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REPORT

ENFORCEMENT

Use of Independent Consultants as a Remedy in Securities Enforcement Actions

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Over the past two decades the use of independent consultants as a remedy in securities enforcement actions has grown sharply. The Securities and Exchange Commission ("SEC" or "Commission"), self-regulatory organizations ("SROs"), the Department of Justice, and state regulators (collectively "Regulators"), have all mandated the hiring of independent consultants[1] as a part of settlements and adjudicated deci-

[1] Independent consultants have various names: compliance consultants, disbursement consultants, and monitors. Deferred prosecution agreements often require the appointment of a

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sions.[2] While the use of independent consultants used to be a rare exception, in certain types of cases it has now become part of the Regulators' standard operating procedures to require some kind of independent consultant as part of the remedy, unless facts show that the respondent has taken aggressive steps to identify past errors, remedy those errors, and put safeguards in place to prevent future violations. The nature of the tasks assigned to independent consultants has also evolved to include disbursement of funds, recommending new procedures, overseeing future actions, reporting on future compliance, and more. In some instances independent consultants are called upon to do factual investigations and draw legal conclusions about prior conduct.[3]

Independent consultants offer obvious benefits to Regulators. A Regulator can use an independent consultant to leverage its limited resources. After investigating and reaching a settlement or obtaining a judgment against a respondent, the Regulator can turn over other tasks to an independent consultant, freeing enforcement staff to pursue other cases. A Regulator can also use an independent consultant to perform tasks for which it is poorly suited, such as making disbursements to thousands of possible claimants, recommending new policies and procedures in technical areas, or preparing detailed analyses of compliance going forward.

Perhaps less obvious are the potential advantages to the respondent, who must pay for the independent consultant to recommend potentially costly changes, monitor future compliance, or perform other tasks. While independent consultants are expensive and require a great deal of energy to work with, an independent consultant's less formal methods may be less expensive and disruptive than the methods typically employed by Regulators. In some instances, the use of an independent consultant to review possible violations that have not been fully investigated by the Regulator allows the respondent to bring public closure to a matter by reaching a settlement while the independent consultant's work is performed out of the public eye. By agreeing to hire an independent consultant, a respondent can also avoid other sanctions that the public would perceive as more opprobrious still.

Despite the advantages to both the Regulator and the respondent, the appointment of an independent consultant nevertheless creates an unusual relationship that may ultimately prove unsatisfactory to the respondent.

Accordingly, there are steps that can be taken to lessen the impact of an independent consultant or even to avoid the requirement on an independent consultant altogether. Respondents can make the case to Regulators that the use of an independent consultant is unnecessary or that the tasks assigned to the independent consultant should be limited. To achieve either of these goals the respondent must address the problems before a formal resolution of the Regulator's case, whether by settlement or adjudication. Early efforts can show that the respondent understands and appreciates the Regulator's concerns. These steps can include investigation and reporting on any problems identified by, hinted at, or even unknown to the Regulators, remediation of harm by making voluntary restitution, adopting policies and procedures to prevent future problems, and changes in the responsible personnel. These same steps also provide a starting point for limiting other sanctions such as fines, suspensions, and limitations on activities. They can also be the basis for requesting credit for cooperation.[4]

If the Regulator insists on an independent consultant as part of a settlement, respondents should take care negotiating the settlement document so that the language requiring an independent consultant is clear and avoids an overly broad mandate. The respondent should exercise similar care negotiating the terms of the engagement with the independent consultant.

The use of a third party to recommend and monitor the performance of independent consultants can provide a means of improving the unusual relationship between respondents and independent consultants appointed pursuant to settlements or litigated proceedings.

1. Background

The federal securities laws provide the SEC with a wide range of authority to enforce the laws and protect investors. Section 8A of the Securities Act of 1933 (the

government selected ''monitor'' to oversee compliance with the agreement. The duties of a monitor are functionally similar to the duties of some independent consultants appointed pursuant to an SEC or SRO order. In this article, the term ''independent consultant'' will be used to describe these various kinds of consultants and monitors.

[2] The requirement to retain an independent consultant can be imposed upon: (1) a defendant in a civil suit or in a criminal proceeding brought by a government agency; or (2) a respondent in an administrative proceeding brought by a government agency or an SRO. Recently, the U.S. Sentencing Commission proposed an amendment to the sentencing guidelines that would categorically require independent consultants for all companies sentenced to probation. *See* Brendan Pierson, *Attorneys Fear Return of Outside Compliance Monitors*, Law360 (Mar. 4, 2010), *available at* http://www.law360.com/articles/148680. The requirement is most frequently part of a settlement. For ease of description, this article will use the term ''respondent'' to describe the party that has the obligation to retain an independent consultant or complete some other undertaking.

[3] *See, e.g.*, In re BT Securities Corp., Admin Proc. File No. 3-8579, 1994 SEC LEXIS 4041 (Dec. 22, 1994) (requiring an independent consultant to report on ''any and all improper conduct engaged in by BT Securities with respect to the marketing, offer, purchase, sale, amendment, termination or valuation of privately negotiated over-the-counter derivatives products'' and ''any disciplinary actions against individuals that may be warranted''); In re MBIA Inc., Admin. Proc. File No. 3-12551, 2007 SEC LEXIS 171 (Jan. 29, 2007) (requiring independent consultant to report on, among other topics, ''whether MBIA acted in a manner consistent with generally accepted accounting principles ('GAAP') and the federal securities laws'').

[4] Credit for cooperation is recognized by the SEC and most other Regulators. *See* 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 Actions, Exchange Act Rel. No. 44969, Accounting & Auditing Enforcement Rel. No. 1470 (Oct. 23, 2001) (commonly referred to as the ''Seaboard Report''); Policy Statement Concerning Cooperation by Individuals in its Investigations and Related Enforcement Actions, SEC Rel. No. 34-61340; FINRA Provides Guidance Regarding Credit for Extraordinary Cooperation, Regulatory Notice 08-70 (Nov. 2008); NYSE Information Memorandum 05-65 (Sept. 14, 2005); United States Attorneys' Manual § 9-27.001 *et seq.*, *available at* http://www.justice.gov/usao/eousa/foia_reading_room/usam/.

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''Securities Act'') and Sections 21 and 21C of the Securities Exchange Act of 1934 (the ''Exchange Act'') provide the SEC with a variety of remedies. The SEC can bring a civil action in the proper federal district court.[5] The SEC can also bring administrative and cease and desist actions.[6] In civil actions the SEC is authorized to seek permanent and temporary injunctions, money penalties, equitable relief, an order prohibiting persons from participating in an offering of penny stocks, and ''any equitable relief that may be appropriate or necessary for the benefit of investors.''[7] Similarly, SROs, such as the Financial Industry Regulatory Authority (''FINRA''), have broad authority to enforce their rules. FINRA is authorized to censure, fine, suspend, and impose any other fitting sanction. Other SROs and states have similar authority to craft remedies.[8] Likewise, criminal authorities often impose similar requirements in connection with deferred prosecution agreements.[9]

Some remedial actions have been regular parts of enforcement proceedings since the SEC's inception. Civil injunctions, civil money penalties, disgorgement, and restitution have been used by the Commission and SROs for decades. Other remedies, such as officer and director bars,[10] suits against ''relief defendants,''[11] compensation clawbacks,[12] and undertakings to hire independent consultants are relatively new. Independent consultants are not explicitly authorized by the federal securities laws. They are generally a by-product of settlements containing undertakings on the part of respondents to perform certain actions.[13] Regulators can impose undertakings pursuant to their authority to impose ''any equitable relief appropriate and necessary'' or ''other fitting sanctions.'' These undertakings create obligations to perform such actions as providing restitution to persons harmed by violative conduct, revising procedures, or ceasing to engage in certain kinds of business. A review of SEC settlements and decisions reveals that the regular use of independent consultants began in the early 1990s and became routine in 2003 with the market-timing cases.[14]

The variety of undertakings has increased in the past decade. The global settlement of research analyst cases included an undertaking by each settling firm to hire an independent consultant and furnish independent research for five years.[15] SEC and FINRA settlements with broker-dealers involving auction rate securities (''ARS'') included provisions allowing eligible investors the opportunity to file claims for consequential damages under special procedures administered by FINRA Dispute Resolution.[16] Pursuant to the terms of the undertaking in the ARS settlements, settling firms could only dispute the amount of consequential damages in special arbitrations. Most recently, in 2010 the SEC announced a settlement with Bank of America Corporation (''BAC'') whereby BAC was required to retain: (i) an ''Independent Auditor'' to assess BAC's disclosure controls; (ii) a ''Disclosure Counsel'' to review BAC's disclosure statements for three years; and (iii) a ''Compensation Consultant'' to work with BAC's Compensation Committee for three years.[17]

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[5] Exchange Act § 21(d)(1).

[6] Administrative proceedings are authorized by §§ 15(b)(4), 15(b)(6), 15B, 15C, 15D, 15E, and 17A of the Exchange Act. Cease and Desist proceedings are authorized by § 8A of the Securities Act and § 21C of the Exchange Act.

[7] Exchange Act § 21(d). Securities Act § 8A(a) and Exchange Act § 21C(a) provide similar authority in connection with Cease and Desist actions:

Such order may, in addition to requiring a person to cease and desist from committing or causing a violation, require such person to comply, or to take steps to effect compliance, with such provision, rule, or regulation, upon such terms and conditions and within such time as the Commission may specify in such order. Any such order may, as the Commission deems appropriate, require future compliance or steps to effect future compliance, either permanently or for such period of time as the Commission may specify, with such provision, rule, or regulation with respect to any security, any issuer, or any other person.

[8] *See, e.g.,* New York Stock Exchange Rule 476(a) (available sanctions: ''expulsion; suspension; limitation as to activities, functions, and operations, including the suspension or cancellation of a registration in, or assignment of, one or more stocks; fine; censure; suspension or bar from being associated with any member or member organization; or any other fitting sanction''); In re Jerry W. Slusser, CFTC Docket No. 94-14 (Jan. 28, 1997).

[9] Paul J. Martinek, *Case Highlights Use of Deferred Prosecution Agreements*, COMPLIANCE WEEK (June 28, 2005), *available at* http://www.complianceweek.com/article/1859/case-highlights-use-of-deferred-prosecution-agreements.

[10] Securities Act § 20(e) and Exchange Act § 21(d)(2). Prior to the passage of the Securities Enforcement Remedies and Penny Stock Reform Act of 1990, the SEC relied upon the federal courts to seek officer and director bars. 1 KENNETH B. WINER & SAMUEL J. WINER, SECURITIES ENFORCEMENT: COUNSELING & DEFENSE § 18.03[2][b] (2008).

[11] *See, e.g.*, SEC v. Antar, 120 F. Supp. 2d 431 (D.N.J. 2000), *aff'd* 44 Fed. Appx. 458 (3rd Cir. 2002).

[12] Section 304 of the Sarbanes-Oxley Act of 2002, 107 P.L. 204, Title III, § 304, 116 Stat. 745 (July 30, 2002).

[13] *See generally Kirkpatrick & Lockhart Preston Gates Ellis LLP*, THE SECURITIES ENFORCEMENT MANUAL: TACTICS & STRATEGIES 213 (2d ed. 2007); 1 WINER & WINER, *supra* note 10, at § 17.05[9].

[14] *See, e.g.,* In re Alliance Capital Management, L.P., Admin. Proc. File No. 3-11359, 2003 SEC LEXIS 2997 (Dec. 18, 2003) (requiring respondent to hire an Independent Distribution Consultant and an Independent Compliance Consultant).

[15] SEC, NY Attorney General, NASD, NASAA, NYSE and State Regulators Announce Historic Agreement To Reform Investment Practices; $1.4 Billion Global Settlement Includes Penalties and Funds for Investors, SEC Press Rel. 2002-179 (Dec. 20, 2002) (''For a five-year period, each of the brokerage firms will be required to contract with no less than three independent research firms that will provide research to the brokerage firm's customers. An independent consultant (''monitor'') for each firm, with final authority to procure independent research from independent providers, will be chosen by regulators.'').

[16] Special Arbitration Procedures for Investors Involved in Auction Rate Securities Regulatory Settlements, *available at* http://www.finra.org/ArbitrationMediation/P117440. Under the Special Arbitration Procedures (''SAPs''), firms have limited defenses. Firms may not contest liability relating to the illiquidity of the underlying ARS position or to the ARS sales, including any claims of misrepresentations or omissions of their agents. A firm cannot use as part of its defense an investor's decision not to sell ARS holdings prior to the ARS settlement date or the investor's decision not to borrow money from the firm if such loan facility was made available to ARS holders. Firms also cannot assert statutes of limitations, repose, or any other time bar principles, but may assert lack of eligibility to proceed under the SAPs. However, arbitrators may consider a firm's unconditional buyback offer at par, including the timing and delivery of such offer, in their determination of consequential damages.

[17] Final Consent Judgment, S.E.C. v. Bank of America Corp., No. 1:09-cv-06829-JSR (No. 97) (filed Feb. 24, 2010); *see*

2. Typical SEC Terms for Independent Consultants

The following terms are typically included in settlements of SEC administrative and cease and desist proceedings that provide for the appointment of an independent consultant:[18]

- The respondent shall retain, within a specified number of days from the date of the order, the services of an independent consultant not unacceptable to the staff of the Commission.
- The respondent bears all costs, including compensation and expenses, associated with the retention of the independent consultant.
- A description of the independent consultant's duties. For a broker-dealer respondent, the description typically provides: The respondent shall retain the independent consultant to: (i) review the respondent's written policies and procedures relating to the supervision of registered representatives; (ii) make recommendations concerning these policies and procedures with a view to assuring compliance with supervisory responsibilities and dedication of sufficient resources to the supervision of its registered representatives; and (iii) ensure that the respondent is complying with all remedies ordered.
- The respondent shall provide the Commission staff with a copy of an engagement letter detailing the independent consultant's responsibilities pursuant to the order.
- Within a specified time after the date of the engagement, the respondent shall require the independent consultant to issue a report and submit a copy to the Commission's staff. The independent consultant's report shall describe the review performed, the conclusions reached, and any recommendations deemed necessary.[19]
- Within a specified time (often 30 days after receipt of the independent consultant's report), the respondent shall adopt all recommendations contained in the report and remedy any deficiencies; provided, however, that as to any recommendation that the respondent believes is unnecessary or inappropriate, the respondent may, within a specified number of days after receipt of the report, advise the independent consultant and the Commission's staff in writing. With respect to any such recommendation that the respondent considers unnecessary or inappropriate, the respondent shall propose in writing an alternative policy or procedure designed to achieve the same objective or purpose.
- With respect to any recommendation with which the respondent and the independent consultant do not agree, the respondent shall attempt in good faith to reach an agreement with the independent consultant. In the event that the respondent and the independent consultant are unable to agree on an alternative proposal acceptable to the Commission's staff, the respondent will abide by the original recommendation of the independent consultant.
- Within 180 days of the entry of the order, the respondent shall submit an affidavit to the Commission's staff stating that it has implemented any and all recommendations of the independent consultant, or explaining the circumstances under which it has not implemented such recommendations.
- The respondent shall cooperate fully with the independent consultant and provide access to files, books, records, and personnel as reasonably requested for the independent consultant's review.
- The respondent shall require the independent consultant to enter into an agreement that provides that for the period of engagement and for a period of time (typically one or two years) from completion of the engagement, the independent consultant or any firm with which he is affiliated or of which he is a member, shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with the respondent, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such.

Other terms may be added as the Commission staff deem appropriate, including the ability to meet privately with company personnel, a requirement that the respondent not assert any privilege as grounds for not providing any document, or that the independent consultant will provide information obtained to the Commission staff.[20]

3. The Benefits of an Independent Consultant

a. *Benefits for the Regulator*

To the extent that one of the Regulator's chief goals is specific deterrence—ensuring that the respondent will not repeat the behavior that is the subject of the inquiry—an undertaking that requires an independent consultant can greatly increase the Regulator's confidence that the respondent will comply with the requirements in question. Independent consultants can increase compliance through several methods. First, an independent consultant can monitor compliance and report to the Regulator on a scheduled basis.[21] Second, an independent consultant can recommend changes in business methods[22] designed to prevent or decrease future violations, and the undertaking can make it very

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also Bank of America Agrees to Pay $150 Million to Settle SEC Charges; SEC Litig. Rel. No. 21407 Ex. A (Feb. 4, 2010).

[18] *See, e.g.*, In re Merriman Curhan Ford & Co., Admin. Proc. File No. 3-13681, 2009 SEC LEXIS 4177 (Nov. 10, 2009); In re Morgan Stanley & Co., Admin. Proc. File No. 3-12864, 2007 SEC LEXIS 2381 (Oct. 10, 2007).

[19] *See, e.g.*, Lankler Siffert & Wohl LLP, Report of the Independent Consultant to MBIA Inc. (July 24, 2007) (issued pursuant to an Offer of Settlement submitted by MBIA dated October 28, 2005, *see* note 3 *supra*), *available at* http://www.mbia.com/investor/publications/IC_final_report.pdf; Independent Consultant Initial Report, In the Matter of Hantz Financial Services, Inc. (Jan. 9, 2006) (required by NASD Letter of Acceptance Waiver and Consent No. EAF-040060001 (Aug. 11, 2005)), *available at* http://www.hantzgroup.com/_docs/RIC.pdf.

[20] *See, e.g.*, In re MBIA, *supra* note 3, ¶ 70.

[21] *See, e.g.*, In re Instinet LLC and INET ATS, Inc., Admin. Proc. File No. 3-12088, 2005 SEC LEXIS 2685 (Oct. 18, 2005) (requiring retention of independent consultant to conduct comprehensive audit of respondents' compliance program relating to what is now SEC Rule 605).

[22] *See, e.g.*, In re Morgan Stanley & Co., *supra* note 18, ¶ 11 (''The Respondent shall retain . . .a qualified independent consultant . . .to . . . prepare a Report . . . making recommendations for how the Respondent should modify or supplement its policies, practices, and procedures to remedy the deficiencies identified by the Consultant in the report.'').

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difficult for the respondent to decline to implement such recommendations. Third, it is common to have an independent consultant suggest changes in the respondent's supervisory system, increasing the likelihood that violations will be detected and remedied by the respondent itself.

Some independent consultants are given specific tasks. A Regulator may want an independent consultant to take responsibility to calculate and make disbursements agreed upon as part of a settlement.[23]

Assigning any of these ongoing tasks to an independent consultant relieves the Regulator of much of the burden of ensuring the task is done correctly and in a timely manner. This allows the Regulator to use its limited resources on other matters, rather than being bogged down in tasks that do not require the Regulator's authority and expertise. Enforcement staff are not needed to track down recipients of restitution, calculate damages, or verify ongoing compliance. And where the independent consultant is required to review compliance over a period of time, such as a period of years, the burden shifted to the independent consultant can be significant.

In some cases, independent consultants can also provide expertise that the Regulator lacks. A typical assignment for an independent consultant is to review supervisory procedures and recommend changes to management. Regulators have expertise in uncovering supervisory failures, but have little expertise in drafting procedures tailored to the business of a firm. In these circumstances, the Regulator can promote compliance beyond its own resources by requiring an independent consultant.

A settlement with a Regulator may be the result of an investigation of only a portion of the violations suspected. In these instances an independent consultant may be tasked with reviewing other transactions, determining the responsibility of additional officers or employees of the respondent, or finding additional victims.[24] This type of undertaking involves the most significant delegation of regulatory responsibility to an independent consultant. It poses greater risks for the Regulator and for the respondent. For the Regulator there are the risks that the independent consultant will look at the facts or law more narrowly or more broadly than the view taken by the Regulator, that the review will severely delay final resolution of the matter, that the facts uncovered by the independent consultant will be inconsistent with the Regulator's findings, or that the independent consultant will make the sanctions imposed by the Regulator appear disproportionate to the misconduct.

b. *Benefits to the Respondent*

For the respondent, an independent consultant offers less obvious and less quantifiable benefits. Part of the difficulty in calculating the benefit to the respondent stems from the difficulty in identifying the alternative. Where the Regulator has numerous cases involving similar conduct, the Regulator may be unwilling to settle with any respondent without an independent consultant. The respondent will only have estimates of the potential costs posed by a lengthier investigation, a higher fine for settling without an undertaking, or the cost of litigation. Conversely, the respondent can only estimate the costs and distractions it will incur by retaining an independent consultant. But from the number of settled matters with undertakings requiring respondents to hire independent consultants, it is clear that many respondents perceive the benefits of hiring an independent consultant to outweigh the costs.

First, the public appearance of finality from entering into a settlement with a Regulator allows the respondent to begin to put the issue in the past, even if an independent consultant is just beginning its review. Second, if the independent consultant is to recommend new business practices or new supervisory procedures, the respondent may prefer to deal with an expert rather than negotiate such issues with a Regulator. Third, when independent consultants will be continuing prior investigations, they typically use interviews rather than formal on-the-record testimony. These may be less time consuming and held in more convenient locations. Employees interviewed by an independent consultant may not be represented by separate counsel, although representation of employees at such interviews is increasingly common.

Finally, independent consultants may be able to bring their review to a conclusion more quickly than a similar investigation conducted by a Regulator. An investigation by a law firm, consulting firm, or auditor is also likely to be less distracting than having ongoing inquiries by a Regulator. In the midst of a lengthy, expensive, distracting, and perhaps acrimonious investigation by a Regulator, the thought of ending the regulatory finger-pointing with a review by an independent consultant may seem like a very attractive proposition. But in order to accurately weigh the alternative, an respondent needs to have a realistic idea of what to expect from an independent consultant.

4. The Respondent's Relationship with an Independent Consultant

The respondent's relationship with an independent consultant will be shaped by the terms of the settlement with the Regulator, but in all cases the independent

[23] In re Putnam Investment Management, LLC, Admin. Proc. File No. 3-11317, 2003 SEC LEXIS 2712 (Nov. 13, 2003) (''The Independent Assessment Consultant shall calculate the monetary amounts necessary to fairly compensate Putnam funds' shareholders for losses attributable to excessive short-term trading.''). The Independent Assessment Consultant for Putnam found that the losses to investors totaled $53 million. Commission Announces Completion of Independent Assessment Consultant's Report on Losses Attributable to Market Timing and Excessive Short-Term Trading by Putnam Employees, SEC Press Release 2005-25 (Mar. 3, 2005).

[24] *See supra* note 3.

consultant will be in a far more powerful position than a typical consultant. Under the terms of the undertaking the independent consultant and the respondent cannot have had any business dealings for several years before the engagement begins and cannot do business for several years after the engagement is completed. Regulators also typically have veto power over the selection of independent consultants pursuant to provisions that the independent consultant be ''not unacceptable'' to the Regulator. Independent consultants are given broad powers to examine and review the businesses, and settlement agreements usually make it difficult for respondents to reject or alter the independent consultants' suggestions. Finally, the results of an independent consultant's review are typically provided to the board of directors and the Regulator.

The lack of familiarity between the independent consultant and the respondent at the start of the process increases the risk that the relationship will be strained. The independent consultant will not have an existing knowledge of the respondent's business and personnel. Nor will the parties have a reservoir of pre-existing goodwill to rely upon if misunderstandings or disputes arise. The respondent may view the independent consultant with animosity since the respondent does not really want a review and certainly not a review by a stranger.

Due to the one-sided nature of the relationship and the temporary prohibition on future work between the respondent and the independent consultant, the parties have little incentive to build a strong working relationship. Meanwhile, independent consultants, such as law firms that regularly appear before Regulators, will also seek to maintain the good opinion of the Regulator.

5. Best Practices for Respondents

The response of the respondent prior to the settlement will depend on several variables. First, at what point does the respondent recognize the Regulator's concern? A respondent may see the problem before an investigation begins, as soon as an investigation begins, or only well into the investigation. Second, at what point is the respondent agreeable to making the changes sought by the Regulator? Where the respondent maintains that the conduct does not violate any prohibition, where fixing the problem is very costly, or if changing practices would cause the respondent to operate at a competitive disadvantage, the respondent may be agreeable to a change only well after settlement negotiations have begun. Lastly, what are the objectives of the Regulator in seeking the appointment of an independent consultant? Is the Regulator seeking to shorten its investigation, bring in outside expertise, ensure future compliance, or leverage its resources by having an outside party perform certain tasks?

a. *Persuading the Regulator that an Independent Consultant is not Necessary*

As soon as the respondent recognizes a problem (or that a Regulator perceives a problem), the respondent can begin to attempt to persuade the Regulator that an independent consultant is not necessary. This persuasion usually begins with making the Regulator aware of facts that show that violations were not extensive, did not involve intentional or reckless behavior, or were isolated in time, location, or other circumstance.

The next phase of this effort is to convince the Regulator that the respondent has taken steps to make necessary and beneficial changes. Removing or retraining the individuals responsible for the violation or adding individuals with special credibility can increase the Regulator's confidence that the problem will not reoccur. Adopting new supervisory procedures before a settlement is reached can ward off the need for an independent consultant to address supervision. New procedures can also give the Regulator confidence that future problems will be detected or prevented. Changes in business models, such as additional disclosures to clients or changing compensation methods, can also be effective in persuading a Regulator that further study and intervention is unnecessary. The sooner the changes are implemented and positive results are achieved, the stronger the argument the respondent can make that an independent consultant is not necessary.

However, when the solution to the problem is not clear or the causes of the problem are widespread, it may be impossible to convince the Regulator that an independent consultant is unnecessary.

b. *Negotiating the Terms of the Settlement*

Settlement documents should be negotiated to be as narrow and specific as possible so that the duties of the independent consultant are clearly delineated. Specificity as to the subject matter, type of review, and time to complete the review will all help in this regard. Regulators often have standard language for independent consultants, but the description of the problem and the scope of the review can usually be negotiated. Furthermore, additional provisions can be inserted, such as allowing the respondent to review a preliminary version of the report before it is presented to the Regulator or board of directors in final form.

c. *Negotiating an Agreement with the Independent Consultant*

Before proposing an independent consultant for approval by the Regulator, the respondent should have detailed discussions with the potential independent consultant about how the review will be conducted, how much it will cost, and who will work on it. Relevant terms should be spelled out in an engagement agreement in advance. A regulator may not allow certain terms in the engagement letter that restrict the scope of the review. Limits on how much the independent consultant can spend, who can be interviewed, or what documents can be reviewed may be seen as improper. But in more routine cases with narrower scopes of review, Regulators may be more receptive to such limitations.

d. *Working with the Independent Consultant*

Building and maintaining a relationship with the independent consultant once the review begins is critically important. Those working with the consultant should recognize that the independent consultant is unlike any other consultant they have worked with in the past. In practical terms, the independent consultant reports to the Regulator and then to the board. That means that the respondent will have far less influence on the consultant's scope, methods, and recommendations. The independent consultant is working in a much less collaborative manner than normal consultants and will be anxious to assert its independence. While a regular consultant will be motivated to produce recommendations acceptable to the client, an independent consultant appointed pursuant to an order of a Regulator will be motivated to show that it was thorough, competent, and independent.

  SRLR ISSN 0037-0665

Given these dynamics, those working with the independent consultant should place a high priority on earning and maintaining the independent consultant's trust. Great care should be given to understanding the independent consultant's requests for documents and information. Requests by the independent consultant should be in writing and should be handled by experienced and trusted representatives of the respondent. Respondents should proactively seek to educate the independent consultant before and during the review. Any misunderstanding between the respondent and the independent consultant should be dealt with promptly. As the process often moves quickly, if the direction of the review indicates that the independent consultant may have formed an erroneous conclusion, the issue must be addressed promptly.

In many respects, the respondent should deal with the independent consultant with the care it would use in dealing directly with a Regulator. At the same time, because the review process is less formal than an investigation by the Regulator, the respondent can use the informality to gain greater and easier access to the independent consultant than would normally be possible. The respondent should not, however, be less diligent and careful in protecting its interests because of the informal nature of the review.

e. *Using an Intermediary to Hire and Evaluate an Independent Consultant*

Using an intermediary routinely involved in the selection of independent consultants, such as a law firm or consultant, to help select an independent consultant and to evaluate its performance could restore some of the dynamics that promote effective relationships with typical consultants. For most respondents, hiring an independent consultant will be a once in a lifetime event, and an experienced intermediary can help guide the respondent through the process. An intermediary can also identify consultants that would be acceptable to the Regulator. For independent consultants engaged to perform common assignments, such as reviewing procedures or making disbursements, selecting a consultant with experience could be greatly facilitated by an intermediary with experience in these issues.

While the scope of the independent consultant's duties will be largely spelled out in the settlement document or in an order entered by the Regulator, the intermediary could help define and clarify the tasks and processes that would speed conclusion of the independent consultant's assigned tasks.

The terms of the order requiring an independent consultant will usually provide that once the consultant is hired and approved by the Regulator, the respondent cannot terminate the consultant without approval of the Regulator, must cooperate with the consultant, and will have very limited opportunity to reward or motivate the consultant since the respondent will not be allowed to retain the consultant for a period of years following the engagement. But if the respondent selected the independent consultant with the help of an intermediary, then the intermediary could monitor the actions and cost of the consultant. The respondent could express to the intermediary its concerns or displeasure with the performance of the consultant. Although a Regulator would not be pleased with any direct involvement by an intermediary once the engagement had begun, an intermediary could use knowledge about the performance of the consultant in making subsequent recommendations. The consultant's desire to remain in the good graces of the intermediary could thereby increase the incentive for an independent consultant to cooperate with a respondent.

6. Conclusion

Given the demands placed on Regulators and the reality of finite budgets, Regulators are likely to continue to expand their use of undertakings in general and independent consultants in particular. The increased emphasis of the SEC's Division of Enforcement on cooperation may also lead to more frequent use of independent consultants as fact finders making recommendations as to discipline and remedies. When dealing with an investigation, potential respondents should consider early in the process how their actions and advocacy may affect the Regulator's decision to seek an independent consultant and the scope of the consultant's engagement.

The development of skilled and knowledgeable intermediaries working to match respondents with candidates to serve as independent consultants could help respondents make better choices about whom to select and how to work with independent consultants. And ongoing relationships between intermediaries and independent consultants could ameliorate some of the structural impediments to a mutually satisfactory relationship between independent consultants and respondents.