

## **FINRA Supplements Prior Guidance on Credit for Extraordinary Cooperation**

The Financial Industry Regulatory Authority (“FINRA”) recently released Regulatory Notice 19-23, entitled “*FINRA Supplements Prior Guidance on Credit for Extraordinary Cooperation*,”<sup>1</sup> to clarify Regulatory Notice 08-70, which had provided guidance regarding the circumstances under which credit for extraordinary cooperation will be awarded to firms and individuals, and the nature of the credit available.<sup>2</sup> The clarification acknowledges that more clarity was needed relating to the differences between FINRA Rule 4530(b), Rule 8210, and its “Sanctions Guidelines” — which require certain levels of cooperation — and the concept of “extraordinary cooperation,” which may permit substantially reduced sanctions.

Regulatory Notice 19-23 (the “Notice”) explains that FINRA will continue to consider certain mitigating factors when assessing whether disciplinary action is necessary, and if so, the sanctions that are appropriate, and provides additional detail regarding 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.” The Notice is organized around the following four overarching questions: (i) what is extraordinary cooperation?; (ii) what type of credit will be given in return for such cooperation?; (iii) how will FINRA be more transparent about credit for extraordinary cooperation?; and (iv) can individuals also receive credit?

### **I. What is Extraordinary Cooperation?**

FINRA considers four factors when evaluating whether cooperation by member firms and individuals is sufficiently extraordinary: (i) extraordinary steps to correct deficient procedures and systems; (ii) extraordinary remediation to customers; (iii) self-reporting before regulators are aware of the issue; and (iv) providing substantial assistance to FINRA’s investigation.

#### **A. Providing Credit for Steps Taken to Correct Deficient Procedures and Systems**

When considering whether cooperation is extraordinary, FINRA will analyze whether a firm promptly took steps to correct any deficient supervisory systems, procedures and controls, and whether such steps went beyond FINRA’s baseline requirements. Examples of such corrective steps 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.”<sup>3</sup>

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<sup>1</sup> See FINRA Regulatory Notice 19-23, *FINRA Supplements Prior Guidance on Credit for Extraordinary Cooperation* (July 11, 2019), [https://www.finra.org/sites/default/files/notice\\_doc\\_file\\_ref/regulatory-notice-19-23.pdf](https://www.finra.org/sites/default/files/notice_doc_file_ref/regulatory-notice-19-23.pdf).

<sup>2</sup> See FINRA Regulatory Notice 08-70, *FINRA Provides Guidance Regarding Credit for Extraordinary Cooperation* (Nov. 2008), <https://www.finra.org/sites/default/files/NoticeDocument/p117452.pdf>.

<sup>3</sup> Regulatory Notice 19-23, *supra* note 1, at 5.

- “Hiring independent consultants to ensure the adoption and implementation of improved supervisory systems, procedures and controls.”<sup>4</sup>
- “Organizational changes” in situations where the root cause of a violation relates to institutional weaknesses, by, for example, “creating new supervisory positions, adjusting reporting lines or, if necessary, removing or disciplining responsible individuals, including those in supervisory roles.”<sup>5</sup>

The Notice also explains that 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” as well as “the breadth of a firm’s remediation,” including, “in appropriate circumstances, giving credit for corrective measures taken promptly *after* a firm reports the misconduct.”<sup>6</sup>

## **B. Providing Credit for Restitution to Customers**

FINRA expects firms and associated persons to make “complete and timely restitution to injured customers.”<sup>7</sup> Accordingly, if a respondent’s misconduct has caused a customer harm, the mere payment of restitution will not necessarily 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.”<sup>8</sup>

“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.”<sup>9</sup> Further, “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.”<sup>10</sup>

## **C. Self-Reporting of Violations**

Extraordinary cooperation requires self-reporting to, “at a minimum, ‘go significantly beyond’ what is required to comply with regulatory obligations,” and credit will not be awarded to firms “merely for complying

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<sup>4</sup> *Id.*

<sup>5</sup> *Id.*

<sup>6</sup> *Id.* (emphasis in original).

<sup>7</sup> *Id.* at 6.

<sup>8</sup> *Id.*

<sup>9</sup> *Id.*

<sup>10</sup> *Id.*

with their reporting obligations under Rule 4530.”<sup>11</sup> Likewise, FINRA will not award credit to firms and associated persons “for merely complying with their obligations to provide information or testimony in response to regulatory requests made pursuant to Rule 8210.”<sup>12</sup>

FINRA will consider whether “the firm self-reports information beyond that which is required by the rule[s]” and “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.”<sup>13</sup> 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,” and “whether the firm reported the misconduct to the public and other regulators, as appropriate,” including the firm’s level of cooperation with other regulators in matters involving multiple agencies and/or investigations of misconduct.<sup>14</sup>

#### **D. Providing Substantial Assistance to FINRA Investigations**

Finally, when considering whether to provide credit for extraordinary cooperation, FINRA will analyze whether the respondent provided “substantial assistance to FINRA in its investigation of the underlying misconduct” by evaluating the “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.”<sup>15</sup> Such substantial assistance may include:

- volunteering relevant information that the firm believes would be helpful even if FINRA did not directly request the specific documents or information;
- providing information 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;
- conducting a thorough and expeditious review of an employee’s potential misconduct and promptly sharing the findings with FINRA;
- volunteering relevant industry knowledge to help FINRA quickly assimilate information about a complex product or practice;

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<sup>11</sup> *Id.* at 7.

<sup>12</sup> *Id.*

<sup>13</sup> *Id.*

<sup>14</sup> *Id.*

<sup>15</sup> *Id.* at 8.

- providing detailed summaries or chronologies of relevant events and/or 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.<sup>16</sup>

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

The Notice explains that credit given for extraordinary cooperation “may take many forms,” and that FINRA often concludes that no enforcement action is warranted where an issue has been fully remediated.<sup>17</sup> In some cases, however, FINRA may determine that an enforcement action is appropriate to “remedy or prevent harm,” even though a firm has provided extraordinary cooperation. But in these circumstances, “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.”<sup>18</sup> Indeed, “FINRA may consider imposing formal discipline without any fine” or even “declin[e] to require an undertaking” — such as ordering a firm to hire an independent consultant — in cases where the firm has taken extraordinary steps to address a systemic deficiency that would normally require an impartial observer.<sup>19</sup>

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

In cases where FINRA’s analysis results in a finding of extraordinary cooperation, FINRA will provide the recipients of credit for such cooperation with a letter memorializing the factors that resulted in credit being given, as well as the type of credit.<sup>20</sup>

In order to provide guidance to the industry in general, the Notice explains that “FINRA will take additional steps to distribute information about instances when it has deemed cooperation to be extraordinary,” such as by issuing a press release that will identify the factors that led a respondent to receive credit and the type of credit it received, as well as other public statements on a case-by-case basis, for example, “when FINRA gives credit for extraordinary cooperation that results in FINRA electing to proceed without formal action.”<sup>21</sup> “Unless the firm or

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<sup>16</sup> *Id.*

<sup>17</sup> *Id.* at 9.

<sup>18</sup> *Id.*

<sup>19</sup> *Id.*

<sup>20</sup> *See id.*

<sup>21</sup> *Id.*

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."<sup>22</sup>

The Notice cautions, however, that even where a respondent takes extraordinary steps, "FINRA may recommend a more severe sanction due to aggravating factors in the matter, such as prior disciplinary history [or] the nature of the underlying misconduct, including whether the misconduct was intentional or reckless," "whether the respondent profited from the misconduct," or "whether the respondent engaged in the misconduct notwithstanding prior warnings from FINRA, another regulator or a supervisor."<sup>23</sup>

#### IV. Can Individuals Also Receive Credit for Extraordinary Cooperation?

Finally, the Notice states that "[c]redit for extraordinary corrective measures and cooperation is available to individuals as well as firms."<sup>24</sup> The Notice explains that, while individuals "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 . . . 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, attempts to conceal misconduct from a member firm, and misconduct notwithstanding prior warnings from a supervisor."<sup>25</sup>

In the context of individuals, FINRA will consider the following four factors from the U.S. Securities and Exchange Commission's policy relating to cooperation by individuals: (i) the assistance provided by the individual; (ii) the importance of the underlying matter in which the individual cooperated; (iii) the societal interest in holding the individual accountable for his or her misconduct; and (iv) the appropriateness of credit based upon the profile of the cooperating individual.<sup>26</sup>

#### V. Conclusion

Regulatory Notice 19-23 continues FINRA's efforts to incentivize firms and associated persons to voluntarily and proactively assist FINRA's overarching mission to protect investors and promote vibrant markets by quickly identifying, reporting and remediating misconduct. Accordingly, companies should consider prompt and comprehensive action anytime a firm or individual identifies an issue involving deficient supervisory systems, procedures or controls that may be reportable to FINRA or other regulators.

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<sup>22</sup> *Id.*

<sup>23</sup> *Id.* at 10.

<sup>24</sup> *Id.*

<sup>25</sup> *Id.* at 10–11.

<sup>26</sup> *Id.* at 11.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Helene R. Banks at 212.701.3439 or [hbanks@cahill.com](mailto:hbanks@cahill.com); Bradley J. Bondi at 202.862.8910 or [bbondi@cahill.com](mailto:bbondi@cahill.com); Brock Bosson at 212-701-3136 or [bbosson@cahill.com](mailto:bbosson@cahill.com); Charles A. Gilman at 212.701.3403 or [cgilman@cahill.com](mailto:cgilman@cahill.com); Elai Katz at 212.701.3039 or [ekatz@cahill.com](mailto:ekatz@cahill.com); Geoffrey E. Liebmann at 212.701.3313 or [gliebmann@cahill.com](mailto:gliebmann@cahill.com); Ross Sturman at 212.701.3831 or [rsturman@cahill.com](mailto:rsturman@cahill.com); Sara Ortiz at 212.701.3368 or [sortiz@cahill.com](mailto:sortiz@cahill.com); Bill McCaughey at 202.862.8946 or [wmccaughey@cahill.com](mailto:wmccaughey@cahill.com); or Luke Ryan at 212.701.3525 or [lryan@cahill.com](mailto:lryan@cahill.com).

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