

*NRS Advanced Compliance Training &  
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## ***Managing A Regulatory Crisis***



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# Managing A Regulatory Crisis

- Objectives
- Rapid Response
- Internal Investigations
  - Why investigate?
  - Selecting the Internal Investigator
  - Protection of Information
  - Coordination of Parallel Proceedings
- Contacting Regulators
- Contacting Clients
- Other Disclosure Obligations
- Insurance Issues
- Instituting Prompt Remedial Steps
- Regulatory Filings and Relief
- Handling Press Inquiries

# Objectives

- Rapid response
- Swift resolution
- Minimal disruption

# Rapid Response

- Form a SWAT team
  - Management
  - Compliance
  - Legal counsel
  - Finance/insurance
  - PR
- Governmental / SRO communications
- Avoid premature public disclosure
- Gather facts
  - Scope out what you don't know
  - Assess collateral implications
    - Disqualification
    - Client or shareholder lawsuits
    - Criminal exposure
    - Other collateral results
  - Assess need for an internal investigation

# Internal Investigations: Why investigate?

- Minimize penalties and fines
- Minimize or avoid private litigation
- Formulate defenses for future litigation
- Determine reporting obligations

# Internal Investigations

- An investigation must begin immediately on learning potential misconduct material to a firm's operations
- The review must be thorough and complete
- Prompt attention must be devoted to three key issues
  - Cessation of the misconduct
  - Discipline imposed on errant employees
  - Retention of relevant documents and materials (including e-mail communications, tape recordings, memoranda, etc.)

# Internal Investigations: Selecting the Internal Investigator

- Use of in-house investigators/counsel
- Retention of independent outside investigators/counsel
- Use of the firm's regular outside counsel

# Internal Investigations: Protection of Information

- Protection of information and materials gathered during the investigation is an important aspect of any such review
- Freeze documents and electronic data
  - Avoid obstruction of justice
  - Avoid destruction of evidence
  - Avoid manipulation of data
- Consider ways to maximize protections afforded by the attorney-client privilege and attorney work-product doctrine
- Issues to be considered include:
  - Directing that all work be conducted by or through counsel
  - Labeling properly materials created to identify them as protected by the attorney-client privilege and attorney work doctrine
  - Handling properly documents to avoid inadvertent waivers

# Internal Investigations: Coordination of Parallel Proceedings

- Significant efforts must be made to coordinate the internal investigation with
  - Parallel government & SRO investigations
  - Private arbitrations or litigation
- Consideration should be given to:
  - Establishing a single contact for the investigator and regulators who will be responsible for coordinating document, testimony and interview requests
  - Carefully producing materials to third parties to avoid submitting documents protected by privilege
  - Coordinating interviews and testimony of employees to avoid duplication
  - Keeping relevant business leaders and counsel handling disparate matters informed about the investigation

# Internal Investigations: End Product

- The end product of the internal investigation must be carefully considered
- Thought should be given to whether
  - A written report will be created
  - An oral report will be presented to management

# Contacting Regulators

- SEC's October 2001 Section 21(a) report
  - Articulated a broad framework for evaluating a company's cooperation
- The key measures cited by the SEC were a company's
  - Self-policing
  - Self-reporting
  - Self-remediation
  - Cooperation

# Contacting Regulators

- Given SEC's 21(a) report and industry practice, firms facing a serious regulatory crisis must consider:
  - Benefits to be gained through self-reporting, including:
    - Obtaining potential leniency in the imposition of sanctions
    - Burnishing the reputation of the firm
    - Solidifying professional and personal relationships with regulators
    - Controlling, to the extent possible, the investigatory process
  - Risks that regulators will discover the misconduct
  - Extent of cooperation a firm is willing to afford to regulators
    - Will the company consider waiving applicable privileges?

# Contacting Clients

- General Anti-Fraud Considerations
- Rule 206(4)-4 Requirements
  - Requires disclosure of
    - “A financial condition ... that is reasonably likely to impair the ability of the adviser to meet contractual commitments to clients”
    - “legal or disciplinary event that is material to an evaluation of the adviser's integrity or ability to meet contractual commitments to clients”
      - Certain court, federal & state regulatory and SRO proceedings are presumed material
  - Timing and manner of disclosure
- Pragmatic Considerations
  - Alerting clients may enhance (or lessen any tarnish on) the firm's reputation with clients
  - Altering and settling with affected clients early in the process without the urging of any regulator may earn points with regulators

# Other Disclosure Obligations

- Public company disclosure obligations
- Disclosures to bank regulatory authorities (as applicable)

# Insurance Issues

- Consider extent of coverage and limitations
- Some policies exclude coverage
  - Where insured fails to provide timely notice
  - Where insured admits wrongdoing without the insurance company's consent
  - Where insured seeks to settle without the insurance company's consent

# Instituting Prompt Remedial Steps

- Regulators evaluate firms on the remedial steps they take
- The following should be considered:
  - Speed with which remedial steps are instituted
    - Generally, prompt remedial actions should be taken
    - Remedial actions must address each area of misconduct
  - Imposition of internal discipline
    - This can range from oral warnings, letters of reprimand, fines, restrictions on activities, suspensions and terminations
  - Development and implementation of new policies and procedures
  - Customer reimbursement
    - Firms receive the most credit where they proactively reach out to customers and, without urging of a regulator, reimburse customers
  - Additional training of employees
    - It is important to document any such activities
  - Creation and deployment of new systems
  - Changes in management in affected business areas

# Regulatory Filings and Relief

- Disclosure and reporting of certain disciplinary events
  - Form ADV
  - Form BD
  - Form U-4s
  - SRO reporting obligations
  - State reporting obligations
- Obtaining exemptive relief
  - Certain disciplinary events trigger automatic bars - for which prompt exemptive relief may be required
    - Investment Company Act Section 9(a)
    - Advisers Act Rule 206(4)-3

# Handling Press Inquiries

- Differences in visibility
  - SEC, SRO and Justice Department/U.S. Attorney investigations are generally confidential and non-public
  - State securities investigations and Congressional inquiries may often become public even in their initial stages
- As a result,
  - Firms should consider retaining experienced public relations personnel to deal with media inquiries
  - Employees should be cautioned to refer all media inquiries to a central person either within the firm or at the company's outside public relations firm to assure consistent responses and messages being conveyed through the press

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