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FINRA Update

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FINRA Issues New Guidance on Credit for Extraordinary Cooperation

On July 11, 2019, the Financial Industry Regulatory Authority (FINRA) restated and supplemented prior guidance regarding the circumstances under which FINRA will award credit for “extraordinary cooperation” in investigations and the nature of credit available.¹ This guidance comes more than 10 years after FINRA last provided formal guidance on this issue. Although the new guidance does not alter the criteria FINRA uses to assess cooperation, it clarifies the difference between required cooperation and extraordinary cooperation and provides significantly more transparency into FINRA’s assessment of conduct meriting extraordinary cooperation credit. In particular, FINRA noted the importance of broad and prompt corrective measures, customer restitution, and substantial assistance to FINRA.

Susan Schroeder, Executive Vice President, FINRA Enforcement, explained in a July 11 Webcast that FINRA’s goal was to provide clear direction on the types of conduct that will be rewarded.² Consistent with this goal, going forward, FINRA will include in its Letters of Acceptance, Waiver and Consent (AWCs) a new section titled “Credit for

Extraordinary Cooperation,” which will recite the factors on which cooperation credit was premised and the type of credit the respondent received.³

In its November 2008 guidance, FINRA identified four factors that could result in cooperation credit: (1) self-reporting before regulators are aware of the issue; (2) extraordinary steps to correct deficient procedures and systems; (3) extraordinary remediation to customers; and (4) providing substantial assistance to FINRA’s investigation.⁴

The updated guidance reaffirms FINRA’s prior guidance and provides additional information and examples to clarify how FINRA determines whether cooperation is “extraordinary.” FINRA also highlighted examples of recent enforcement actions in which credit was given to respondents.

The key areas in which FINRA provided *updated* or *new* guidance include:

- Specific examples of corrective steps that may receive cooperation credit and the importance of taking such steps promptly and broadly;⁵
- Factors relevant to FINRA’s evaluation of whether restitution reflects extraordinary cooperation;⁶
- How FINRA considers self-reporting in light of FINRA Rule 4530(b), which was adopted in 2011 and requires member firms to report its

conclusions of violations of certain laws, rules, regulations, or standards of conduct;⁷

- Examples of how a respondent may substantially assist FINRA Staff (or other regulators) during and before an investigation beyond conduct required by FINRA Rule 8210;⁸ and
- Clarifying that FINRA considers the same factors as the SEC in evaluating whether to give individuals credit for extraordinary cooperation.⁹

Steps to Correct Deficient Procedures and Systems

Because firms must take steps to fully remediate deficient supervisory systems, procedures, and controls, extraordinary cooperation credit is reserved for instances in which these steps go *beyond these baseline requirements*. Examples of such exceptional steps include: (1) conducting an independent investigation that is thorough and beyond the scope of the immediate issue; (2) hiring independent consultants to ensure effective adoption and implementation of remedial improvements; and (3) as appropriate, making organizational changes tailored to the deficiency (for example, creating new supervisory positions, adjusting reporting lines, or removing or disciplining responsible individuals, including those in supervisory roles).¹⁰

Considerations include whether the firm took corrective steps *promptly* following its discovery of the misconduct and whether the firm maintained an “open dialogue” with FINRA Staff during the remedial process, including providing FINRA with ready access and information to evaluate the reasonableness of the new systems, procedures, and controls. FINRA Staff also will consider the breadth of the firm’s remediation. By way of example, the guidance advises that, when a firm identifies deficient procedures in a certain department or product line, FINRA may conclude that a firm took extraordinary steps if its review and remediation went beyond the particular known deficiencies, to encompass similar procedures in other

aspects of the business. The guidance also notes that, to encourage timely self-reporting of misconduct, FINRA may take into account corrective measures taken promptly *after* a firm reports the misconduct.

Restitution to Customers

FINRA emphasized the importance of making *complete and timely* restitution to injured customers, specifically noting that FINRA will consider whether firms have proactively and voluntarily taken steps to ensure restitution is paid as quickly as possible. Open dialogue with FINRA Staff to explain the restitution approach is important to maximizing the likelihood of receiving credit. In that vein, in a 2018 speech, Schroeder highlighted two examples of firms that received extraordinary cooperation credit because they had spent “significant time and resources analyzing the effects of its supervisory failure on customers, establishing a restitution plan early in the process and sharing its methodology with [FINRA].”¹¹

The new guidance provides examples of extraordinary steps a firm might take with respect to restitution, including: (1) implementing a methodology, such as a statistical approach, that reduces the time it takes for customers to receive restitution; (2) dedicating more resources to this effort where manual work is needed; and (3) engaging with FINRA Staff on the best method for calculating restitution. In appropriate circumstances, Firms may be awarded credit where restitution is paid *after* FINRA becomes aware of the misconduct.

Self-Reporting of Violations

FINRA issued its guidance in part to clarify how FINRA considers self-reporting in light of the adoption of Rule 4530(b). As noted in the Rule 4530 Frequently Asked Questions, self-reporting must “go significantly beyond” what is required to comply with reporting obligations under Rule 4530 or Rule 8210.¹² The guidance provides examples of how a respondent’s disclosure may go “above and beyond”

its existing reporting requirements and therefore be considered as potentially meriting cooperation credit: (1) the firm self-reports misconduct that does not fall within the reporting requirements of Rule 4530; (2) the firm provides information beyond what is required, such as summaries of key facts and chronologies; (3) the firm made diligent efforts to inform FINRA of the relevant facts when discovered and kept FINRA updated during its investigation; (4) the firm proactively detected misconduct through compliance, audits, or other surveillance, as opposed to identifying the misconduct by customers or regulators; and (5) the firm reported the misconduct to the public and other regulators as appropriate.

Substantial Assistance to FINRA Investigations

FINRA emphasized that, to constitute “substantial assistance,” respondents must inform FINRA Staff of potential misconduct in ways that are considerably more expansive than would satisfy requests made under Rule 8210. Examples of substantial assistance include: (1) providing analyses of trading or other activity; (2) giving demonstrations of the systems at issue; (3) offering relevant industry knowledge; and (4) voluntarily making witnesses available for interviews. The guidance emphasized that, in evaluating whether a firm has provided substantial assistance, FINRA will consider the degree of assistance that might be expected given a firm’s size and resources, as well as the scope of the misconduct and steps taken to address systemic deficiencies. The references to “mere” compliance appear designed to remind firms that simply producing documents, trading records, and communications, absent more, does not amount to substantial assistance or extraordinary cooperation. But if member firms take the opportunity of a Staff request to provide assistance of the type described (for example, demonstrations, useful explanations of complex products or practices, or demonstratives that help convey industry knowledge and practice), they can

and should reasonably expect some recognition for that effort.

Credit also may be awarded for initiating a thorough and independent investigation by counsel or consultants and fully disclosing the findings to the Staff. Importantly, FINRA reiterated its existing policy that a firm’s decision whether to waive privilege will not be considered in connection with granting credit for cooperation.¹³

Credit for Individuals

FINRA noted that credit for extraordinary cooperation is available to individual respondents, though such credit will be less likely in proceedings with aggravating factors such as intentional or reckless misconduct.

FINRA clarified that in addition to the factors applicable to firms, it will consider four general factors outlined in the SEC’s policy in assessing cooperation credit for individuals: (1) the assistance provided by the individual; (2) the importance of the underlying matter in which the individual cooperated (for example, the type and number of violations, the age and duration of the misconduct, and the harm to investors and others); (3) the societal interest in holding the individual accountable for his or her misconduct; and (4) the appropriateness of credit based on the profile of the cooperating individual (for example, history of lawfulness, degree of acceptance of responsibility, and opportunity to commit future violations).¹⁴

Credit Given for Extraordinary Cooperation

The guidance did not expand the types of credit it may give and merely repeated the categories listed in the 2008 guidance: (1) reduction in fines, (2) limited or no undertaking, or (3) no enforcement action.¹⁵ In addition to including information on credit given in AWCs, FINRA will note the factors that led a respondent to receive credit and the type of credit received in any accompanying press release. Notably, FINRA will determine on a case-by-case

basis whether to publish information about matters where it elects to bring no enforcement action due to credit for extraordinary cooperation, noting that, in such circumstances, it would preserve anonymity unless the firm or individual consented to being named.¹⁶ Over time, these AWCs may form useful precedent on cooperation credit.

Conclusion

FINRA's updated guidance provides more transparency into FINRA's thought process for determining whether to award credit for extraordinary cooperation. While the guidance does not alter the factors FINRA laid out in 2008, it does clarify how a member firm or covered individual can go above and beyond the minimum requirements for responding to a regulatory request under Rule 8210 or self-reporting a violation under Rule 4530, in order to obtain credit. Member firms and their counsel that discover possible violations, particularly those that may require self-reporting, and face potential investigations by FINRA should carefully review the updated guidance to determine how best to position the firm so that it is able to earn credit for extraordinary cooperation.

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NOTES

- ¹ FINRA Reg. Not. 19-23 (July 2019), available at <http://www.finra.org/industry/notices/19-23>.
- ² Remarks by Susan Schroeder, Webcast (July 11, 2019), available at <http://www.finra.org/industry/credit-extraordinary-cooperation>.
- ³ FINRA Reg. Not. 19-23 at 9.
- ⁴ FINRA Reg. Not. 08-70 at 1 (Nov. 2008), available at <http://www.finra.org/sites/default/files/Notice Document/p117452.pdf>.
- ⁵ FINRA Reg. Not. 19-23 at 5.
- ⁶ *Id.* at 6.
- ⁷ *Id.* at 7.
- ⁸ *Id.* at 8.
- ⁹ *Id.* at 10-11.
- ¹⁰ FINRA noted that personnel changes are not necessarily required to obtain credit for extraordinary cooperation.
- ¹¹ Susan Schroeder, Remarks at SIFMA AML, New York, NY (Feb. 12, 2018), transcript available at <https://www.finra.org/newsroom/speeches/021218-remarks-sifma-aml>.
- ¹² See also Rule 4530 Frequently Asked Questions, Regulatory Notice 11-32 at A6 (July 2011).
- ¹³ FINRA Reg. Not. 19-23 at n.14 (*citing* FINRA Reg. Not. 08-70 at n.9).
- ¹⁴ *Id.* at 11 (*citing* SEC Policy Statement Concerning Cooperation by Individuals in Its Investigations and Related Enforcement Actions, Release No. 34-61340, 17 C.F.R. Part 202 (Jan. 19, 2010)).
- ¹⁵ *Id.* at 9; FINRA Reg. Not. 08-70 at 2.
- ¹⁶ FINRA Reg. Not. 19-23 at 9.

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