



Financial Services & Products ADVISORY ■

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FINRA's New Guidance on Credit for Cooperation in Investigations

As you may have seen, FINRA recently issued updated guidance, [Regulatory Notice 19-23](#), on the credit it grants for extraordinary cooperation in FINRA investigations. This guidance follows prior similar guidance provided by FINRA over 10 years ago, published at the time via Regulatory Notice 08-70.

FINRA emphasizes throughout the Notice that FINRA member firms must remain cognizant of the distinction between complying with their required reporting and responsiveness obligations, chiefly as mandated by FINRA Rules 4530 and 8210, and being credited with extraordinary efforts to assist FINRA in the course of its investigations. The Notice states that FINRA's aim is "to incentivize firms and associated persons to voluntarily and proactively assist FINRA," which will in turn aid FINRA in "meeting its objectives of investor protection and market integrity by quickly identifying and remediating misconduct."

Defining "Extraordinary Cooperation"

In discussing the question of what constitutes "extraordinary cooperation," the Notice first references existing factors contained in FINRA's Sanction Guidelines, which FINRA Enforcement must consider in assessing whether to take disciplinary action and what sanctions are necessary. The highlighted factors include whether a firm:

- i. accepted responsibility for and acknowledged the misconduct prior to detection and intervention by ...a regulator;
- ii. voluntarily employed corrective measures, prior to detection or intervention ... by a regulator, to revise general and/or specific procedures to avoid recurrence of the misconduct;
- iii. voluntarily and reasonably attempted, prior to detection and intervention by a regulator, to pay restitution or otherwise remedy the misconduct; and
- iv. provided substantial assistance to FINRA in its examination and/or investigation of the underlying misconduct.

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Without providing a precise definition of when the combination of these factors constitutes “extraordinary cooperation,” FINRA states that in assessing these factors, it will consider whether firms “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.”

To this end, FINRA cites several matters from recent years as “good examples of its existing policy” regarding extraordinary cooperation and notes in particular that these reflect the importance of “corrective measures and cooperation aimed at broadly and quickly remediating harm”:

- The mutual fund share class waiver settlements reached in 2015 through 2018, when FINRA declined to impose fines based on extraordinary cooperation including the voluntary initiation of investigations, promptly established plans of remediation, prompt self-reporting and remedial action, and employment of subsequent corrective measures to revise relevant procedures.
- A settlement reached with a firm in September 2017 regarding unsuitable short-term trading of unit investment trusts. FINRA notes that while the settlement involved a \$3.25 million fine, this figure included “substantial credit” for extraordinary cooperation and remediation to customers. FINRA further notes the firm’s cooperation included a firmwide investigation to identify the scope of potentially unsuitable trades, including interviewing a substantial number of firm personnel and retaining an outside consultant to conduct a statistical analysis, identifying harmed customers and a plan of remediation, and providing substantial assistance to FINRA in its investigation.
- A settlement reached with a firm in October 2018 regarding a failure to supervise functions outsourced to a firm vendor, which erroneously applied fees during automated rebalancing of certain wealth management accounts. FINRA notes its decision to not impose a fine following the firm’s voluntary payment of \$4.6 million in restitution, as well as additional factors including a remediation plan that included meeting weekly with senior management of the vendor, hiring two full-time employees to implement relevant controls, 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.

FINRA also highlighted its recent 529 Plan Share Class Initiative, noting that it would recommend settlements with no fines for those firms that choose to review their supervisory systems and procedures, self-report supervisory violations, and provide FINRA with a plan to remediate harmed customers, in accordance with the guidance provided in the initiative.

How Credit Is Given for Extraordinary Cooperation

In defining how credit is given for cooperation, the Notice notes that the credit granted by FINRA may take many forms, including closing a matter with no further action or issuing a cautionary action letter, reducing or altogether eliminating the sanctions imposed, or declining to require a firm to agree to an undertaking, such as the retention of an outside consultant.

Factors in Granting Credit for Extraordinary Cooperation

The Notice describes four categories of factors FINRA takes into account in its decision to grant credit for extraordinary cooperation.

Correcting deficient procedures and systems

Noting that member firms have an existing regulatory obligation to correct any supervisory deficiencies they identify, FINRA states that examples of corrective steps that go beyond this baseline obligation include:

- 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 any resulting enhancements to its supervisory systems are adopted and implemented.
- Instituting organizational changes to correct issues that contributed to the root cause of a violation (e.g., inadequate staffing, changing reporting lines, and/or removal/discipline of relevant personnel).

FINRA notes that an important factor is the promptness of these actions, with priority given to remediation. FINRA will also consider whether the firm maintained an open dialogue with FINRA staff and provided FINRA with ready access and information to evaluate any new or enhanced supervisory systems. FINRA will also consider the breadth of the remediation, for example whether the firm’s assessment and remediation go beyond the scope of the original investigation or impacted business. In making these statements, FINRA acknowledges 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 and other regulators,” and for that reason, FINRA will consider giving credit for corrective measures taken promptly after a firm reports the misconduct.

Restitution to customers

The Notice emphasizes that restitution for harmed customers is FINRA’s highest priority and that “complete and timely” restitution to any injured customers is an essential prerequisite to credit for extraordinary cooperation. In addition, FINRA emphasizes that the mere payment of restitution will not result in credit for cooperation; rather, only additional “proactive and voluntary steps” such as paying restitution as quickly as possible, “in a manner that ensures all harmed customers are made whole,” will result in credit.

As a hypothetical example, FINRA notes that in an investigation involving a firm’s failure to supervise compliance with suitability obligations, while a firm could conduct an individualized assessment of each potentially impacted recommendation, since this would result in a complex and time-consuming process, an extraordinary step in this context would be to significantly accelerate the process by using a more efficient identification methodology, such as a statistically based approach, that could meaningfully reduce the time to restitution being paid. If a firm opts to conduct a trade-by-trade review, FINRA states that devoting additional resources to accelerate the review could constitute extraordinary efforts. FINRA further notes that the degree to which member firms are proactive in identifying and proposing an expeditious

methodology, and willing to engage in dialogue with FINRA about the methodology and calculations, is an important factor. Finally, FINRA states that even when restitution is paid after FINRA becomes aware of the misconduct, firms can receive credit when the restitution remediated all harm and was paid promptly by the firm before any regulatory order.

Self-reporting of violations

FINRA notes that a specific reason for its issuance of the Notice is to clarify how credit is granted in comparison to the requirement of self-reporting. The Notice stresses that, as already made clear under existing guidance, credit will not be awarded for firms that simply comply with their regulatory obligation to self-report and/or respond to requests for information. Rather, in order to receive credit, firms must report matters that do not fall within their regulatory obligations under Rule 4530 or provide information beyond what is required under that rule.

As an example, FINRA notes that proactively requesting to meet with staff, providing summaries of key facts, and identifying and explaining key documents all could constitute extraordinary efforts. The Notice further states that additional factors for granting of credit will include whether the conduct was proactively detected through compliance, audits, or surveillance (compared with notice from customers, counterparties, or regulators), and whether the firm made diligent efforts to identify and inform FINRA of the relevant facts as soon it discovered the issue and kept FINRA apprised of new facts. Finally, FINRA will consider whether the misconduct was reported to the public and other regulators and the level of the firm's cooperation with other regulators and law enforcement in multijurisdictional matters.

Substantial assistance to regulators

FINRA states that, in assessing whether firms have provided substantial assistance, factors will include the firm's size and resources, the scope of the misconduct, and steps taken to address deficiencies. FINRA emphasizes that there is no "one-size-fits-all approach" to determining what constitutes substantial assistance in the context of a FINRA investigation. The Notice underscores that firms must fully inform FINRA about the potential misconduct—including all relevant issues, products, markets, and industry participants—in a manner that goes "far beyond merely responding to requests" made under Rule 8210.

Examples of potential substantial assistance include:

- Volunteering relevant information, even if not requested by FINRA.
- Providing relevant analysis that would assist FINRA in understanding the issues.
- Volunteering facts of the particular parties involved in the relevant violations.
- Providing demonstrations of relevant systems.
- For misconduct by an individual employee, promptly conducting a "thorough and expeditious review" of the employee's misconduct and promptly sharing the findings with FINRA.
- For complex products or practices, "volunteering relevant industry knowledge to help FINRA quickly assimilate information" about the issue, including the considerations that affect an industry-wide common practice.

- Voluntarily providing detailed summaries or chronologies of relevant events before a request for such information.
- Voluntarily assisting FINRA in obtaining effective access to firm offices, records, or computer systems before a request for such information.
- Identifying, and making available for interview, witnesses who possess relevant information, “including witnesses over whom FINRA lacks jurisdiction.”
- “Conducting a thorough and independent audit or investigation,” through counsel or consultants where appropriate, and fully disclosing the findings to FINRA (but FINRA reiterates that its position on attorney-client privilege remains unchanged: the decision to waive, or not waive, privilege will not be considered in giving credit).

Providing Greater Transparency When Credit Is Given

The Notice includes several commitments from FINRA to provide greater transparency when credit for cooperation is given to provide more useful guidance to industry members. To this end, FINRA states that in each case where credit is given for cooperation, the settlement document (or AWC) will include a new section titled “Credit for Extraordinary Cooperation,” which will describe the factors that resulted in credit being given and the type of credit given. The Notice further states that FINRA will be taking additional steps to distribute information about instances of extraordinary credit, including press releases that note factors leading to extraordinary credit, and in certain cases, publishing information about individual cases that proceed without formal action. In such cases, FINRA notes that unless the firm gives permission to be named, FINRA will preserve its anonymity by describing its cooperation at a sufficiently high level to shield its identity.

FINRA also offers the distinction between matters deemed to involve extraordinary cooperation and matters in which a firm’s conduct did not exceed its regulatory obligations but sanctions determinations were impacted by “other considerations.” As an example, FINRA notes that even though voluntary corrective measures and payment of restitution may not always rise to the level of extraordinary cooperation, such actions may result in the sanctions being imposed on the low end of the Guidelines. FINRA reiterates that such actions may rise to the level of “extraordinary” when, for instance, the firm takes significant steps to expedite restitution.

In comparison, FINRA notes that the presence of aggravating factors can materially affect the sanction determination. Even when a respondent remediates and makes restitution as expected, a more severe sanction may be recommended due to aggravating factors such as prior disciplinary history, intentional or reckless misconduct, numerous bad acts or patterns of misconduct, the nature and extent of injuries caused by the misconduct, and whether the misconduct occurred notwithstanding prior warnings from FINRA or other regulators.

As with its commitment to call out extraordinary cooperation in the AWC document, FINRA states that future AWCs will include a new section titled “Sanctions Considerations,” where FINRA may identify mitigating or aggravating factors that affected FINRA’s determination.

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