Regulatory Notice 19-23

FINRA Investigations

FINRA Supplements Prior Guidance on Credit for Extraordinary Cooperation

July 11, 2019

Notice Type
- Guidance

Suggested Routing
- Compliance
- Legal
- Operations
- Senior Management

Key Topic
- Extraordinary Cooperation

Referenced Rules & Notices
- FINRA Rule 4530
- FINRA Rule 8210
- FINRA Rule 8313
- Regulatory Notice 08-70
- Regulatory Notice 11-32
- Regulatory Notice 19-04
- Sanction Guidelines

Summary

FINRA is issuing this *Notice* to restate and supplement prior guidance regarding the circumstances under which a firm or individual may influence the outcome of an investigation by demonstrating extraordinary cooperation. This *Notice* incorporates FINRA's prior guidance and provides clarification and additional information about how FINRA assesses whether a potential respondent's cooperation is "extraordinary" and distinct from the level of cooperation expected of all member firms and their associated persons.

Questions concerning this *Notice* should be directed to:

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Background & Discussion

FINRA recognizes extraordinary cooperation by respondents when making its enforcement determinations. In 2008, FINRA published *Regulatory Notice 08-70* to apprise industry participants of the factors FINRA considers in determining whether and how to award credit for extraordinary cooperation in a FINRA investigation. FINRA noted that 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. The guidance set forth in *Regulatory Notice 08-70* is restated and incorporated into this *Notice*.

Subsequent changes to FINRA's rules, including the adoption of FINRA Rule 4530(b)—which requires member firms to report internal conclusions of violations of certain laws, rules, regulations or standards of conduct—may have created uncertainty around the continued impact that self-reporting may have on a potential respondent's ability to receive credit for extraordinary cooperation. In addition, other FINRA rules and policies—such as FINRA Rule 8210 and FINRA's *Sanction Guidelines*—expect certain levels of cooperation in every case.

To provide further clarity on the differences between required cooperation and extraordinary efforts, and in response to comments from the industry requesting further transparency,[1] FINRA is issuing this *Notice*, which incorporates its prior guidance and provides additional information regarding the circumstances under which credit for extraordinary cooperation will be awarded and the nature of credit available. In doing so, FINRA hopes to incentivize firms and associated persons to voluntarily and proactively assist FINRA. This, in turn, will aid FINRA in meeting its objectives of investor protection and market integrity by quickly identifying and remediating misconduct.

What Is Extraordinary Cooperation?

FINRA's *Sanction Guidelines* state, "Sanctions in disciplinary proceedings are intended to be remedial and to prevent the recurrence of misconduct."[2] While disciplinary actions are an important tool that FINRA uses to achieve the goals of remediation and prevention, actions taken by member firms and associated persons are also an important part of that effort. Action by member firms and associated persons that demonstrates their commitment to remediating past misconduct and preventing recurrence is essential to furthering FINRA's mission of investor protection and market integrity.

Therefore, FINRA always considers factors such as corrective measures and payment of restitution in assessing whether a disciplinary action is necessary, and, if so, what sanctions are appropriate. FINRA's *Sanction Guidelines* direct Enforcement to consider whether a respondent:

i. accepted responsibility for and acknowledged the misconduct prior to detection and intervention by the firm or a regulator;[3]

ii. voluntarily employed subsequent corrective measures, prior to detection or intervention by the firm or by a regulator, to revise general and/or specific procedures to avoid recurrence of the misconduct;[4]

iii. voluntarily and reasonably attempted, prior to detection and intervention by a regulator, to pay restitution or otherwise remedy the misconduct;[5] and

iv. provided substantial assistance to FINRA in its examination and/or investigation of the underlying misconduct.[6]

FINRA has and will continue to look to these factors when assessing sanctions in disciplinary matters.[7] For example, Enforcement may recommend a sanction that is on the low end of the specified range in the *Sanction Guidelines* based on the presence of these mitigating factors. In certain circumstances, Enforcement also may determine to forgo recommending formal disciplinary action entirely.

Enforcement may recommend a sanction that is **well below** the range set forth in the *Sanction Guidelines* or comparable precedents when respondents have voluntarily provided such material assistance to FINRA in its investigation, or effected such expedient and effective remediation, that FINRA deems these steps to constitute "extraordinary cooperation" beyond what it requires of any member firm or associated person. Member firms and associated persons who take proactive and voluntary steps well beyond those required under FINRA rules materially assist FINRA in meeting its goals of investor protection and market integrity. To recognize and incentivize such conduct, FINRA weighs these mitigating factors so heavily that the outcome of the matter is materially different than it would have been absent the respondent's extraordinary conduct.

In several matters in recent years, FINRA has granted substantial credit to firms based on their extraordinary cooperation:

- Beginning in 2015 through 2018, FINRA ordered a number of firms to pay more than $75 million in restitution, including interest, to affected customers for failing to waive mutual fund sales charges for certain charitable and retirement accounts. FINRA did not impose fines in those matters based on the firms' extraordinary cooperation. Firms initiated, prior to detection or intervention by a regulator, investigations to identify whether the misconduct existed; promptly established a plan of remediation for affected customers; promptly self-reported the conduct to FINRA; promptly took action and remedial steps to correct the violative conduct; and employed subsequent corrective measures, prior to detection or intervention by a regulator, to revise their procedures to avoid recurrence of the misconduct.

- In September 2017, FINRA ordered a respondent firm to pay approximately $9.8 million in restitution to customers who were affected by the firm's failure to establish and maintain a supervisory system reasonably designed to detect and prevent unsuitable short-term trading of unit investment trusts. While FINRA fined the firm $3.25 million, this reflected substantial credit for the firm's extraordinary cooperation and remediation to customers. The firm initiated, prior to intervention by a regulator, a firm-wide investigation to identify the scope of potentially unsuitable trades, which included the interview of a substantial number of firm personnel and the retention of an outside consultant to conduct a statistical analysis; identified harmed customers and established a plan to provide remediation; and provided substantial assistance to FINRA in its investigation.

- In October 2018, FINRA sanctioned a firm for failures to supervise firm functions it outsourced to a vendor. FINRA did not impose a fine, acknowledging, among other things, the firm's self-report, which extended beyond its obligation to self-report pursuant to FINRA Rule 4530; the extraordinary steps the firm took to remediate, including weekly meetings with the vendor's CEO and COO, hiring two full-time employees to implement controls, and assigning a dedicated manager to oversee the vendor; changing its billing structure to avoid similar issues; and conducting a comprehensive review of all its wealth management accounts to identify impacted investors, whom it voluntarily paid $4.6 million in restitution.

FINRA resolved these matters in consideration of the factors set forth in both the *Sanction Guidelines* and *Regulatory Notice 08-70*, including a consideration of both the timeliness and quality of the respondents' corrective measures and cooperation. FINRA believes these cases are good examples of its existing policy. Although the impact of extraordinary cooperation depended upon the facts and circumstances of each particular case, these matters demonstrate, among other things, that the receipt of substantial credit depended on corrective measures and cooperation aimed at broadly and quickly remediating harm.

Most recently, in January 2019, FINRA announced in *Regulatory Notice 19-04* its 529 Plan Share Class Initiative, encouraging firms to review their supervision of 529 plan sales. FINRA described common supervisory issues it had observed concerning share class recommendations and stated that it would recommend settlements with no fines for firms that choose to review their supervisory systems and procedures, self-report supervisory violations, and provide FINRA with a plan to remediate harmed customers. This initiative was announced to promote firms' compliance with the rules governing 529 plan recommendations, to promptly remedy violations, and to return money to harmed investors as quickly and efficiently as possible.

As in these prior matters, FINRA will continue to consider the factors that are set forth in the *Sanction Guidelines* and *Regulatory Notice 08-70* when determining whether credit will be given for extraordinary cooperation. Those factors are reiterated below, with additional guidance regarding how they impact FINRA's decision making:

1. Providing Credit for Steps Taken to Correct Deficient Procedures and Systems

When a firm identifies a problem involving deficient supervisory systems, procedures and controls, the firm must take corrective steps to fully remediate the problem. In considering whether to provide substantial credit for extraordinary cooperation, FINRA will consider whether a firm's steps to correct deficient systems and procedures go beyond these baseline requirements. Examples of corrective steps that may result in credit for extraordinary cooperation include:

- Engaging or conducting an independent audit or investigation that is thorough and far-reaching in scope beyond the immediate issue, with an eye toward identifying and remediating all related misconduct that may have occurred.
- Hiring independent consultants to ensure the adoption and implementation of improved supervisory systems, procedures and controls.
- Where the root cause of a violation relates to organizational weaknesses such as where a firm dedicated inadequate staff to the supervision of a particular business line, making organizational changes by, for example, creating new supervisory positions, adjusting reporting lines or, if necessary, removing or disciplining responsible individuals, including those in supervisory roles (although personnel changes are not necessarily required to achieve extraordinary cooperation).

FINRA will consider whether the firm took these or other corrective steps promptly following its discovery of the misconduct, prioritizing the remediation of any deficiencies. Additionally, FINRA will consider whether the firm maintained an open dialogue with FINRA staff regarding improvements to supervisory systems, procedures and controls, and provided FINRA with ready access and information to evaluate whether new systems, procedures and controls are reasonable.

FINRA staff will also consider the breadth of a firm's remediation. For example, if a firm identifies deficient procedures that affect a particular department or product line, the firm must review and correct the identified procedures. In contrast, FINRA may consider the firm's responses "extraordinary" when the firm conducts a broader assessment, which goes beyond the scope of the original investigation, and looks for and remediates similar deficiencies in procedures that govern other aspects of its business.

Although FINRA will, consistent with the *Sanction Guidelines*, take into consideration the timing of steps taken to correct deficient systems or procedures when deciding whether to award credit,[8] FINRA recognizes that there is some tension between expecting firms to report misconduct promptly and, at the same time, giving priority to corrective measures that a firm takes prior to detection by FINRA or other regulators (*e.g.*, prior to any self-report). For that reason, and in order to encourage the timely self-reporting of misconduct, FINRA will consider, in appropriate circumstances, giving credit for corrective measures taken promptly **after** a firm reports the misconduct.

2. Providing Credit for Restitution to Customers

FINRA's overarching mission is to protect investors and promote vibrant markets. As FINRA has previously stated, when a member firm or registered representative engages in misconduct, restitution for harmed customers is our highest priority. Therefore, if a respondent's misconduct has caused customer harm, it will be difficult for that respondent to obtain credit for extraordinary cooperation without making complete and timely restitution to injured customers.

The *Sanction Guidelines* recognize the importance of prompt restitution and treat as a mitigating factor for sanctions purposes the fact that a firm or associated person voluntarily paid restitution prior to detection or intervention by a regulator.[9] Because FINRA expects firms and associated persons to make full restitution to injured customers[10] in all cases, the mere payment of restitution will not result in credit for extraordinary cooperation. Rather, as with other corrective measures, FINRA will consider whether a firm or associated person has proactively and voluntarily taken extraordinary steps to ensure that restitution is paid as quickly as possible, in a manner that ensures all harmed customers are made whole.

This is particularly relevant in matters involving widespread, systemic failures, where identifying injured customers and calculating each individual's losses can be complex and time consuming. For example, where a firm's failure to supervise compliance with its suitability obligations has resulted in customer losses, it could review the recommendations made in each of its customer's accounts, calculate individual losses resulting from the failure to comply with the suitability duty, and pay restitution to the customers who were harmed. This complex process can take significant time. An extraordinary step, in contrast, could be one that significantly accelerates the process in order to return money to investors sooner. For example, implementing a methodology to efficiently identify customers for restitution, such as a statistical approach, could meaningfully reduce the time it would take for investors to receive restitution. Similarly, taking steps to accelerate a trade-by-trade review (such as dedicating staff members, hiring temporary help, paying for overtime, or re-prioritizing other projects) may constitute extraordinary efforts.

When assessing whether a respondent has exceeded expectations regarding restitution, FINRA will consider whether the respondent is proactive about identifying and proposing an expeditious methodology, and willing to engage in a dialogue with FINRA and other regulators about the appropriate way to identify the pool of affected customers and to calculate the amount of restitution to pay back customers as swiftly as possible.

Even where restitution is paid after FINRA becomes aware of the misconduct (for example, if the firm reports the misconduct within 30 days of discovery as required by Rule 4530), FINRA will consider whether to award credit when the restitution remediated all potential harm and was paid promptly at the initiative of the firm, prior to any order by FINRA or another regulator.

3. Self-Reporting of Violations

One reason for this updated guidance is to clarify how FINRA considers self-reporting in light of the adoption of Rule 4530. Rule 4530 replaced NASD Rule 3070 in February 2011 and, in subsection (b), unlike its predecessor, requires member firms to self-report internal conclusions regarding violations of certain laws, rules, regulations or standards of conduct. Although self-reporting of such internal conclusions was already required for NYSE member firms under NYSE Rule 351(a)(1), FINRA Rule 4530(b) represented a significant change for many firms.

As noted previously in the Rule 4530 Frequently Asked Questions, to be considered "extraordinary cooperation," self-reporting must, at a minimum, "go significantly beyond" what is required to comply with regulatory obligations.[11] Credit will not be awarded to firms merely for complying with their reporting obligations under Rule 4530. Nor will firms and associated persons be given credit for merely complying with their obligations to provide information or testimony in response to regulatory requests made pursuant to Rule 8210. If, however, a firm self-reports misconduct that does not fall within the reporting requirements of Rule 4530, then self-reporting will be considered in determining whether to award credit.

In matters where a self-report is required pursuant to Rule 4530, FINRA will consider whether the firm self-reports information beyond that which is required by the rule. For example, a firm exceeds its regulatory obligation when it proactively and voluntarily asks to meet with FINRA staff, provides summaries of key facts, and identifies and explains key documents. This type of substantial assistance is further described below.

FINRA also will consider whether the firm proactively detected the misconduct through compliance, audits or other surveillance, as opposed to identifying the misconduct only after receiving notice from customers, counterparties or regulators. FINRA also will consider whether the firm made diligent efforts to identify and inform FINRA of the relevant facts as soon as it discovered the issue, and kept FINRA updated as it learned new facts through continuing investigation.

Finally, FINRA will consider whether the firm reported the misconduct to the public and other regulators, as appropriate. FINRA also may consider the level of the firm's cooperation with other regulators and, if appropriate, law enforcement bodies, particularly in matters where multiple agencies are investigating the misconduct.[12]

4. Providing Substantial Assistance to FINRA Investigations

In addition to the above factors, FINRA also will consider giving credit to firms or associated persons for providing substantial assistance to FINRA in its investigation of the underlying misconduct.[13] In assessing whether firms have 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 within the organization and the steps taken to address systemic deficiencies; there is no one-size-fits-all approach to the steps that FINRA would consider substantial assistance. Credit is potentially available to any firm or individual that cooperates substantially, including the largest broker-dealers and single-employee firms.

To constitute substantial assistance, industry participants should fully inform FINRA about the potential misconduct—including all relevant issues, products, markets and industry participants—in ways that go far beyond merely responding to requests made under Rule 8210. For example, substantial assistance deserving of credit might include:

- volunteering relevant information that the firm believes would be helpful even if FINRA did not directly request the specific documents or information;
- providing analysis of trading or other activity that assists FINRA in understanding the conduct at issue;
- volunteering facts related to the involvement of particular parties who may have committed violations;
- providing demonstrations of trading or other systems at issue;
- after identifying misconduct by an individual employee, conducting a thorough and expeditious review of the employee's misconduct and promptly sharing the findings with FINRA;
- volunteering relevant industry knowledge to help FINRA quickly assimilate information about a complex product or practice. Examples could include providing information about the considerations or issues that affect an industry-wide common practice;
- providing detailed summaries or chronologies of relevant events prior to receiving a Rule 8210 or other regulatory request;
- voluntarily assisting FINRA in obtaining effective access to firm offices, records or computer systems prior to receiving a Rule 8210 or other regulatory request;
- identifying witnesses who possess relevant information, including witnesses over whom FINRA lacks jurisdiction, and making those witnesses available for interviews; and
- conducting a thorough and independent audit or investigation, using counsel or consultants where appropriate, and fully disclosing the findings to FINRA.[14]

What Type of Credit Will Be Given in Return for Extraordinary Cooperation?

When FINRA determines that a firm should be given credit for extraordinary cooperation, that credit may take many forms. For example, where a problem has been fully remediated, FINRA often concludes that no enforcement action is warranted and closes an investigation with no further action or with a Cautionary Action Letter.

In other cases, FINRA might determine that an enforcement action is appropriate to remedy or prevent harm, even where a firm has provided extraordinary cooperation. In those matters, FINRA may provide credit by reducing the sanctions imposed. When credit is given in the form of a reduced fine, the reduction normally will be substantial. Indeed, in appropriate cases, as illustrated in several of the examples above, FINRA may consider imposing formal discipline without any fine. FINRA also may give credit by declining to require an undertaking. For example, FINRA may forego requiring a firm to hire an independent consultant where, although a systemic deficiency is in an extended period of remediation, the firm is taking other extraordinary steps to address the problem.

How Does FINRA Plan To Be More Transparent About Credit for Extraordinary Cooperation?

In each case where the applicable principal considerations and the factors set forth in this *Regulatory Notice* result in a respondent receiving credit for extraordinary cooperation, FINRA will include in the Letter of Acceptance, Waiver and Consent (AWC) memorializing the settlement a new section titled, "Credit for Extraordinary Cooperation." FINRA will describe the factors that resulted in credit being given, as well as the type of credit.

In order to provide more useful guidance to the industry, FINRA will take additional steps to distribute information about instances when it has deemed cooperation to be extraordinary, in ways that are more accessible and easier to identify. For example, FINRA occasionally issues press releases in connection with individual cases to highlight matters deemed worthy of public attention.[15] In press releases, FINRA will note factors that led the respondent to receive credit, as well as the type of credit. Similarly, when FINRA proceeds without formal action in connection with an investigation, traditionally FINRA has not made public a statement regarding the action. Going forward, when FINRA gives credit for extraordinary cooperation that results in FINRA electing to proceed without formal action, FINRA will determine, on a case-by-case basis, whether it would be useful to provide additional transparency regarding the factors that led to FINRA's decision and, when appropriate, publish information about those individual cases. Unless the firm or associated person gives permission to be named, FINRA will preserve their anonymity by describing the respondents' extraordinary cooperation at a sufficiently high level to shield their identities.

FINRA also seeks to provide clear guidance on the difference between matters characterized by extraordinary cooperation, and matters in which the respondent's conduct did not exceed its regulatory obligations but sanctions determinations were materially affected by other considerations. As described above, FINRA always considers factors such as corrective measures and payment of restitution in assessing whether a disciplinary action is necessary and what sanctions are appropriate. For example, the Principal Considerations in the *Sanction Guidelines* include "Whether the respondent voluntarily and reasonably attempted, prior to detection and intervention, to pay restitution or otherwise remedy the misconduct." Accordingly, Enforcement may consider a firm's voluntary payment of restitution to be mitigating and recommend a sanction on the low end of the specified range in the Sanction Guidelines. In contrast, Enforcement may consider it "extraordinary" if a firm takes significant steps to effect speedy restitution, such as re-prioritizing other projects or developing a rules-based approach to accelerate the process. Under those circumstances, FINRA may consider these additional steps so extraordinary that it recommends a sanction well below the *Sanction Guidelines* or other similar cases.

At other times, the presence of aggravating factors may materially affect the sanction determination. For example, even if a respondent remediates the problem and makes restitution as expected, FINRA may recommend a more severe sanction due to aggravating factors in the matter, such as prior disciplinary history;[16] the nature of the underlying misconduct, including whether the misconduct was intentional or reckless,[17] involved numerous acts or a pattern of misconduct, and continued over an extended period of time;[18] the nature and extent of injury to the investing public, a member firm and other market participants;[19] whether the respondent profited from the misconduct;[20] and whether the respondent engaged in the misconduct notwithstanding prior warnings from FINRA, another regulator or a supervisor.[21]

In general, the factual findings set forth in an AWC should always include any facts that were considered as aggravating or mitigating for sanctions purposes. However, where appropriate an AWC may also include a new section titled, "Sanctions Considerations." In that section, FINRA may identify mitigating or aggravating factors (such as those discussed in the relevant Principal Considerations from the *Sanction Guidelines*) that affected FINRA's sanction determination.

Can Individuals Also Receive Credit for Extraordinary Cooperation?

Credit for extraordinary corrective measures and cooperation is available to individuals as well as firms. FINRA believes many of the principles discussed above may apply equally to individuals. For example, although individuals may not be able to correct deficient firm procedures and systems, they may still self-report misconduct, provide substantial assistance during an investigation, and pay restitution to customers with appropriate notice to and involvement by a member firm. However, the presence of aggravating factors may weigh against credit for extraordinary cooperation, and certain aggravating factors

are more likely to be present in cases involving individuals, such as intentional or reckless misconduct,[22] attempts to conceal misconduct from a member firm,[23] and misconduct notwithstanding prior warnings from a supervisor.[24]

In evaluating whether to give credit to an individual, FINRA also will consider the same four general factors outlined in the SEC's policy regarding cooperation by individuals: (1) the assistance provided by the individual; (2) the importance of the underlying matter in which the individual cooperated; (3) the societal interest in holding the individual accountable for his or her misconduct; and (4) the appropriateness of credit based upon the profile of the cooperating individual.[25]

Endnotes

1. *See* May 8, 2017, letter from the Securities Industry and Financial Markets Association to FINRA in response to Special Notice – Engagement Initiative (Mar. 21, 2017), at 8 (urging FINRA to, among other things, "publicize when good credit is given").
2. *Sanction Guidelines* (March 2019 version), at 3.
3. Principal Consideration No. 2.
4. Principal Consideration No. 3.
5. Principal Consideration No. 4.
6. Principal Consideration No. 12.
7. As was the case with *Regulatory Notice 08-70*, this *Notice* is intended to provide the industry with additional guidance concerning the factors that FINRA considers in assessing whether formal discipline is warranted and, if so, the appropriate sanctions in the context of settlement discussions prior to initiation of a disciplinary proceeding. Nothing herein is intended to alter the *Sanction Guidelines*, FINRA rules or other applicable requirements.
8. *See* Principal Consideration No. 3 (treating as a mitigating factor corrective measures taken "prior to detection or intervention" by a regulator).
9. Principal Consideration No. 4.
10. FINRA reminds associated persons that paying restitution or otherwise settling a customer complaint without notice to the firm is a violation of FINRA Rule 2010, and can result in sanctions of up to two years or, in egregious cases, a bar. *Sanction Guidelines*, at 34.
11. *Regulatory Notice 11-32*, A6.
12. *Cf.* General Principles Applicable to All Sanction Determinations, No. 7 (directing adjudicators to consider, where appropriate, sanctions previously imposed by other regulators for the same conduct).
13. Principal Consideration No. 12.
14. Nothing has changed about FINRA's approach with respect to attorney-client privilege. The waiver or non-waiver of privilege itself will not be considered in connection with granting credit for cooperation. *See* endnote 9 in *Regulatory Notice 08-70*.

15. *See www.finra.org/newsroom/newsreleases*.
16. Principal Consideration No. 1.
17. Principal Consideration No. 13.
18. Principal Consideration Nos. 8, 9.
19. Principal Consideration No. 11.
20. Principal Consideration No. 16.
21. Principal Consideration No. 14.
22. Principal Consideration No. 13.
23. Principal Consideration No. 10.
24. Principal Consideration No. 14.
25. SEC Policy Statement Concerning Cooperation by Individuals in its Investigations and Related Enforcement Actions, Release No. 34-61340, 17 CFR Part 202 (Jan. 19, 2010).