

Delicate FINRA Balancing Act: To Self-Report or Not?

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FINRA Rule 4530(a) requires member firms to promptly report certain enumerated events. Rule 4530(b) is less specific, with supplemental guidance advising that a firm should report when it concludes or reasonably should have concluded that conduct or events will result in "widespread or potential widespread impact to the member, its customers or the markets," or ensue from a "material failure of the firm's systems, policies or practices involving numerous customers, multiple errors or significant dollar amounts." But which events or conduct should a member firm consider self-reporting under 4530(b)? Little guidance is available to firms, which could expose themselves to a regulatory investigation or an enforcement action by making non-mandatory disclosure. Nevertheless, a firm may benefit from self-reporting certain misconduct, regardless of whether the rule really requires such disclosure. For starters, self-reporting may yield certain "cooperation credit," which could translate to smaller fines and no or fewer charges or sanctions. Yet, whether and to what extent a firm would be rewarded with cooperation credit is uncertain. For example, in 2008, FINRA issued Regulatory Notice 08-70 acknowledging that "extraordinary cooperation" may directly influence the outcome of an investigation to the member's benefit. Since then, examples of cases citing such "extraordinary cooperation" mainly involve large institutions that preemptively and voluntarily pay millions of dollars in restitution to clients for potential violations. All such cases involved firms that took significant remedial measures in addition to self-reporting, and none involved self-reporting alone. Thus, some smaller member firms that lack the means to proffer large sums in restitution payment may prefer to keep silent. FINRA should clarify the benefits to firms for self-reporting, which may lead to an increase of members' cooperation with FINRA. In fact, FINRA – recognizing that firms often struggle with whether to self-report certain conduct or events – has announced that regulators soon will seek to clarify the scope of cooperation credit. Members should stay tuned.

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