



COMPLIANCE WATCH: FINRA Issues Guidance On Cooperation

By Suzanne Barlyn

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NEW YORK (Dow Jones)--New industry guidance explains standards for assessing whether a firm's conduct constitutes "extraordinary cooperation" during an enforcement action. The determination could result in a more favorable outcome, depending on a firm's behavior, according to a regulatory notice issued by the Financial Industry Regulatory Authority, or Finra, on Friday.

Finra also announced a proposed rule that would replace two NASD and NYSE rules governing a securities firm's duties to report conduct violations.

The two notices underscore the self-regulator's continuing efforts to consolidate existing rulebooks from its two predecessors, the National Association of Securities Dealers, or NASD, and the member-regulation operations of the New York Stock Exchange, or NYSE, which merged to become Finra in 2007.

Extraordinary Cooperation

Finra's notice regarding "extraordinary cooperation" effectively harmonizes NASD sanction guidelines and an NYSE memorandum about cooperation, according to Stephen Luparello, Finra senior executive vice president who oversees enforcement and regulation.

Industry compliance with regulatory requests is a cornerstone of the investigative and enforcement authority of self-regulatory organizations in the securities industry, according to Finra's regulatory notice 08-70. However, "in certain situations, actions taken by firms or individuals go far beyond such compliance and rise to the level of extraordinary cooperation. Depending on the facts and circumstances, there are instances where cooperation is so extraordinary that it should be taken into consideration in determining the appropriate

regulatory response," the notice says.

Luparello says the standards outlined in the notice "compel good behavior by firms" and allow Finra to better allocate its resources.

Self-reporting of violations prior to a regulatory inquiry of the conduct followed by extraordinary steps to correct deficiencies are standards that Finra examines in determining whether special consideration is appropriate. Luparello says many self-reported violations are immaterial, but that a firm's effort to self-report more serious issues involving customer harm and swift remediation may be considered during the enforcement action and sanctions.

Finra's notice also cites providing substantial assistance to its investigators as another consideration in determining "extraordinary cooperation." The assistance may include providing access to individuals or documents beyond Finra's jurisdiction, or conducting a comprehensive internal investigation and briefing Finra staff on the findings. "Finra has credited these proactive undertakings by firms that greatly assisted the staff's investigations," according to the notice.

Richard Roth, a New York-based attorney who litigates securities-industry disputes, says the guidance is "extremely beneficial."

"I cannot tell you how many times I have dealt with the regulator who has responded, 'I am sorry, there is no provision even though you have been helpful to me,'" he says.

Combined Reporting Requirements

An additional rule proposal announced by Finra would consolidate NASD Rule 3070 and Incorporated NYSE Rule 351, which both require member firms to report certain events, such as regulatory actions, to Finra, as well as quarterly information regarding written customer complaints. The information, in part, aids Finra in identifying and investigating firms and individuals who pose regulatory risk, according to Regulatory Notice 08-71.

Finra's proposal would narrow a provision in the NASD rule, which requires firms to report violations of "any" rule or standard of conduct imposed by a variety of entities outside the firm, including government agencies, self-regulatory organizations, and financial business or professional organizations. The proposal more clearly specifies the types of rules which must be violated in order to trigger reporting duties - including those governing the securities, insurance and commodities industries, as well as financial business and professional organizations.

Roth, the securities litigation attorney, says the increased specificity is beneficial to brokers. Firms would not be able to include noninvestment industry-related complaints or violations about brokers on Form U5, which broker-dealers file with Finra to terminate the registrations of departing brokers. **Roth** says that marking up a broker's Form U5 with frivolous entries sometimes occurs when firms and departing brokers dispute their entitlement to certain clients.

The proposal also reflects a similar NYSE rule that requires firms to report when they've concluded, internally, that a conduct violation has occurred. However, firms would no longer have to report certain internal conclusions that a violation of business or professional organizational rules has occurred. "Finra does not expect a firm to report an isolated violation that can be reasonably viewed as a ministerial violation of the applicable rules that did not result in customer harm and was remedied promptly upon discovery," according to the notice.

Firms would continue to be obliged to report quarterly statistical information regarding written customer complaints under the new proposal. The proposal would also consolidate existing rules governing the reporting of disciplinary actions against brokers and whether the firm or certain brokers are statutorily disqualified from participating in some transactions because of their business or financial activities.

Additionally, existing duties to report claims for damages in legal actions and file copies of certain legal complaints with Finra would extend to insurance-related actions, in addition to securities.

Finra has not yet filed the proposal on reporting with the Securities and Exchange Commission. The self-regulator has requested comments by Dec. 29.

(Suzanne Barlyn writes Compliance Watch, a column that focuses on compliance and regulatory issues affecting financial advisors. She can be reached at 201-938-4546 or by email at suzanne.barlyn@dowjones.com)

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