

## **Tracker impact analysis: FINRA provides guidance on obtaining credit for extraordinary cooperation**

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Last week, the Financial Industry Regulatory Authority publicly announced factors it will consider in determining whether to give firms and individuals credit for extraordinary cooperation. FINRA regulatory notice [08-70](#) (the Notice) represents the self-regulatory organization's first formal guidance to members on the topic since FINRA was formed in July 2007 upon the merger of the NASD and New York Stock Exchange Regulation. The NYSE published information memo [05-65](#) in 2005, which detailed how members could earn credit for extraordinary cooperation, and the NASD sanction guidelines identified conduct that could qualify for reduced sanctions. The newly announced FINRA guidance draws upon information memo 05-65 and the NASD sanction guidelines in some, but not all, respects.

The Notice stresses that FINRA imposes affirmative duties of cooperation and disclosure on its member firms. However, in certain instances, a firm that is the subject of a FINRA investigation may demonstrate "extraordinary cooperation" that exceeds mandatory compliance levels and which FINRA believes should be recognized in the outcome of the matter. Specifically, the Notice identifies four "extraordinary cooperation" factors:

1. **Proactive and early self-reporting of violations.** FINRA may award credit for self-reporting if a firm discloses a violation before the commencement of a FINRA inquiry. The disclosure must be "prompt, detailed, complete and straightforward in order to warrant special consideration." Self-reporting conduct that is subject to mandatory reporting requirements (e.g., NASD rule [3070](#) and NYSE rule [351](#)) does not qualify as extraordinary cooperation.
2. **Extraordinary steps to correct deficient procedures and systems.** In order to provide an incentive for firms to self-correct deficiencies, FINRA may award credit to firms that proactively remedy their inadequate procedures. A firm may receive credit, even if its remediation occurs after FINRA detected the deficiency, if the remediation is implemented without regulatory prompting and "well before completion of FINRA's investigation." According to the Notice, if a firm delays before implementing the correction, it may not receive credit because member firms have a duty to fix deficient policies and procedures.
3. **Extraordinary remediation to customers.** FINRA may award credit to firms that take "extraordinary steps" to compensate injured customers, such as "promptly and immediately identifying injured customers and making such investors whole." FINRA also may award credit to firms that provide remediation to customers for transactions that are outside the scope of FINRA's investigation.
4. **Providing substantial assistance to FINRA investigations.** FINRA may award credit for a firm's substantial assistance that expedites FINRA's investigation or eases its investigative burden. Examples of "substantial assistance" include providing access to individuals or documents beyond FINRA's jurisdictional reach, briefing FINRA on internal investigations, and assisting FINRA to detect "substantial industry wrongdoing."

## **Effect of credit for extraordinary cooperation**

In the Notice, FINRA identifies four ways in which firms may receive credit for extraordinary cooperation. First, FINRA may reduce the fine amount required to settle a matter. Second, FINRA may dispense with the requirement of an undertaking or reduce its scope. Third, a firm's cooperation may be reflected in the language of the settlement document and press release. Finally, in unusual circumstances, FINRA may decide to take no disciplinary action against the firm at all.

## FINRA's extraordinary cooperation factors in context

By publishing this Notice, FINRA joins the US Securities and Exchange Commission and US Department of Justice (DOJ) in providing guidance as to how firms under investigation may receive more favorable treatment through cooperation.

In the October 2001 Report of Investigation Pursuant to section [21\(a\)](#) of the Securities Exchange Act of 1934 and Commission Statement on the Relationship of Cooperation to Agency Enforcement Decisions, commonly referred to as the [Seaboard Report](#), the SEC set forth factors that it would consider in determining whether firms should receive credit for cooperation. Examples of such factors include the length of time between the discovery of the misconduct and implementation of an effective response, the steps the company took upon learning of the misconduct, the company's commitment to fully and expeditiously identifying the scope and consequences of the misconduct, and the company's willingness to share both the results of its review and the scope of its response with the SEC staff.

Consideration of these and other criteria set forth in the Seaboard Report help the SEC determine whether a firm's cooperation merits lighter sanctions, reduced charges, or possibly no enforcement action at all. On October 6, 2008, the SEC's Division of Enforcement publicly released its [Enforcement Manual](#), which reaffirms that the factors listed in the Seaboard Report reflect the SEC's current policy on cooperation.

Similarly, the DOJ's recently revised *Principles of Federal Prosecution of Business Organizations* identifies voluntary and timely disclosures and a willingness to provide relevant information and evidence as potential mitigating factors that could help a corporation avoid indictment or prosecution.

## Waiver of applicable privileges a nonfactor

Notably, FINRA's new guidance mirrors the recent policy shift among law enforcement officials and securities regulators away from encouraging waivers of the attorney-client privilege and work-product immunities and towards obtaining relevant factual information by other means.

## Department of Justice

In a 1999 memorandum written by then-Deputy Attorney General Eric H Holder, who was recently selected by President-Elect Barack Obama to serve as US Attorney General, the DOJ adopted a policy that considered whether a corporation agreed to waive the attorney-client and work-product privileges in assessing cooperation. The DOJ subsequently reiterated this policy in a 2003 memorandum written by then-Deputy Attorney General Larry D Thompson. In 2006, in reaction to criticism of this policy, then-Deputy Attorney General Paul McNulty issued a memorandum that signaled a shift in the DOJ's approach to privilege waivers.

Pursuant to the "McNulty Memo," prosecutors were required to determine whether there was a legitimate need for a waiver and, if such a need existed, obtain approval from the Assistant Attorney General for the Criminal Division, and in some instances, the Deputy Attorney General, before making a waiver demand. In August 2008, Deputy Attorney General Mark R Filip went further and announced that the DOJ will no longer consider waiver of the attorney-client and work-product privileges in evaluating a corporation's cooperation and that federal prosecutors will no longer request disclosure of privileged materials. In addition, the subsequently revised *Principles of Federal Prosecution of Business Organizations* directs prosecutors not to ask for privilege waivers.

# Securities and Exchange Commission

The 2001 Seaboard Report did not require a company to waive a privilege in order to receive cooperation credit as long as the company provided the SEC staff with the relevant facts. However, the Seaboard Report recognized that waiver of a privilege might sometimes be a necessary means of providing relevant and critical information to the SEC staff. The newly published SEC Division of Enforcement Manual takes a step towards protecting the attorney-client and work-product privileges by expressly directing the Enforcement staff not to ask parties to waive these protections, and reaffirming that the relevant cooperation inquiry is not whether a privilege has been waived but whether all relevant facts have been disclosed.

## NYSE/FINRA

NYSE information memo no. 05-65 expressed a "respect" for the attorney-client privilege but noted that "waiver of the attorney-client privilege or any other relevant privilege is a significant step that can often expedite an investigation and may demonstrate a level of commitment to the Exchange's investigation, by a firm or by an individual, sufficient to advance a claim of exceptional cooperation." Similar to the DOJ's and SEC's shifts, as discussed above, FINRA now takes the position that cooperation credit derives not from the waiver of the attorney-client privilege, but from providing "extraordinary assistance" to FINRA staff in sharing the relevant facts of an investigation. Indeed, according to the Notice, the waiver or nonwaiver of the attorney-client privilege will have no bearing on FINRA's decision to grant credit for cooperation.

## Practice pointers

FINRA's recent guidance makes clear that in its view, extraordinary cooperation goes far beyond ordinary compliance. FINRA will consider awarding credit to firms that not only meet their existing obligations as member firms but go above and beyond that standard with respect to the four factors outlined in the Notice and discussed above.

Firms need not waive their attorney-client and work-product privileges in order to demonstrate "extraordinary cooperation" with FINRA. Instead, they should explore ways to gather relevant facts from all sources, including privileged documents, and transmit to FINRA just the facts without sharing documents or information that would reveal privileged material.

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*Morgan Lewis has more than 100 attorneys dedicated to representing financial institutions and issuers in connection with securities law issues. As part of that practice, the firm's Securities Litigation and Enforcement Practice Group regularly represents investment banks, investment advisers, and mutual funds and their employees in connection with SEC, FINRA and state securities commission investigations and proceedings. Morgan Lewis also conducts internal investigations for those entities and has acted as independent consultant to firms in connection with regulatory settlements.*

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