but, even if supervisory requirements are broader, they are not boundless.

Compliance programs should be “reasonably designed and implemented” to prevent, detect, and remediate misconduct...

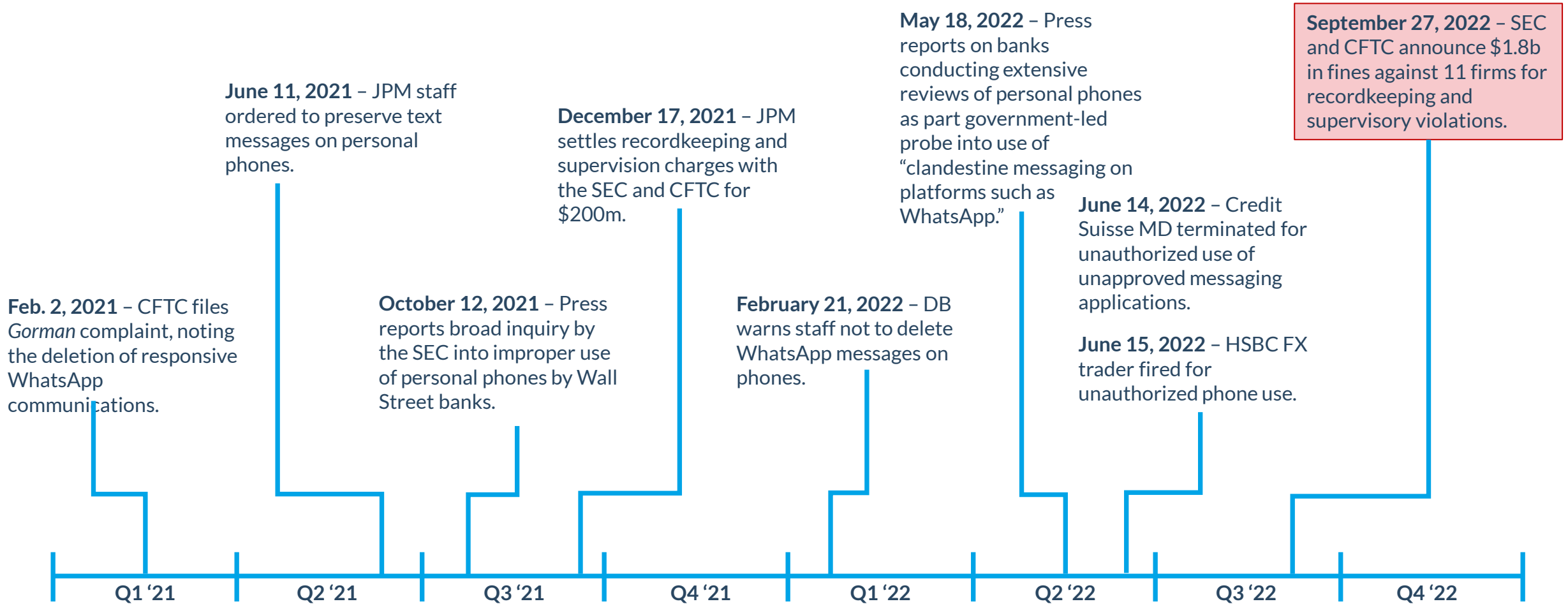
... but, what does that mean in practice for firms trying to maintain compliance programs?



The slide features a white background with decorative geometric shapes. In the top left corner, there is a small, partially visible 3D-style shape composed of green and blue planes. On the right side, there are large, overlapping, semi-transparent geometric shapes in light blue and light green, extending from the top right towards the center. The main title is centered in a dark blue, sans-serif font.

Overview of recent enforcement actions

Evolution of recordkeeping cases



Key takeaways from the recent cases

Key themes:

- Widespread, longstanding use of “off-channel” platforms
- Some communications were “regulatory records”
- Communications not maintained or monitored despite policies prohibiting use of unapproved methods of communications (i.e., policies were openly ignored)
- Violations involved supervisors responsible for compliance

Specific violations:

- Recordkeeping
 - failure to maintain, failure to produce upon request

* - CFTC Rules 1.31, 1.35, 23.20*(a), and 23.202(a)(1) and (b)(1); SEC Exchange Act Rule 17a-4(b)(4).

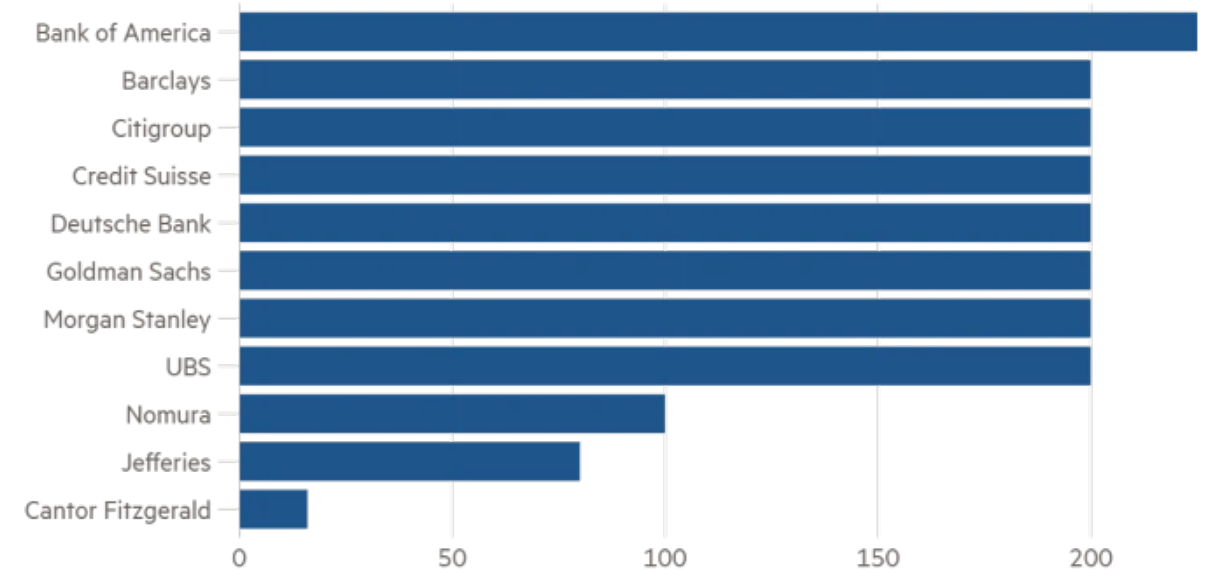
** - CFTC Rule 23.602(a) and 166.3; Exchange Act Section 15(b)(4)(E).

14 Supervision:

- as designed, system was generally inadequate**

\$1.8bn in fines for Wall Street recordkeeping failings

Combined fines from the SEC and CFTC (\$mn)



Excludes earlier fine for JPMorgan Chase announced in December 2021

Sources: SEC, CFTC

© FT

Source: ft.com

Key takeaways from the recent cases

Required undertakings:

- Compliance consultant (SEC only)
- Review of compliance program related to off-channel communications
- Report back to the agencies and adopt consultant recommendations
- One-year progress evaluation and report back to agencies
- Reporting to the agencies on discipline for two years
- Internal audit requirement (SEC only)



Likely aggravating factors:

- Supervisor involvement
- Knowledge of prior misconduct
- Failure to produce responsive material
- Compromised and delayed SEC investigations
- Intentional deletion of messages



Broader enforcement implications

Enforcement implications: looking forward

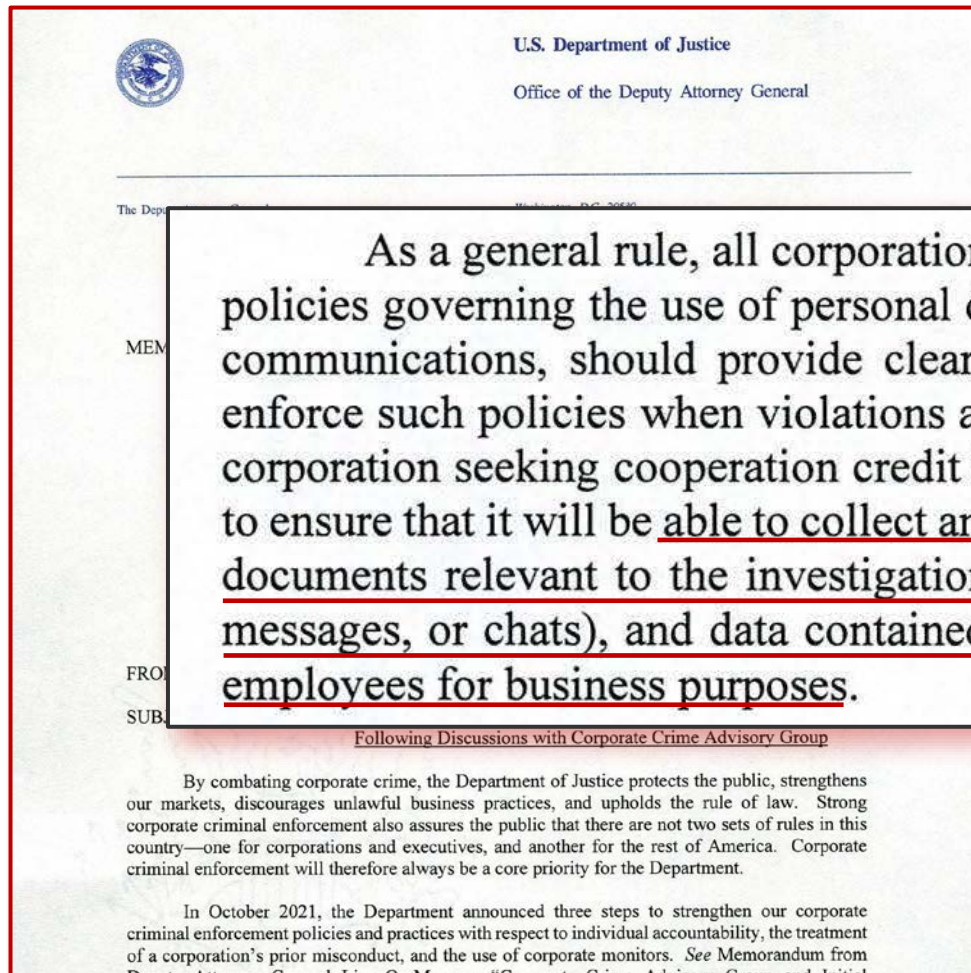
How we respond to document requests in the future will emphasize even further:

- Personal phones will be “in scope” much more often
 - Imaging will be more common
 - Metadata issues will be more common
 - Privacy issues will be more common and more difficult to resolve, particularly for cross-border investigations
 - Use of the IOSCO MOU will be more common
- **Ensuring proper implementation of preservation requests will become more difficult**

“Accompanying violations” will become more common:

- Add-on supervisory charges will continue
- Add-on charges possible (and likely):
 - Recordkeeping (for missing records)
 - Failure to preserve (as failure to supervise)
 - “Readily accessible” (for records that could not be accessed quickly)
 - “Promptly” produced (for responses that are delayed due to issues retrieving records from phones)

Enforcement implications: looking forward



- **Monaco memo re: corporate criminal enforcement – applies to all corporate defendants, not just registrants**

Enforcement implications: looking backwards



A harder question is how to handle past conduct

- Should firms ask to image employee phones?
 - If yes, all employees, or only certain ones?
 - How to handle former employees?
 - Implications for employees who decline such a request?
- If phones are imaged, should the communications be reviewed?
 - By whom? (after all, personal phones are personal)
- Should firms revisit prior responses to document requests?
 - When? Which ones? How? To what extent?

The slide features a white background with a dark blue header bar at the top. In the top left corner, there is a small graphic of overlapping green and blue shapes. On the right side, there are large, overlapping geometric shapes in light blue and light green. The main text is centered on the left side of the slide.

Building and defending a “reasonable” and “diligent” compliance program



What is “reasonable” and “diligent”?

Basic principles:

- Structural issues – a supervisory system is not reasonable if the relevant systems are “generally inadequate”
- Operational issues – even a well designed system will fail if it is not administered “diligently”
- Fit for purpose – reasonableness of design accounts for risk profile of the entity

Key issues:

- Long-standing, repeat violations
- Knowledge of violations by supervisors
- Policies that do not reflect current business practices and / or disregard for those policies
- Extent to which violations impact a registrant’s ability to comply with other regulatory obligations

Practical advice:

- Identify permitted communications platforms, make sure communications on those platforms are captured and supervised
 - Prohibit all business communication from anything other than the approved platforms
- Reinforce policies with effective training
- Consider attestations of compliance

But...

- What about close calls? We can’t record everything.
- What really is a “business communication”?
- What about individuals who mess up (by accident or otherwise)?

Speakers



Jonathan Flynn

Senior Counsel – Boston

[Contact](#)

Tel +1 202 683 3858

jonathan.flynn@allenoverly.com

Jonathan Flynn focuses his practice on commodities, securities, derivatives and related regulatory and litigation matters. He represents a wide range of participants in the physical commodity and financial markets, including investment banks, major commodity merchants and trading houses, hedge funds and other asset managers, market intermediaries, and industry trade associations, on a broad range of regulatory issues involving the Commodity Futures Trading Commission (CFTC), the National Futures Association (NFA), the Securities and Exchange Commission (SEC), and the Federal Trade Commission (FTC). Jon also represents companies and individuals in government investigations by the government regulators and the U.S. Department of Justice related to manipulation, fraud, price reporting and commodity indexes, supervisory controls, position limits, and other prohibited trade practices.



Anthony Mansfield

Partner – Washington, D.C.

[Contact](#)

Tel +1 202 683 3884

anthony.mansfield@allenoverly.com

Tony Mansfield is a member of the investigations and litigation practice. He focuses his practice on commodities, securities and related derivatives litigation, complex commercial litigation and regulatory/enforcement matters. His representations include regulatory advice, compliance, enforcement and litigation matters involving the Commodity Futures Trading Commission (CFTC), the Federal Trade Commission, the Federal Energy Regulatory Commission (FERC), other federal and state regulatory agencies, the UK Financial Conduct Authority and the European Commission. He represents a broad range of market participants, including financial institutions, major oil companies, global trading companies, hedge funds, energy marketers, futures commission merchants and exchanges.



Gregory Mocek

Partner – Washington, D.C.

[Contact](#)

Tel +1 202 683 3887

gregory.mocek@allenoverly.com

Gregory Mocek's practice involves legal and strategic guidance on a broad range of issues, including regulatory, government investigations, internal investigations, the Dodd-Frank Act, litigation, legislation, compliance, global financial regulatory and operational risk. Gregory is one of the top commodity and derivatives lawyers in the United States, and has advised clients and led investigations in more than a dozen countries. In addition to recognition by Chambers, Washington D.C. Super Lawyers, and The Legal 500, he was selected for inclusion in The Best Lawyers in America since 2012 in the area of Derivatives and Futures Law. He also was honored as Lawyer of the Year in The Best Lawyers in America 2013 for Derivatives and Futures Law. Chambers USA said Gregory is a lawyer who has "encyclopedic knowledge of the CFTC." As a member of the Board of Directors of the Commodity Markets Council, Gregory is involved in rulemaking and policy discussions with industry and regulators.

Speakers



Hilary Sunghee Seo

Senior Counsel – New York

[Contact](#)

Tel +1 212 756 1155

hilarysunghee.seo@allenoverly.com

Hilary is a Senior Counsel and core member of Allen & Overy’s U.S. Financial Services Regulatory Practice. Her practice focuses on advising domestic and international financial institutions, including securities firms, banks, private wealth management businesses, asset managers, and FinTech and digital asset firms, in assessing the impact of financial regulations on their business activities and strategies and on their regulatory and compliance obligations.



Sean Batson

Associate – Washington, D.C.

[Contact](#)

Tel +1 202 683 3877

sean.batson@allenoverly.com

Sean represents clients in connection with regulatory investigations in the commodities, derivatives, and securities spaces. Prior to joining A&O, Sean worked as an Enforcement attorney at FINRA.

FIA

The image features the letters 'FIA' in a bold, sans-serif font. The 'F' is dark grey. The 'I' is dark grey with a green-to-yellow gradient on its right side. The 'A' is blue with a yellow-to-green gradient on its left side. The background consists of large, overlapping geometric shapes in light green, light blue, and yellow.