

FINRA Investigations

FINRA Provides Guidance Regarding Credit for Extraordinary Cooperation

Executive Summary

FINRA is issuing this guidance to apprise firms of the circumstances in which extraordinary cooperation by a firm or individual may directly influence the outcome of an investigation. The types of extraordinary cooperation by a firm or individual that could result in credit can be categorized as follows: (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. These steps alone or taken together can be viewed in a particular case as extraordinary cooperation and, depending on the facts and circumstances, can have an impact on FINRA's enforcement decisions.¹

Questions regarding this *Notice*, should be directed to Susan Merrill, Executive Vice President, Enforcement, at (646) 315-7300.

Background & Discussion

The cornerstone of the investigative and enforcement authority of self-regulatory organizations in the securities industry is the requirement that firms and individuals employed in the industry comply with regulatory requests for information or testimony.² Notwithstanding this obligation, in certain situations, actions taken by firms or individuals go far beyond such compliance and rise to the level of extraordinary cooperation. Depending on the facts and circumstances, there are instances where cooperation by a firm or individual is so extraordinary that it should be taken into consideration in determining the appropriate regulatory response.

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Notice Type

- Guidance

Suggested Routing

- Compliance
- Internal Audit
- Legal

Key Topics

- Investigations
- Self-reporting

Referenced Rules and Notices

- NASD Rule 3070(a)
- NASD Rule 8210
- NYSE Rule 351(a)
- NYSE Information Memorandum 05-65

There is significant regulatory value in crediting conduct that rises to the level of extraordinary cooperation.³ Such cooperation may put the regulator on notice of regulatory problems before it finds them during an examination or investigation or assist the regulator in resolving matters more quickly, thereby allowing it to deploy regulatory resources more efficiently. This enables FINRA to achieve its mission of investor protection and market integrity more effectively.

Credit for extraordinary cooperation in FINRA matters may be reflected in a variety of ways, including a reduction in the fine imposed, eliminating the need for or otherwise limiting an undertaking, and including language in the settlement document and press release that notes the cooperation and its positive effect on the final settlement by FINRA Enforcement. In an unusual case, depending on the facts and circumstances involved, the level of extraordinary cooperation could lead FINRA to determine to take no disciplinary action at all.

By publishing these standards of cooperation, FINRA seeks to increase transparency as to the basis for sanctions imposed in cases and to encourage firms to root out, correct and remediate violative behavior. By making clear that FINRA has given credit for extraordinary cooperation in a particular case, FINRA will inform firms and associated persons of the types of conduct considered and the degree to which such actions are to the individual or firm's benefit.

It is important to note that the level of cooperation is just one factor to be considered in determining the appropriate disciplinary action and sanctions. Other factors include the nature of the conduct, the extent of customer harm, the duration of the misconduct, and the existence of prior disciplinary history, all of which impact the appropriate sanction in any particular matter.

FINRA will consider the following factors in assessing cooperation:

1. Self-Reporting of Violations

FINRA will consider credit for self-reporting of violations before any regulatory inquiry into the conduct at issue has begun and before the violation otherwise comes to the regulator's attention. The self-reporting must be prompt, detailed, complete and straightforward in order to warrant special consideration. The type of reporting that is contemplated here is beyond that which is otherwise required to be reported pursuant to regulatory reporting requirements.⁴

2. Extraordinary Steps to Correct Deficient Procedures and Systems

FINRA may credit correction of procedures that occurs prior to detection by FINRA and, in appropriate circumstances, even after detection by FINRA. In order to encourage firms to take immediate, proactive steps to correct systems, procedures and controls that may have contributed to problems that occurred at the firm, FINRA considers it appropriate to credit such steps in reaching its decision regarding the appropriate regulatory response.

Credit for correction of procedures prior to regulatory detection is consistent with the FINRA Sanction Guidelines and cases that FINRA has recently brought. Firms that have found a problem and fully corrected related procedures before the examination or investigation began have received credit in the form of a reduction of the sanction imposed in the disciplinary action.

Credit for remediation of procedures post-detection by FINRA would be appropriately limited to those situations where, notwithstanding the fact that the firm did not discover the problem on its own, the firm nevertheless promptly and completely remediated the deficient procedures as soon as it became aware of the problem without prompting by FINRA or another regulator or law enforcement agency.⁵ To qualify for credit for extraordinary cooperation, the post-detection remediation must be taken early on, well before completion of FINRA's investigation. Steps taken later in the investigation to correct procedures will not be considered extraordinary steps and would not yield credit in the sanction determination, because a firm has a duty to correct deficient procedures.⁶

3. Extraordinary Remediation to Customers

FINRA recognizes that credit should be given for extraordinary steps taken to remediate customers, including promptly and immediately identifying injured customers and making such investors whole.⁷ FINRA also will consider the extent to which a firm proactively identifies and provides restitution to injured customers that goes beyond the universe of customers and transactions covered by the staff's investigation.⁸

4. Providing Substantial Assistance to FINRA Investigations

FINRA recognizes that receiving substantial assistance from firms during an investigation can assist FINRA in efficiently resolving investigations into violative conduct. Such assistance can have far-reaching benefits, including, among other things, shortening investigations and enhancing FINRA's ability to effectively and efficiently investigate large scale and complicated systemic failures, thereby reducing the regulatory burden on firms and FINRA resources. Examples of the types of substantial assistance that may, depending on the circumstances, warrant credit include:

- Providing access to individuals or documents outside FINRA's jurisdiction that are critical to a full investigation of violative conduct.
- Providing extraordinary assistance with the investigation. Upon learning of a problem, firms often undertake comprehensive internal investigations, and then brief FINRA staff on their findings. FINRA has credited these proactive undertakings by firms that greatly assisted the staff's investigations.⁹

- Cooperation with FINRA to uncover substantial industry wrongdoing. When on-going violative conduct has numerous participants yet is difficult to uncover, collaboration with the regulator can have a dramatic impact on regulatory consequences. This can include apprising FINRA of wrongdoing beyond the scope of the original investigation and alerting staff to industry-wide, systemic problems. When a firm or individual brings to the regulator's attention a pattern or practice of which the regulator was unaware, or is the first to come forward to cooperate in a widespread, industry-wide investigation and thereby assists the regulator in understanding, scoping and resolving the investigation, this assistance should be credited. Conditions for such credit include: (i) cooperation with the regulator to uncover related industry wrongdoing; (ii) providing substantial assistance in furtherance of the resulting investigation; and (iii) cooperating in all relevant respects.

Conclusion

Crediting extraordinary cooperation by firms and individuals in appropriate situations advances important regulatory goals. Among other things, it can shorten investigations, thereby reducing regulatory burdens on firms and FINRA resources, as well as apprise FINRA staff of wrongdoing beyond the scope of the original investigation and alerting staff to industry-wide, systemic problems. Encouraging firms and individuals to take immediate, proactive and meaningful steps and appropriately acknowledging the cooperative conduct in settlement documents may encourage others to take similar steps and will provide transparency into sanction terms and how the conduct was actually credited.

While FINRA staff will continue to assess the particular facts and circumstances in each case, including the nature of the conduct, the extent of customer harm, the duration of the misconduct and the existence of disciplinary history, the extent of a firm's extraordinary cooperation will be an important factor in determining the appropriate disciplinary action and the sanctions that will be sought by FINRA Enforcement.

Endnotes

- 1 This *Regulatory Notice* is intended to provide member firms and their associated persons with guidance concerning the factors that FINRA Enforcement considers when assessing the sanctions it will seek in the context of settlement discussions that precede the filing of a formal disciplinary action. Nothing herein is intended to alter the guidance for adjudicators set forth in the *Principal Considerations in Determining Sanctions* contained in FINRA's Sanction Guidelines.
- 2 NASD Rule 8210.
- 3 The FINRA Sanction Guidelines recognize that certain proactive, corrective measures taken by firms and individuals involved in the disciplinary process may have an impact on sanction determinations. Specifically, the *Principal Considerations* under the Guidelines provide for consideration in determining sanctions of, among other factors, self-reporting, corrective measures, and restitution prior to detection by the firm (in the case of an individual) or by a regulator (in the case of a firm), as well as substantial assistance to FINRA in its examination and/or investigation of the conduct. These Guidelines and *Principal Considerations* provide a foundation for much of what we say here, although it is important to note that they apply, strictly speaking, to adjudicators in contested matters.

The relevant *Principal Considerations* that apply to adjudicators in determining sanctions in contested matters are:
 2. Whether an individual or member firm respondent accepted responsibility for and acknowledged the misconduct to his or her employer (in the case of an individual) or a regulator prior to detection and intervention by the firm (in the case of an individual) or a regulator.
 3. Whether an individual or member firm respondent voluntarily employed subsequent corrective measures, prior to detection or intervention by the firm (in the case of an individual) or by a regulator, to revise general and/or specific procedures to avoid recurrence of misconduct.
 4. Whether the respondent voluntarily and reasonably attempted, prior to detection and intervention, to pay restitution or otherwise remedy the misconduct.
 12. Whether the respondent provided substantial assistance to FINRA in its examination and/or investigation of the underlying misconduct, or whether the respondent attempted to delay FINRA's investigation, to conceal information from FINRA, or to provide inaccurate or misleading testimony or documentary information to FINRA.
- 4 NYSE Rule 351(a) and NASD Rule 3070(a) both require firms to report certain violations to FINRA but at different times. These rules will be harmonized in the rulebook consolidation project. The type of self-reporting contemplated as extraordinary and deserving of credit would go significantly beyond these regulatory requirements. For example, a firm may satisfy its reporting requirement under Rule 351(a) by filing a brief RE-3 with FINRA. Self-reporting deserving of credit for cooperation would, at a minimum, have to include a detailed account of the discovered conduct and an offer to explain in complete detail all aspects of the conduct and provide relevant documents. See, NYSE Information Memorandum 05-65.

Endnotes (cont'd)

- 5 See, e.g., *DOE v. Morgan Stanley DW, Inc.*, AWC Action No. EAF0301160001 (Aug. 1, 2005) (The press release states: "In sanctioning Morgan Stanley, NASD took into account the firm's demonstrable steps, undertaken shortly after NASD's inquiry began, to enhance its system and procedures and which led to the firm's identification and removal of large numbers of accounts for which the Choice program was not appropriate."); *DOE v. CIBC World Markets Corp.*, AWC Action No. 2006004464101 (Jan. 8, 2008) (The press release states: "The fine for CIBC was reduced in recognition of the firm's actions in reporting the problem to FINRA and taking prompt remedial actions to correct the problem.")
- 6 This is not meant to suggest that a firm or individual cannot defend an Enforcement investigation into deficient policies and procedures. A firm that believes its procedures are adequate and does not change them promptly or until the very end of an investigation should not expect to receive a sanction reflecting credit for extraordinary cooperation in any settlement.
- 7 See, e.g., *DOE v. Northwestern Mutual Investment Services, LLC*, AWC Action No. 2006005084401 (June 28, 2007) (The press release states: "NASD imposed a reduced fine in recognition of the firm's prompt remedial steps after an NASD examination to assess client harm and provide remediation to eligible clients.")
- 8 See, e.g., *DOE v. AXA Advisors, LLC* AWC Action No. 2005002269401 (Sept. 5, 2007) (The press release states: "FINRA ordered AXA Advisors to return \$1.4 million in fees to approximately 1800 customers. AXA Advisors voluntarily refunded an additional \$1.2 million to customers... AXA Advisors also unilaterally took steps to enhance its systems and procedures and to close accounts that were not appropriate for the fee based program.
- FINRA considered these steps in determining the sanctions in this case."); *DOE v. Banc of America Investment Services, Inc.*, AWC Action No. EAF0401010002 (Nov. 21, 2006) (The press release states: "In connection with the sanctions imposed in this AWC, NASD has taken into account certain demonstrable steps undertaken by BAIS, shortly after NASD issued Notice to Members 03-68, to update and enhance its systems and procedures relating to fee-based accounts. NASD also considered BAIS's self-reporting of certain conduct... [O]n its own initiative, BAIS identified the customers affected by this conduct and has reimbursed the customers the amounts they were charged for the transactions at issue.")
- 9 See, e.g., *DOE v. Instinet/Island*, AWC Action No. 2004200002601 (Oct. 3, 2005) and *DOE v. Piper Jaffrey*, AWC Action No. 2006006755701 (Dec 18, 2007). Firms often assert attorney-client privilege in connection with a firm's internal investigation. Such a firm could still receive credit for extraordinary cooperation if it found other ways to inform FINRA staff of pertinent facts without waiving the privilege. Indeed, consistent with FINRA's duty "to provide a fair procedure for the disciplining of members and persons associated with members," FINRA as a general matter recognizes the attorney-client privilege in its adjudicatory forum. Securities Exchange Act of 1934, 15 U.S.C. § 78(o)-3. Therefore, the waiver or non-waiver of the privilege itself will not be considered in connection with granting credit for cooperation. Moreover, it is not the waiver of attorney-client privilege that warrants credit for cooperation but rather the extraordinary assistance to the staff in uncovering the facts in an investigation that yields the benefit.

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