

Compliance Review

Ongoing compliance updates for independent investment advisors

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Regulatory focus on off-channel communications: What you need to know for your compliance program

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I. Introduction

Off-channel communications in the securities advisory space continues to be a hot topic, in part because of rapidly evolving communication technologies used by the financial industry, as well as the SEC's response to such evolving business practices that pose new compliance concerns.

As of August 2024, a myriad of firms have been charged for failure to meet recordkeeping requirements for off-channel communications, with civil penalties collectively more than \$3 billion. Along with the threat of regulatory enforcement actions and no one-size-fits-all blueprint for compliance guidelines, many financial industry practitioners are left with questions unanswered.

This white paper will explore off-channel communications, providing legal and compliance insight into current regulatory expectations of investment advisors by the SEC, as well as steps to consider as you enhance compliance program efforts to address these regulatory requirements. Through a case study, we will explore ways to maintain and preserve employee off-channel communication records and provide tips for mitigating associated risks.

II. What are off-channel communications?

Off-channel communications are generally defined as business-related communications conducted over devices

or platforms that have not been approved or authorized for business use, and that are not monitored by the firm. For example, text messaging business communications on a personal phone device (versus a company-issued phone that is captured, maintained, and supervised by a firm) are off-channel communications. In contrast, *in-channel* communications are those sent on a platform that is permitted by the firm for business use and captured as part of the firm's books and records. An example would be emails to customers sent from your business email address.¹

Pursuant to Rule 204-2 of the Investment Advisers Act of 1940, as amended (the "Advisers Act"), "every investment adviser registered or required to be registered under section 203 of the Act shall make and keep true, accurate and current certain books and records relating to its investment advisory business."² Practically speaking, for supervisory and maintenance purposes, all business communications of the advisor and its personnel should be maintained for the prescribed periods.

Notably, in 2024, the SEC staff have suggested that the industry take heed of the books and records rules set forth in the Advisers Act. Within the maintenance and retention requirements, there is no distinction of what an internal or external communication is, nor is there a delineation between what is an "administrative" communication (such as messaging one will be late for a meeting) or "formal"

¹ For purposes of this article, we will not opine on what communications constitute business-related communications.

² For more information, please refer to <https://www.law.cornell.edu/cfr/text/17/275.204-2>.

communication (such as instruction to take a particular action). Rather, the books and records rules encompass *all* activities of the advisor, and communication related to the business. Said another way, but for the relationship with the advisor and its business, the communication would not be occurring.

The plethora of communication channels, especially cloud-based, encrypted platforms, pose a greater risk of noncompliance than the device on which business communication occurs.

Devices are the hardware on which the communication takes place and include phones, laptops, tablets, Apple phones, and more.

Channels, on the other hand, typically determine the platform on which communication occurs and include phone calls (on-premise/land line, cell, and cloud-based), text messaging platforms, online messaging apps, social media public and private messaging apps, other online public forums, and more.

Employers may find it challenging to monitor employees' personal devices adequately to ensure all communications occur via approved channels, and adding software to alert or restrict use may violate privacy laws. This does not mean that work-assigned devices are better unless such communications are monitored and maintained and are administered with device restrictions on which platforms to use, and are supported by ongoing employee training.

Rule 204-2³ of the Advisers Act requires investment advisory firms to maintain various books and records, such as records of business-related communications, including digital communications such as text messages and communication via encrypted platforms.

Under Rule 206(4)-7⁴ of the Advisers Act, advisory firms are also required to establish reasonably designed policies and procedures to prevent violations of federal securities laws and outline the firm's requirements for its associated persons, which would include protocols and restrictions for off-channel communications. From recent SEC enforcement actions, it appears that while investment advisors may have policies and procedures addressing in-channel communications, they have fallen short in maintaining books and records related to off-channel communications through which business communications occurred using non-firm devices or channels.

Off-channel communications that have made recent headlines include text messages related to trades captured on an advisor's personal cell phone; business

communications via WhatsApp; instant messages on Zoom and other messaging platforms; and business emails between a client and associated person using the associated person's personal email account.

In a day and age where artificial intelligence is prevalent in every facet of the business and communication forums are expanding, each firm is faced with the challenge of identifying what forums and platforms are needed today to service the firm's clients. Identifying all communication avenues that can (or should) be used by clients' preference can be challenging, particularly since most clients will opt to use text messaging over emails based on the desire for speed and convenience. The methods for quickly communicating with internal team members and clients, particularly when traveling, can be challenging, and they do not always correlate with current recordkeeping practices of advisors. With the SEC's recent fines against financial industry companies, investment advisors and their personnel are effectively being put on notice that such practices are not acceptable and will result in significant fines that will impact the firms, and by extension, associated persons alike.

III. Current regulatory focus

SEC recordkeeping rules are not new to investment advisors. However, as previously mentioned, the SEC, FINRA, and the CFTC have charged dozens of firms for recordkeeping failures and collected civil penalties exceeding \$3 billion to date. In February 2024 alone, the SEC charged 16 Wall Street firms for failure to monitor and maintain records of business-related communications, resulting in combined civil penalties of more than \$81 million. On April 3, 2024, the SEC announced that it had reached its first off-channel communications settlement with a stand-alone registered investment advisor, Senvest Management, LLC ("Senvest")⁵. These SEC enforcement actions have put the industry on notice to stay vigilant over maintaining communications that are business related.

Summarized on the following page are the enforcement actions leading up to the Senvest matter, which illuminate the key compliance issues that the SEC is targeting—and why. From December 2021 to April 2024, several firms were charged with a range of violations related to off-channel communications, including failure to maintain employee communications about the business that were delivered through text messages, failure to maintain communications relating to recommendations made and advice given across several off-channel avenues, failure to supervise, violations of firm policies and procedures, and widespread recordkeeping failures such as failure to preserve and maintain electronic communications.

³ Available at <https://www.law.cornell.edu/cfr/text/17/275.204-2>.

⁴ Available at [https://www.law.cornell.edu/cfr/text/17/275.206\(4\)-7](https://www.law.cornell.edu/cfr/text/17/275.206(4)-7).

⁵ See *In the Matter of Senvest Management, LLC*, IA Rel. No. 6581 (Apr. 3, 2024).

SEC enforcement actions surrounding off-channel communications

December 17, 2021: The SEC charged J.P. Morgan & Co. with failure to record business-related communications that took place over email and unauthorized messaging apps. The firm admitted to company-wide violations since 2018, stating that most of the employees, even supervisors, communicated via personal devices openly, with no efforts to capture and retain those communications. There was widespread use of text messaging, personal emails, and encrypted messaging platforms to discuss business matters. The company was ordered to cease and desist from off-channel communications, implement a business communications strategy, and pay a civil penalty of \$125 million.

As technology changes, it's even more important that registrants appropriately conduct their communications about business matters within only official channels, and they must maintain and preserve those communications.⁶

Gary Gensler, Chairperson, SEC

September 27, 2022: The SEC charged 15 broker-dealers and one affiliated investment advisor for violations of recordkeeping regulations by failing to maintain and preserve business-related communications sent over text messaging applications on their personal devices. Collectively, the firms agreed to pay penalties of more than \$1.1 billion. As stated by Chair Gensler in the SEC's press release, "As technology changes, it's even more important that registrants appropriately conduct their communications about business matters within only official channels, and they must maintain and preserve those communications."⁶ Notably, the staff shared that the firms' failure to maintain such records had deprived the SEC of these off-channel communications in various SEC investigations. Gurbir S. Grewel, director of the SEC's Division of Enforcement, stated, "If there are allegations of wrongdoing or misconduct, we [the SEC] must be able to examine a firm's books and records to determine what happened." Through these actions, the SEC warned Wall Street that they are expected to comply with recordkeeping rules, have strong policies and procedures in place relating to the retention of electronic communications found on personal devices, and develop a framework for addressing non-compliance by employees, including senior executives.

If there are allegations of wrongdoing or misconduct, we [the SEC] must be able to examine a firm's books and records to determine what happened.

Gurbir S. Grewel, Director, SEC Division of Enforcement

August 8, 2023: The SEC announced that it charged 10 broker-dealers and one dually registered broker-dealer and investment advisor a collective total of \$289 million for widespread recordkeeping violations by failing to maintain and preserve electronic communications. The SEC found

that employees, including high-ranking key employees, habitually used unauthorized communications channels and failed to maintain and preserve records of those interactions. They also found that the firms had developed policies and procedures but had violated their internal protocols and had failed to monitor employee business communications adequately. Penalties ranged from \$9 million to \$125 million.

September 29, 2023: The SEC charged five broker-dealers, three dually registered broker-dealers and investment advisors, and two affiliated advisors for recordkeeping violations. At least as far back as 2019, all 10 firms had employees who communicated via text message about their firm's business, and the investment advisors admitted to having employees send and receive off-channel communications related to investment recommendations. Civil penalties ranged from \$35 million down to \$2.5 million.

February 9, 2024: The SEC charged five broker-dealers, seven dually registered investment advisors, and four affiliated investment advisors for failure to maintain and preserve records of business-related electronic communications. Civil penalties, which collectively totaled over \$81 million, ranged from \$1.25 million to \$16.5 million. The allegations against the broker-dealers involved failure to maintain employee communications about the business that were delivered through text messages, whereas the allegations against the investment advisors involved failure to maintain communications relating to recommendations made and advice given across several off-channel avenues. The firms were also cited with failure to supervise.

April 3, 2024: This date marked the first time that the SEC charged a stand-alone registered investment advisory firm for widespread recordkeeping failures. From January 2019 through December 2021, certain Senvest employees used personal devices to send and receive thousands of text messages related to firm business, including recommendations and advice given or proposed to be given about securities. Such communications took place using personal texting platforms and non-Senvest messaging applications, which were not captured and maintained, in violation of the firm's policies and procedures and the Advisers Act. Moreover, three senior employees communicated on personal devices wherein the off-channel communication was set to delete in 30 days. The SEC also found that the firm failed to have an effective supervisory framework for overseeing such recordkeeping. To settle the matter, Senvest agreed to a \$6.5 million civil penalty.

⁶ SEC, "SEC Charges 16 Wall Street Firms with Widespread Recordkeeping Failures" (Sept. 27, 2022).

Lessons learned

At a time when speed of communication is critically important to customers and employees alike, instant messaging and text messaging are the norm. However, these technologies come with recordkeeping requirements.

The challenge for investment advisors is the associated compliance risks: How do you know which off-channel platforms are or could be used by employees, and how do you develop strong electronic policies, procedures, and internal controls to capture, archive, and monitor these business-related electronic communications? Unofficial channels also may lack the necessary security protocols, increasing the risk of data breaches and client information leakage. Moreover, noncompliance and information security breaches can severely harm an advisory firm's reputation.

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IV. Strategies for managing off-channel communications

Successful management of off-channel communications depends on understanding and acting on current trends in how professionals communicate today.

Understand trends in business communication habits.

Due to convenience and immediacy, current business communication trends point to an increased use of SMS and encrypted messaging apps. With the spike in remote work and preference for quick responses, text and messaging apps are on the rise for business communications. Professionals rely on and use their mobile devices more than ever. Moreover, the ease with which employees can communicate via several platforms—including both monitored and unmonitored channels—directly impacts how firms govern the tracking and monitoring of business-related communications.

Keep up with compliance trends. To stay ahead of the curve, there are many steps you can take to help manage off-channel communications. Consider the following:

- **Policy and procedure development:** Develop a clear policy that outlines permissible communication channels and the use of personal devices. This policy should be communicated effectively to all associated persons and include procedures for monitoring and enforcement, as discussed below.

- **Training and awareness:** Regular training sessions should be conducted to ensure that all employees understand the risks and policies related to off-channel communications. Technology can be designed with training modules to be completed by employees throughout the year. The modules can be customized by topic and employee level, and set up as required reading, testing, and/or certifications.
- **Technological solutions:** Implement technological solutions that can capture and archive communications across various platforms, including mobile devices and social media.
- **Monitoring and governance:** Regularly monitor communications and strictly enforce policies. Consider implementing certifications by associated persons relating to their compliance with the firm's off-channel communication policies. Noncompliance should be addressed with appropriate disciplinary measures.
- **Advisory client education:** Educate clients about the importance of using official channels for all investment-related communications. This can include information sessions, written communications, and reminders during meetings.
- **Regular audits and reviews:** Conduct regular audits of communication records to ensure compliance and identify any potential gaps in policy or training.

V. Legal and regulatory framework governing off-channel communications

The regulatory framework that governs an advisor's off-channel communications is multifaceted. While recordkeeping is at the forefront, there are other regulations that should be considered. Here is a summary of those Advisers Act rules that can touch upon off-channel communication concerns.

Books and records requirements. Investment advisors are held to the SEC Recordkeeping Rules established under Rule 204-2 of the Advisers Act. This requires, among other things, that registered investment advisors must maintain comprehensive and updated records of business activities, including written and electronic communications, documentation of recommendations and investment advice given, and records pertaining to investment strategies.

Fiduciary duty. Pursuant to Section 206 of the Advisers Act, registered investment advisors are held to a fiduciary duty standard, which is based on a duty of loyalty and duty of care to act in the best interests of their clients at all times.

Looking for more information on compliance or regulatory issues?

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The duty of care requires investment advisors to act prudently and provide advice that is in clients' best interest, while the duty of loyalty requires an advisor to place clients' best interest before theirs by providing full disclosure and addressing or mitigating any conflicts of interest.

Compliance program rule requirements. Rule 206(4)-7 of the Advisers Act requires investment advisors to, among other things, have written policies and procedures reasonably designed to prevent violations under federal securities laws. This includes designing internal controls to prevent, detect, and correct violations of the Advisers Act, which includes maintaining books and records of business-related communications.

Marketing rule requirements. Under the Marketing Rule (Rule 206(4)-1 of the Advisers Act), the SEC defines an advertisement as any direct or indirect communication made by an investment advisor that offers securities advisory services. Such definition is broad, and includes communications disseminated through emails, social media, videos, and hard copy, which must be accurate, fair, and balanced.

Regulation S-P. Regulation S-P requires investment advisors and broker-dealers to, among other things, "adopt written policies and procedures that address administrative, technical, and physical safeguards for the protection of customer records and information."⁷ Safeguarding client data includes implementing stringent information security protocols, providing ongoing employee training, routinely performing risk assessments to identify and address areas of risk, and properly disposing of consumer information.

Each of these rules directly relates to both in-channel and off-channel communications and must be considered by investment advisors as they develop their internal controls. In conjunction with this, advisors must consider the common channels used for off-channel communications and map how they are capturing and supervising related books and records. For example, this can be achieved by using advanced compliance technologies that integrate with various communication platforms to ensure that all communications are captured, archived, and able to be monitored.

VI. Common channels for electronic communications

To build effective internal controls, you must be familiar with the various ways that your team communicates. Below are some of the most popular electronic communication methods and platforms.

Email: one of the most common forms of digital exchanges of business-related communications between two or more people via computers and other electronic devices.

Social media: a digital platform where individuals, groups, or companies can share information efficiently with their virtual communities and the public.

- X (formerly known as Twitter) is a social media platform where users can create and share short text posts or images, as well as interact with others.
- YouTube is a user content and video-sharing platform where users can create, upload, edit, and share videos digitally.
- Facebook Messenger is a platform for Facebook users to send private messages to other Facebook users.
- LinkedIn InMessages is the platform used by LinkedIn users to send private messages to other LinkedIn users. This platform is generally used for business-related communications.
- SnapChat is a multimedia platform where users can share ephemeral (disappearing) messages between each other or in groups. This platform is distinguishable by users' ability to set a time limit for their message, after which it will be deleted.

Text messaging: digital written communications sent from one cell (mobile) phone to another or others. The communication is typically brief and informal.

- SMS (short message system) is the technology that makes it possible to send text messages between two or more cell phones. It is universal and can be used on most, if not all, mobile phone networks.
- iMessage is a text-messaging platform available only between Apple, Inc. devices.

Messaging applications: cloud-based messaging platforms that allow for the exchange of text, audio, or video information.

- WhatsApp is a secure (end-to-end encryption) online platform where individuals and groups can communicate via text and voice messages, have video chats, or even share images.
- Zoom Chat allows users to send private or group messages during or after a Zoom meeting.
- Instant Bloomberg is a communication platform that enables secure communication between users, including group chats and collaboration; it also provides compliance tools for monitoring conversations.
- MS Teams, part of the Microsoft 365 Suite, is an internal communication platform used for teams to chat, call, and collaborate; it includes robust security features, including data encryption.

⁷ See [17 CFR § 248.30](#).

- Signal is a messaging application best known for its secure end-to-end encryption. It is favored for its focus on communicators' privacy and security. However, this focus presents challenges in meeting recordkeeping compliance requirements, as Signal's end-to-end encryption and platform designed to minimize data retention make tracking and storing business-related communication difficult, if not impossible.
- Telegram is another messaging platform that offers high levels of privacy and security. Telegram supports two layers of encryption: a standard "client-server" encryption and an end-to-end encryption for its "Secret Chats." In addition, the platform offers users the option of "ephemeral messaging," which is essentially a self-destruct feature that makes monitoring and recording a challenge.

Take steps to gain an understanding of the unique characteristics of each platform and identify whether an advanced compliance technology is available to capture business-related communications. Ultimately, the executive management team (with advisement by compliance) will need to determine if the method and/or platform is permissible, and evaluate the impact associated with this decision.

VII. Case study: Considerations for investigating off-channel communications

Kate works at Social Capital Management (SCM) as its chief compliance officer. During an annual review, Kate decides to interview certain senior management team members to ensure that SCM supervisors are complying with the advisor's off-channel communication policy, particularly since use of personal devices is permitted by the firm. SCM's policy states:

"Use of unapproved electronic business communication methods, such as text, 'chats', or instant messaging, is not permitted on personal devices. Furthermore, use of personal email, chats, or text messaging application for business purposes is not permitted, nor is the forwarding of work-related communications to personal devices."

Kate interviews three senior executives and asks each if they are using text messaging to communicate with internal employees, or applications such as WhatsApp to communicate when they are on international travels. Here are their responses:

Chief Executive Officer: "Kate, when our largest client texts and asks me to buy AAPL, I must acknowledge that request. When I travel, it is a lot easier for me to use WhatsApp, but those communications are to my assistant instructing him what to do, so that shouldn't be a problem."

Operations, SVP: "Kate, I only have exchanged messages with an SCM colleague related to a client's request to do a wire transfer. Of course, from time to time I will also need to text staff related to SCM business."

Chief Investment Officer: "Kate, I am very careful. I do receive and reply to communications from SCM personal and external contacts in the securities industry; it would be rude not to. But I try not to do this frequently."

Kate quickly discovers that the employees are engaging in off-channel communications. She promptly takes steps to set a meeting with the executive management committee to discuss her findings and explore whether the firm's policy should be modified to permit use of certain channels (such as Zoom chat in lieu of WhatsApp) so that employees can easily communicate with one another while they are traveling. She explores what advanced compliance technologies are available and the associated cost of each, and she works with outside counsel to explore other steps she should consider when presenting this information to senior management.

As part of this conversation, Kate discusses what steps she may be able to take to address and mitigate the risks associated with her findings, which includes possibly self-reporting to the SEC.

Kate presents this information to the executive management committee with outside counsel in attendance, and outlines the steps she intends to take:

- Investigate what other forms of off-channel communication are occurring, and by whom.
- Determine if any past off-channel communications can be captured, and how.
- Explore whether clients were provided with guidance on how to communicate with employees when they are traveling and the acceptable methods of the firm.
- Provide recommendations as to whether the firm's policy should be modified and/or strengthened. Once determined by senior management, adopt and implement new policies and procedures and include use of advanced compliance technologies, as needed, to capture books and records of related business communications.
- Develop a quarterly compliance attestation related to the associated person's adherence to the firm's new electronic communications policy.
- Conduct training for all employees to ensure they understand any changes to the firm's electronic communications policy.
- For infractions, escalate to a disciplinary committee for further investigation and disciplinary actions; get outside counsel involved, as necessary.

- Conduct forensic tests during the annual review to assess whether the new policy is effective and is not being circumvented by employees.
- Take steps to ensure that the electronic communication records are maintained and monitored frequently.

VIII. Conclusion

The handling of off-channel communications is a complex and essential consideration for registered investment advisors as they assess their compliance programs. Begin by reviewing your internal controls: Is the firm capturing required business-related communications? Next, explore whether off-channel communications are being used. Then, discuss with senior management your findings, including the desired methods and platforms to consider for electronic communications. Be prepared to discuss, however, the impact this may have on your compliance program. Likely, you will be required to engage a vendor to

provide a compliance technology solution to capture the business-related communications. You will also need to develop new policies and procedures, conduct employee training, integrate new technologies, and proactively discuss with clients how they can best communicate with you. Remain vigilant as new platforms and technologies are released and keep abreast of the regulatory landscape and new SEC guidance involving electronic communications.

As we look toward the future, it is important for investment advisory firms to continue to innovate and invest in solutions that address the challenges of off-channel communications. This includes developing more sophisticated monitoring tools, enhancing client communications with acceptable methods to communicate with the firm and its associated persons, deploying robust supervisory controls, and developing training programs on policies and procedures to reflect your firm's electronic communication requirements and best practices.

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Previously, Ms. Jacko served as Of Counsel at Shustak & Partners, PC. Prior to that, she was Vice President of Compliance and Branch Manager of the Home Office Supervision team at LPL Financial Services, Corporation (Linsco/Private Ledger). She also served as Legal Counsel of Investments and Chief Compliance Officer at First American Trust, FSB; held the position of Compliance Manager at Nicholas-Applegate Capital Management; and was Compliance Officer at PIM Financial Services, Inc.

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