

**Employee Misconduct: Managing the Intersection of Tracking,
Escalation, Discipline and Self-Reporting Programs**

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“As FINRA works to enhance its efforts to protect investors from bad actors, the vigilance of our member firms is also critical. As I highlighted at the outset, stopping bad actors is an area in which we have a shared interest. Firms must do their part by, among other steps, reviewing their hiring practices, monitoring their brokers, improving supervisory systems, and investigating red flags suggestive of misconduct.”

Robert Cook, President and CEO, FINRA
Remarks at Georgetown University, McDonough School of Business
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I. Identifying Employee Misconduct – The Basics

A. The core rule remains FINRA Rule 3110

1. Rule 3110(a): “Each member shall establish and maintain a system to supervise the activities of each associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules. Final responsibility for proper supervision shall rest with the member.” (emphasis added)

¹ This outline was prepared by Bressler, Amery & Ross, P.C. This outline is provided as a general informational service and should not be construed as, and does not constitute, legal advice on any specific matter, nor does its dissemination create an attorney-client relationship.

² <https://www.finra.org/media-center/speeches-testimony/protecting-investors-bad-actors>

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2. FINRA rules address supervisory requirements for specific areas where potential employee misconduct may be identified, including:
 - a) Employee trading and account surveillance (R. 3110(d)), including, outside account activity reviews (R. 3210);
 - b) Correspondence and email reviews (R. 3110(b)(4));
 - c) Customer complaint reviews (R. 3110(b)(5));
 - d) Employee outside business activities and private securities transactions (Rules 3270, 3280);
 - e) Discretionary account reviews (R. 3260);
3. Tools to Identify Employee Misconduct
 - a) Account and trading surveillance
 - b) Electronic communications review software
 - (1) “Flagged” communications based on keyword or other criteria
 - (2) Randomized reviews
 - c) Customer contacts and check-ins
 - d) Employee hotlines and/or whistleblower protocols
 - e) Ombudsman
 - f) Post-hire background checks
 - g) Trained and experienced internal investigators

II. Initiating and Conducting Internal Reviews

- A. Establish clear protocols for when an “internal review” begins.
 1. Not necessarily the first time a matter or an employee appears on a surveillance report.
 2. The firm’s internal policies and procedures should make clear when an “internal review” commences.

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a) Generally, it is important to be clear about the start of an internal review for fundamental due process and fairness considerations.

(1) Firms are not required to advise employees that an internal review has commenced.

(2) Firms should consider whether, in certain cases, advising the employee could hinder the investigation.

b) Form U5 concerns. Disclosure under Question 7B of the Form U5 is required for employees whose registrations are terminated (either voluntarily or for any other reason) while they are under “internal review.”

(1) It is important to identify the nature of the internal review at the outset. For purposes of the Form U5, disclosure is required when the employee is, at the time of the termination of the registration, “under internal review for fraud or wrongful taking of property, or violating investment-related statutes, regulations, rules or industry standards of conduct.” Form U5 Q.7B

(a) For example, an employee under internal review for misuse of a firm expense account or credit card would be considered to be under internal review for “fraud or wrongful taking of property.”

(b) Similarly, internal reviews into potential violations of “*investment-related* statutes, regulations, rules or industry standards of conduct” is broadly defined to include investigations pertaining to “securities, commodities, banking, insurance, or real estate (including but not limited to, acting or being associated with a broker-dealer, issuer, investment company, investment adviser, futures sponsor, bank, or savings association).” Form U5 Explanation of Terms.

(2) For purposes of Form U5, internal reviews for non-investment related statutes, regulations, rules or industry standards of conduct, and that do not involve fraud or the wrongful taking of property, do not necessarily require reporting. However, firms should carefully consider whether Q.7B reporting

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is required in the case of certain types of internal reviews. For example, the guidance is not necessarily clear whether reporting under Q.7B is required in the case of:

(a) Internal investigations into potential violations of non-compete or non-solicitation clauses in employee contracts. Previously, FINRA has advised firms that, generally, Q. 7B is “used to report matters relating to compliance, not matters of a competitive nature. Responses should not include situations relating to disputes between the firm and the individual over ownership or possession of information or records pertaining to business conducted by the individual.” Web CRD User’s Manual, Chapter 13, Disclosure (June – Version 2011.2); or

(b) Internal investigations into potential workplace conduct violations (*i.e.*, workplace discrimination or similar claims).

c) Firms should be aware that after a disclosure under Q.7B is made, the firm should “close” out, or update the disclosure when the investigation has concluded.

d) When a Q.7B disclosure is “closed out” and the firm updates the disclosure with a finding that the firm believes the representative has violated a statute, rule, or industry standard of conduct, the firm is not obligated (and should not) file a subsequent Q.7F disclosure. As discussed in more detail below, Q.7F disclosures are intended to report terminations as a result of a finding or conclusion by the firm that a representative has either committed fraud or the wrongful taking of property, or has violated an investment-related statute, rule, or industry standard of conduct, and that the representative has been terminated (or permitted to resign, or voluntarily resigned) as a result of that finding.

B. Conducting the Internal Review

1. Who conducts? Counsel? Non-attorney compliance or investigatory personnel?

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- a) Privilege considerations play an important role in determining who, or what department conducts the internal review.
 - b) If an investigation is intended to be conducted on a privileged basis, steps should be taken at the outset to have the business client direct or request that an attorney conduct the review for purposes of providing legal advice to the firm. Second, there should be clear delineations of responsibility in order that it can be demonstrated that counsel is directing the investigation once requested. This permits the use of non-legal resources (compliance, security, etc.) to conduct aspects of the investigation “at the direction of counsel.” Finally, interim and final reporting lines back to the business client should be clearly established, keeping in mind that the larger the reporting group, the more likely an inadvertent dissemination of privileged communications becomes.
2. Establish process to advise business/supervisory personnel about initiation of review.
- a) Keeping in mind the privilege considerations above, protocols for advising managers within the relevant business lines should be established in order that those managers can fulfill any upstream or other reporting they may need to make.
3. Be clear about scope of the review.
- a) If time is of the essence (*i.e.*, is there a risk of immediate financial or other harm to a customer or to the markets), investigations should be targeted to identify relevant facts as quickly as possible.
 - b) In other circumstances, investigators should be empowered to follow up on leads, red flags, or other facts and circumstances that, in their experience, warrant additional review.
4. Also keeping in mind the privilege points above, investigators and the business should be clear about the timing, manner of delivery, and to whom final investigative reports, conclusions and/or recommendations will be made. Establish procedures for any interim reporting, if necessary.
5. Employee interviews

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a) Upjohn warnings: “Soft” v. “Full” Upjohn. See generally, Upjohn Co. v. United States, 449 U.S. 383 (1981). When conducting investigations, the role of any attorney conducting the review should be explained to any associated person interviewed during the course of the review. It should, at a minimum, be made clear that the attorney conducting the review represents the firm, not any particular individuals, and that, while the interviews themselves may be privileged, the privilege belongs to the firm and that any information learned during the course of the review may be shared by the firm with its regulators. The extent of the Upjohn warning may depend on whether the interviewee is a target or subject of the investigation, or a fact witness. The fact an Upjohn warning has been given should be documented within the interview notes.

C. Internal risk, audit or other institutional reporting procedures

1. Many firms have internal audit, risk or other reporting structures that require certain types of internal reporting of ongoing investigations or other similar reviews.

2. For such internal reporting, be cognizant of privilege and jurisdictional issues

a) For example, would reporting of particular information about an internal investigation to a parent company or foreign affiliate jeopardize the privilege?

b) Additionally, consider whether such external reporting could impact or expand the jurisdictional reach of particular regulators.

III. Post-Disciplinary Action Regulatory Reporting

A. FINRA Reporting – Form U5 and Rule 4530

1. Form U5 is the form used to terminate a registered person’s U4 with a particular firm. Termination disclosures are carefully scrutinized by FINRA. U5s must be filed within 30 calendar days of termination. Firms are required to amend the U5 of a former registered employee if it learns of any reportable event regarding the former employee that occurred while the employee was employed by the member firm. Amendments to Form U5 must be made within 30 calendar days of the date the firm “learn[s] of the facts or circumstances giving rise to the amendment.” Updates to Form U5 are filed through Web CRD.

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- a) Internal Review and Termination Disclosures under Form U5
 - (1) Form U5 Question 3.
 - (a) Question 3 of the Form U5 requires firms to indicate the “reason for termination” of the representative’s registration. Radio buttons within Q.3 allow for the firm to respond with “discharged,” “other,” “permitted to resign,” “deceased,” or “voluntary.”
 - (b) Indicating “permitted to resign,” “discharged,” or “other” requires a narrative explanation for the reason for the termination.
 - (i) “Other” is used most commonly in situations involving reductions in force, reorganizations, or similar circumstances.
 - (c) While amendments to a Q.3 disclosure are permitted, firms must provide a specific reason why any such amendment is being made.
 - (d) Disclosures under Q.3 are not publicly available through BrokerCheck.
 - (2) Form U5 Question 7B
 - (a) As discussed above, Question 7B asks whether, at the time of the termination of the representative’s registration, was the representative “under internal review for fraud or wrongful taking of property, or violating investment-related statutes, regulations, rules, or industry standards of conduct.”
 - (b) A common circumstance requiring a Q.7B disclosure occurs when a registered person is advised that they are under internal review for a potential investment-related issue, and prior to an interview (or prior to the conclusion of the review), the representative voluntarily resigns.
 - (i) In this case, the termination disclosure under Q.3 of Form U5 will still be “voluntary”, but

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the required disclosure under Q.7B will provide FINRA with details concerning the investigation.

(c) The Form U5 Explanation of Terms does not define “internal review.” For firms with formalized internal review or internal investigation protocols, whether a representative was under “internal review” at the time of the termination of their registration should be clear. For firms without formalized internal review procedures, whether a representative was under internal review at the time of the termination of the registration will be facts and circumstances dependent.

(d) Question 7B disclosures are not publicly available on BrokerCheck, but are available to FINRA, potential employers entitled to view a representative’s Central Registration Depository (“CRD”) records, and to state securities regulators.

(3) Form U5 Question 7F

(a) Form U5 Question 7F asks:

Did the individual voluntarily resign from your firm, or was the individual discharged or permitted to resign from your firm, after allegations were made that accused the individual of:

1. violating investment-related statutes, regulations, rules, or industry standards of conduct?
2. fraud or the wrongful taking of property?
3. failure to supervise in connection with investment-related statutes, regulations, rules, or industry standards of conduct?

(b) While there is no specific written guidance from FINRA on this point, it is understood that the “allegations were made” language is intended to require reporting when a firm has reached a conclusion that one of the violations enumerated in 1-3 has taken place, and, as a

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result of that conclusion, the firm has either discharged the representative, the representative has voluntarily resigned, or the representative has been “permitted to resign.”

(c) Advising a representative that they are under internal review (and therefore subject to a Q.7B report if they resign) does not rise to the level of “allegations were made” requiring a Q.7F report.

(d) Post-investigation conclusions of violations involving a representative who voluntarily resigned and was subject to a Q.7B report do not require a subsequent Q.7F report.

(e) Question 7F disclosures are publicly available through BrokerCheck.

b) A form U5 filing does not obviate the need for a Form U4 amendment filing by the registered representative once he/she learns of the reportable event. Thus a Form U5 filing by a former firm may require an amended U4 filing by that registered representative at his or her new firm.

c) Regulatory Notice 10-39

(1) Regulatory Notice 10-39 “reminds firms of their obligation to provide timely, complete and accurate information on Form U5.”

(2) “FINRA notes that, with respect to factual situations that would cause a reasonable person to answer affirmatively any disclosure question in Form U5, a firm may not parse through the questions in a manner that would allow the firm to avoid responding affirmatively to a question.” (emphasis added).

(3) Specifically, in Reg. Notice 10-39, FINRA advises firms that:

- “A firm must provide sufficient detail when responding to Form U5 questions such that a reasonable person may understand the circumstances that triggered the affirmative response. For example, for purposes of Section

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3 on Form U5, it is not sufficient for a firm to report only that a person's registration was terminated because that person violated 'firm policy.' If a firm is obligated to report that a registered person was terminated because he or she violated a firm policy, the firm must identify the policy, provide sufficient facts and circumstances to enable the reader to understand what conduct was involved, and review other questions on the form to determine whether an affirmative response to any other question is required."

- "A firm that is terminating a registered person for misconduct subject to disclosure specified in Question 7F is required to answer that question in the affirmative, irrespective of whether or not the firm is the entity making the allegations of misconduct. Question 7F asks whether the individual who is the subject of the Form U5 voluntarily resigned, or was discharged or permitted to resign, after allegations were made that accused the individual of certain types of misconduct. Question 7F does not specify or require that the terminating firm be the source of those allegations. For example, if an affiliate of a firm employing a registered person discharges the registered person after making allegations of fraud against that person and the firm thereafter discharges the person, the firm would need to provide an affirmative answer to the appropriate part of Question 7F and indicate that it was discharging the person after allegations of fraud had been made against him or her."
 - "A firm should err on the side of interpreting the term 'investment-related' in an expansive manner in line with the scope of the term when reporting information on Form U5. The scope of the term pertains to securities, commodities, banking, insurance or real estate (including, but not limited to, acting as or being associated with a broker-dealer, issuer, investment company, investment adviser, futures sponsor, bank or savings association). Accordingly, a firm may be required to provide an affirmative answer to a question even if the matter is not securities-related. Furthermore, the type of conduct

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described in Form U5 questions need not always pertain to or involve a customer of the terminating firm in order to require an affirmative answer. Several questions ask about specific types of misconduct without regard to whether such misconduct involved a customer of the terminating firm. Therefore, the issue of whether the conduct involved a customer of the terminating firm is not necessarily determinative as to whether the conduct may require an affirmative answer to a Form U5 question.”

d) Other Sources For Form U5 Interpretive Guidance

(1) Form U4/U5 Frequently Asked Questions

(a) The FAQs are a disclosure-question by disclosure-question series of Q&As that address many key reporting scenarios. The FAQs may be found at <http://www.finra.org/Industry/Compliance/Registration/CRD/FilingGuidance/>.

2. Reporting Internal Discipline or Terminations Under FINRA Rule 4530

a) FINRA Rule 4530 requires reporting whenever the member or person associated with the member:

(1) has been found to have violated any securities-, insurance-, commodities-, financial- or investment-related laws, rules, regulations or standards of conduct of any domestic or foreign regulatory body, self-regulatory organization or business or professional organization (4530(a)(1)(A));

(2) is the subject of any written customer complaint involving allegations of theft or misappropriation of funds or securities or of forgery (4530(a)(1)(B));

(3) is named as a defendant or respondent in any proceeding brought by a domestic or foreign regulatory body or self-regulatory organization alleging the violation of any provision of the Exchange Act, or of any other federal, state or foreign securities, insurance or commodities statute, or of any rule or regulation thereunder, or of any provision of the by-laws, rules or similar governing instruments of any securities, insurance or

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commodities domestic or foreign regulatory body or self-regulatory organization (4530(a)(1)(C));

(4) is denied registration or is expelled, enjoined, directed to cease and desist, suspended or otherwise disciplined by any securities, insurance or commodities industry domestic or foreign regulatory body or self-regulatory organization or is denied membership or continued membership in any such self-regulatory organization; or is barred from becoming associated with any member of any such self-regulatory organization (4530(a)(1)(D));

(5) is indicted, or convicted of, or pleads guilty to, or pleads no contest to, any felony; or any misdemeanor that involves the purchase or sale of any security, the taking of a false oath, the making of a false report, bribery, perjury, burglary, larceny, theft, robbery, extortion, forgery, counterfeiting, fraudulent concealment, embezzlement, fraudulent conversion, or misappropriation of funds, or securities, or a conspiracy to commit any of these offenses, or substantially equivalent activity in a domestic, military or foreign court (4530(a)(1)(E));

(6) is a director, controlling stockholder, partner, officer or sole proprietor of, or an associated person with, a broker, dealer, investment company, investment advisor, underwriter or insurance company that was suspended, expelled or had its registration denied or revoked by any domestic or foreign regulatory body, jurisdiction or organization or is associated in such a capacity with a bank, trust company or other financial institution that was convicted of or pleaded no contest to, any felony or misdemeanor in a domestic or foreign court (4530(a)(1)(F));

(7) is a defendant or respondent in any securities- or commodities-related civil litigation or arbitration, is a defendant or respondent in any financial-related insurance civil litigation or arbitration, or is the subject of any claim for damages by a customer, broker or dealer that relates to the provision of financial services or relates to a financial transaction, and such civil litigation, arbitration or claim for damages has been disposed of by judgment, award or settlement for an amount exceeding

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\$15,000. However, when the member is the defendant or respondent or is the subject of any claim for damages by a customer, broker or dealer, then the reporting to FINRA shall be required only when such judgment, award or settlement is for an amount exceeding \$25,000 (4530(a)(1)(G));

(8) is, or is involved in the sale of any financial instrument, the provision of any investment advice or the financing of any such activities with any person who is, subject to a “statutory disqualification” as that term is defined in the Exchange Act. The report shall include the name of the person subject to the statutory disqualification and details concerning the disqualification (4530(a)(1)(H)); or

b) FINRA Rule 4530(a)(2) reporting is required when “an associated person of the member is the subject of any disciplinary action taken by the member involving suspension, termination, the withholding of compensation or of any other remuneration in excess of \$2,500, the imposition of fines in excess of \$2,500 or is otherwise disciplined in any manner that would have a significant limitation on the individual’s activities on a temporary or permanent basis.” (4530(a)(2))

(1) Note that the scope of “associated persons” is broader than simply registered persons. FINRA By-Laws Article I(rr) defines “person associated with a member” or “associated person of a member” as “(1) a natural person who is registered or has applied for registration under the Rules of the Corporation; (2) a sole proprietor, partner, officer, director, or branch manager of a member, or other natural person occupying a similar status or performing similar functions, or a natural person engaged in the investment banking or securities business who is directly or indirectly controlling or controlled by a member, whether or not any such person is registered or exempt from registration with the Corporation under these By-Laws or the Rules of the Corporation; and (3) for purposes of Rule 8210, any other person listed in Schedule A of Form BD of a member.”

(2) FINRA has not specifically delineated what constitutes “disciplinary action.” Generally speaking, reducing a bonus for poor performance would not be considered a “disciplinary

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action,” but if the firm has reached a conclusion about an associated persons potentially violative conduct and imposes one of the enumerated sanctions, then that would be considered “disciplinary” activity.

(3) Rule 4530(a)(2) disclosures are not necessarily restricted to “securities-related” or “investment-related” conduct. Any suspensions, fines, or other disciplinary actions that meet the reporting thresholds should be evaluated for potential reporting.

c) The 4530(b) self-reporting requirements are meant to address conduct that has “widespread or potential widespread impact to the firm, its customers or the markets or conduct that arises from a material failure of the firm’s systems, policies or practices involving numerous customers, multiple errors or significant dollar amounts.”

(1) Not all remedial measures require a corresponding self-report.

(2) Firm procedures should clearly identify person responsible for determining whether a violation has occurred and whether it requires reporting, establish a protocol for escalating potential violations, and provide a protocol for reporting internal conclusions of violations.

d) Sources for Guidance on 4530 Reporting

(1) Regulatory Notice 11-06 (Rule 4530)

(2) Regulatory Notice 11-32

(3) FINRA’s Rule 4530 Frequently Asked Questions.
<https://www.finra.org/filing-reporting/regulatory-filing-systems/rule-4530/faq>

B. SEC - Form ADV Disclosures for Investment Advisers

1. Form ADV Parts 1 (Item 11) and 2 (Item 9) require disclosure of information regarding certain events related to the disciplinary history of the advisory firm and the disciplinary history of all advisory affiliates. Several key disclosures include, but are not limited to, false statements or omissions made to the SEC or CFTC; false statements or omissions made to any foreign financial

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regulatory authority; and whether a broker has been enjoined for any investment related activity by any domestic or foreign court.

a) However, while the Form ADV requires disclosure of certain “disciplinary” events, it does not require the disclosure of internal disciplinary actions or terminations.

b) The fact of the departure from the adviser of certain individuals may constitute a “material change” to the adviser that would require reporting under Form ADV or an update to the ADV Brochure, but it is not necessarily the case that the reasons for a departure are required to be disclosed. Advisory firms should carefully evaluate whether the imposition of internal disciplinary action or terminations are of sufficient materiality to warrant public disclosure.

C. Suspicious Activity Reports under the Bank Secrecy Act

1. With two limited exceptions, broker-dealers are not required to file SARS on federal securities law or SRO rule violations if they report the violation to the SEC or SRO. This applies to employees misconduct also. The exception is that BSA violations with regard to currency reporting and foreign transactions must always be reported.

2. In practice, broker-dealers typically only report employee violations (unless involves fraud, theft or other egregious conduct) to SEC or SRO. In instances in which it is egregious misconduct firms will report to SEC and/or SRO and file a SAR Also.

3. Core requirements contained within 31 C.F.R § 1023.320, which provides:

(a) General.

(1) Every broker or dealer in securities within the United States (for purposes of this section, a “broker-dealer”) shall file with FinCEN, to the extent and in the manner required by this section, a report of any suspicious transaction relevant to a possible violation of law or regulation. A broker-dealer may also file with FinCEN a report of any suspicious transaction that it believes is relevant to the possible violation of any law or regulation but whose reporting is not required by this section. Filing a report of a suspicious transaction does not relieve a broker-dealer from the responsibility of complying with any other

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reporting requirements imposed by the Securities and Exchange Commission or a self-regulatory organization (“SRO”) (as defined in section 3(a)(26) of the Securities Exchange Act of 1934, 15 U.S.C. 78c(a)(26)).

(2) A transaction requires reporting under the terms of this section if it is conducted or attempted by, at, or through a broker-dealer, it involves or aggregates funds or other assets of at least \$5,000, and the broker-dealer knows, suspects, or has reason to suspect that the transaction (or a pattern of transactions of which the transaction is a part):

- (i) Involves funds derived from illegal activity or is intended or conducted in order to hide or disguise funds or assets derived from illegal activity (including, without limitation, the ownership, nature, source, location, or control of such funds or assets) as part of a plan to violate or evade any Federal law or regulation or to avoid any transaction reporting requirement under Federal law or regulation;
- (ii) Is designed, whether through structuring or other means, to evade any requirements of this chapter or of any other regulations promulgated under the Bank Secrecy Act;
- (iii) Has no business or apparent lawful purpose or is not the sort in which the particular customer would normally be expected to engage, and the broker-dealer knows of no reasonable explanation for the transaction after examining the available facts, including the background and possible purpose of the transaction; or
- (iv) Involves use of the broker-dealer to facilitate criminal activity.

(3) The obligation to identify and properly and timely to report a suspicious transaction rests with each broker-dealer involved in the transaction, provided that no more than one report is required to be filed by the broker-dealers involved in a particular transaction (so long as the report filed contains all relevant facts).

(b) Filing procedures -

(1) What to file. A suspicious transaction shall be reported by completing a Suspicious Activity Report (“SAR”), and collecting and maintaining supporting documentation as required by paragraph (d) of this section.

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(2) Where to file. The SAR shall be filed with FinCEN in a central location, to be determined by FinCEN, as indicated in the instructions to the SAR.

(3) When to file. A SAR shall be filed no later than 30 calendar days after the date of the initial detection by the reporting broker-dealer of facts that may constitute a basis for filing a SAR under this section. If no suspect is identified on the date of such initial detection, a broker-dealer may delay filing a SAR for an additional 30 calendar days to identify a suspect, but in no case shall reporting be delayed more than 60 calendar days after the date of such initial detection. In situations involving violations that require immediate attention, such as terrorist financing or ongoing money laundering schemes, the broker-dealer shall immediately notify by telephone an appropriate law enforcement authority in addition to filing timely a SAR. Broker-dealers wishing voluntarily to report suspicious transactions that may relate to terrorist activity may call FinCEN's Financial Institutions Hotline at 1-866-556-3974 in addition to filing timely a SAR if required by this section. The broker-dealer may also, but is not required to, contact the Securities and Exchange Commission to report in such situations.

(c) Exceptions.

(1) A broker-dealer is not required to file a SAR to report:

(i) A robbery or burglary committed or attempted of the broker-dealer that is reported to appropriate law enforcement authorities, or for lost, missing, counterfeit, or stolen securities with respect to which the broker-dealer files a report pursuant to the reporting requirements of 17 CFR 240.17f-1;

(ii) A violation otherwise required to be reported under this section of any of the Federal securities laws or rules of an SRO by the broker-dealer or any of its officers, directors, employees, or other registered representatives, other than a violation of 17 CFR 240.17a-8 or 17 CFR 405.4, so long as such violation is appropriately reported to the SEC or an SRO.

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(2) A broker-dealer may be required to demonstrate that it has relied on an exception in paragraph (c)(1) of this section, and must maintain records of its determinations to do so for the period specified in paragraph (d) of this section. To the extent that a Form RE-3, Form U-4, or Form U-5 concerning the transaction is filed consistent with the SRO rules, a copy of that form will be a sufficient record for purposes of this paragraph (c)(2).

(3) For the purposes of this paragraph (c) the term “Federal securities laws” means the “securities laws,” as that term is defined in section 3(a)(47) of the Securities Exchange Act of 1934, 15 U.S.C. 78c(a)(47), and the rules and regulations promulgated by the Securities and Exchange Commission under such laws.

D. NFA Disclosures

1. Termination disclosures under Form 8T

a) For registered representatives who are also futures-licensed (Series 3), reasons for terminations are disclosed under the NFA’s Form 8T.

b) If a firm files a Form U5, Form 8T incorporates the questions in the Form U5 and allows for filing the same information with NFA.

E. State Insurance Regulators

1. For representatives with state insurance licenses, it is important to consider whether the imposition of any disciplinary action by the firm (including terminations) require additional reporting to any state insurance regulator.

2. Termination disclosures under NAIC Uniform Forms

a) Each state’s laws and applicable regulations should be consulted for specific reporting requirements. For those states that have adopted the National Association of Insurance Commissioners (“NAIC”) Uniform Application for Individual Producer License/Registration, specific disclosures of internal disciplinary actions is not required. However, if a representative’s employment is terminated, that representative will have an obligation to promptly update their information with all states where they are insurance licensed.

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- F. (Non-SAR) Banking Regulator Disclosures/Considerations
- a) No comparable Form U5, Rule 4530, Form ADV or self-reporting requirements.
 - b) Possible Overlap Disclosure Requests - In limited situations, banking regulators may request information on terminated employees by affiliated securities entities that are subject to banking regulators purview. See OCC Comptroller’s Handbook “Government Securities Act” booklet.
 - c) In 2014, and again in 2017, officials from the Federal reserve bank of New York floated the idea of a securities-industry style system of disclosure designed to spot “rolling bad apples.” See Remarks of William C. Dudley, Enhancing Financial Stability by Improving Culture in the Financial Services Industry (October 20, 2014)(www.newyorkfed.org/newsevents/speeches/2014/dud141020a) (“... one approach would be to create a central registry that tracks the hiring and firing of traders and other financial professionals across the industry. There would be many details to sort out regarding how to do this in a manner that was both transparent and consistent with due process.”); see also, Remarks of Michael Held, Reforming Culture and Conduct in the Financial Services Industry: How Can Lawyers Help? (March 8, 2017)(www.newyorkfed.org/newsevents/speeches/2017/hel170308#)
- G. Self-Reporting as an Essential Element of “Cooperation Credit”
- 1. FINRA Cooperation Credit Guidance
 - a) Sanction Guidelines – Principal Considerations No. 2: “Whether an individual or member firm respondent accepted responsibility for and acknowledged the misconduct to his or her employer (in the case of an individual) or a regulator prior to detection and intervention by the firm (in the case of an individual) or a regulator.” FINRA Sanction Guidelines (2019).
 - b) Regulatory Notice 19-23
“Enforcement may recommend a sanction that is well below the range set forth in the Sanction Guidelines or comparable precedents when respondents have voluntarily provided such

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material assistance to FINRA in its investigation, or effected such expedient and effective remediation, that FINRA deems these steps to constitute “extraordinary cooperation” beyond what it requires of any member firm or associated person. Member firms and associated persons who take proactive and voluntary steps well beyond those required under FINRA rules materially assist FINRA in meeting its goals of investor protection and market integrity. To recognize and incentivize such conduct, FINRA weighs these mitigating factors so heavily that the outcome of the matter is materially different than it would have been absent the respondent’s extraordinary conduct.”

FINRA Reg. Not. 19-23 (July 11, 2019) (www.finra.org/rules-guidance/notices/19-23)

2. SEC Cooperation Considerations

a) “The discussion of whether and when to self-report is, I think, a bit more developed in the context of FCPA cases than in other types of cases. As I have previously said, companies are gambling if they fail to self-report FCPA misconduct to us. After all, given the success of the SEC’s whistleblower program, we may well hear about that conduct from another source. But self-reporting is advisable not just in the FCPA context. Firms need to be giving additional consideration to it in other contexts as well. This includes self-reporting by registered firms of misconduct by associated persons, for example, and misconduct by issuer employees. Where Enforcement staff uncovers such misconduct ourselves, a natural question for us to ask is why the firm didn’t tell us about it. Was it because the firm didn’t know of the misconduct? If so, what does that say about the firm’s supervisory systems, compliance program, and other controls? On the other hand, if the firm did know about it, and the misconduct was significant, why didn’t the firm report it to us? There will be significant consequences in that scenario from the failure to self-report.” *The SEC’s Cooperation Program: Reflections on Five Years of Experience*, Remarks of Andrew Ceresney, Director, Division of Enforcement, May 13, 2015 (www.sec.gov/news/speech/sec-cooperation-program.html)

b) Key Elements for cooperation credit are found in the 2001 *Seaboard Report* and include: (1) Self-policing prior to the discovery of

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the misconduct, including establishing effective compliance procedures and an appropriate tone at the top; (2) Self-reporting of misconduct when it is discovered, including conducting a thorough review of the nature, extent, origins and consequences of the misconduct, and promptly, completely and effectively disclosing the misconduct to the public, to regulatory agencies, and to self-regulatory organizations; (3) Remediation, including dismissing or appropriately disciplining wrongdoers, modifying and improving internal controls and procedures to prevent recurrence of the misconduct, and appropriately compensating those adversely affected; and (4) Cooperation with law enforcement authorities, including providing the Commission staff with all information relevant to the underlying violations and the company's remedial efforts. SEC Exch. Act Rel. 44969 (October 23, 2001) (<https://www.sec.gov/litigation/investreport/34-44969.htm>)

3. Commodity Futures Trading Commission

a) Cooperation credit considered when the party: (i) voluntarily reports the wrongdoing to the CFTC's enforcement division, (ii) fully cooperates with the division through the investigation, and (iii) timely and appropriately remediates the misconduct. See, Speech by James McDonald, CFTC Division of Enforcement, Sept. 25, 2017 (www.cftc.gov/PressRoom/SpeechesTestimony/opamcdonald092517)

4. Department of Justice

a) Modifying the approach of the Yates Memorandum (Sept. 9, 2015) (<https://www.justice.gov/archives/dag/file/769036/download>), which required the identification of "all" involved individuals in order to receive "any" cooperation credit, the revisions to the Justice Manual (formerly the U.S. Attorneys' Manual), Title 9, Sec. 9-28.700 "The Value of Cooperation" calls for the identification of those "substantially involved" in the misconduct:

General Principle: In order for a company to receive any consideration for cooperation under this section, the company must identify all individuals substantially involved in or responsible for the misconduct at issue, regardless of their position, status or seniority, and provide to the Department all relevant facts relating to that misconduct. If a company seeking

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cooperation credit declines to learn of such facts or to provide the Department with complete factual information about the individuals substantially involved in or responsible for the misconduct, its cooperation will not be considered a mitigating factor under this section.

IV. Private Litigation Concerns and Regulatory Follow-Up

A. Defamation claims based on Form U5 Disclosures

1. Generally speaking, a representative who seeks to have information related to the reasons for a termination expunged from their CRD records must proceed under protocols established under what is known as the “1999 Moratorium.” See NASD Notices to members 99-09 and 99-54. These types of expungement requests are not governed by Rule 2080, which involves only requests to expunge customer dispute information.

2. Under the 1999 Moratorium, an arbitration panel may grant expungement of disclosures related to a termination if they make an affirmative finding that expungement is warranted due to the “defamatory nature of the information.” Awards under the 1999 Moratorium’s protocol do not have to be confirmed by a court of competent jurisdiction before CRD will remove the information.

3. FINRA has not defined what constitutes information that is “defamatory in nature” – a standard that appears to require less than a finding of actual defamation.

4. While in most cases, arbitration panels are not required to provide the reasons for its awards, if expungement relief is granted, the award will specify that the expungement has been granted due to the “defamatory nature” of the information disclosed.

5. Absolute v. Qualified Immunity

a) In addition to the customary defenses to defamations claims (*i.e.*, the truth of the information disclosed), many states a qualified immunity from liability for statements made in Form U5 filings. See, e.g., Dickinson v. Merrill Lynch, Pierce, Fenner & Smith Inc., 431 F. Supp. 2d 247, 261–62 (D. Conn. 2006); Andrews v. Prudential Sec. Inc., 160 F.3d 304, 307 (6th Cir. 1998) (applying Michigan law); Glennon v. Dean Witter Reynolds, Inc., 83 F.3d 132, 137 (6th Cir. 1996) (applying Tennessee law); Baravati v.

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Josephthal, Lyon & Ross, Inc., 28 F.3d 704, 708 (7th Cir. 1994); see also Uniform Securities Act Section 507 (providing for qualified privilege); Haw. Rev. Stat. Ann. § 485A-507; Iowa Code Ann. § 502.507; Me. Rev. Stat. Ann. 32 § 16507; Minn. Stat. Ann. § 80A.74; S.C. Code Ann. § 35-1-507.

b) New York and California have applied absolute privileges to Form U5 disclosures. See, Rosenberg v. Metlife, Inc., 866 N.E.2d 439, 445 (N.Y. 2007) (“Form U-5’s compulsory nature and its role in [FINRA’s] quasi-judicial process, together with the protection of public interests, lead us to conclude that statements made by an employer on the form should be subject to an absolute privilege.”); Fontani v. Wells Fargo Invest., LLC, 28 Cal. Rptr. 3d 833, 840-41 (Cal. App. 2005) (finding that U5 disclosures are entitled to absolute immunity and protection under California anti-SLAPP statute).

B. FINRA Regulatory Inquiries

1. FINRA’s Office of Fraud Detection and Market Intelligence (“OFDMI”), reviews all Form U5 disclosures (especially termination disclosures under Q.7F and reports of internal investigations under Q.7B. This group also reviews all Rule 4530(a)(2) filings and will typically follow up on these disclosures with targeted preliminary investigation requests.

C. State regulatory inquiries

1. State securities regulators are the co-owners of the Central Registration Depository (“CRD”) and will often review termination disclosures for potentially problematic brokers or activity.

V. Post-Action Reviews and Remedial Action

A. Regulatory expectation to conduct post-action review and take effective steps to remedy.

1. FINRA’s considerations when determining whether and to what extent to impose sanctions for misconduct include whether a firm (i) accepted responsibility for and acknowledged the misconduct prior to detection and intervention by the firm or a regulator; (ii) voluntarily employed subsequent corrective measures, prior to detection or intervention by the firm or by a regulator, to revise general and/or specific procedures to avoid recurrence of the misconduct; (iii) voluntarily and reasonably attempted, prior to detection and

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intervention by a regulator, to pay restitution or otherwise remedy the misconduct; and (iv) provided substantial assistance to FINRA in its examination and/or investigation of the underlying misconduct. FINRA Sanction Guidelines (March 2019)(emphasis added).

2. The effectiveness of a firm's response to the discovery of misconduct can serve as the basis for a finding of "extraordinary cooperation." See Regulatory Notice 19-23 ("... Enforcement may consider it 'extraordinary' if a firm takes significant steps to effect speedy restitution, such as re-prioritizing other projects or developing a rules-based approach to accelerate the process. Under those circumstances, FINRA may consider these additional steps so extraordinary that it recommends a sanction well below the Sanction Guidelines or other similar cases.")