

SEC Announces New Approach to Disqualification Waivers

The Capital Commitment on July 8, 2019

On July 3, 2019, SEC Chairman Jay Clayton issued a [“Statement Regarding Offers of Settlement”](#) (the “Statement”), announcing important changes to how the SEC will consider future requests for waivers from disqualifications in settlements. The Statement may have been prompted by the Bad Actor Disqualification Act of 2019 recently proposed by Representative Maxine Waters. Regardless of the impetus, the Statement should provide settling parties with greater certainty regarding the waiver process. Importantly, the new policy effectively allows a settling party to condition its offer of settlement on whether the SEC grants a requested waiver – if the waiver is not granted, the respondent now is able to retract its offer of settlement.

The federal securities laws provide for a number of automatic disqualifications that prevent a respondent (or an affiliate) found to have violated certain statutes or regulations from taking advantage of certain exemptions or engaging in certain conduct otherwise permitted under the federal securities laws. For example, an issuer subject to an SEC cease-and-desist order (even one issued as part of a settlement) prohibiting the party from violating Section 5 of the Securities Act is automatically disqualified from using the safe harbor provided by Regulation D under the Securities Act to conduct an unregistered offering of securities. A disqualification may be (and often is) unrelated to the misconduct that forms the basis of the SEC enforcement action.

Some disqualifications can be a matter of inconvenience to a party, but others can have severe consequences. For example, absent a waiver, a party subject to certain federal court injunctions may no longer act as an investment adviser to an investment company. The SEC, however, has authority to grant conditional or unconditional waivers from disqualifications, and has frequently used that authority to prevent disproportionate consequences from flowing from a settled enforcement action. The Statement deals with the process by which respondents apply for and the SEC Commissioners consider waivers.

That process grew more complicated in recent years, largely because of what became a public debate regarding the purpose behind disqualifications and whether waivers had been too easily granted. Some within the SEC believed that disqualifications should be viewed as prophylactic only ([Understanding Disqualifications, Exemptions and Waivers Under the Federal Securities Laws, Chair Mary Jo White, Mar. 12, 2015](#)). Under this view, the Commission should grant a waiver so long as the misconduct underlying a settlement does not relate to the conduct subject to the disqualification. Other Commissioners argued that disqualifications should be viewed as an additional sanction for misconduct and waivers should be granted less frequently ([Remarks at the “SEC Speaks” Conference, Commissioner Kara M. Stein, Feb. 20, 2015](#)). Under this view, the Commission should consider additional factors such as recidivism and deterrence – factors typically considered by the SEC in connection with penalties – when deciding whether to grant a waiver.

Complicating the process further was the fact that, as the Statement notes, “[a]lthough settlement offers and waiver requests have generally been made contemporaneously, and resolution of both often is critical to achieving the necessary level of certainty, in recent years, the Commission has considered these matters almost exclusively on a segregated basis.” When a settlement of an SEC enforcement action would trigger a disqualification, separate but contemporaneous negotiations would take place between counsel for the defendants and the Division of Enforcement over the terms of the settlement and the relevant operating division (Corporation Finance or Investment Management) over the terms of the waiver. The results of those negotiations were then separately considered by the SEC Commissioners, or in some cases by SEC Staff pursuant to delegated authority.

This bifurcated process complicated resolution of SEC enforcement actions. For one thing, a Commissioner could vote for a settlement but against a requested waiver, as some did. At the same time, a respondent could not make a settlement offer contingent on the granting of its waiver request. The waiver can be, of course, a critical consideration to many industry participants considering whether to settle or to litigate the charges. For example, for an issuer that relies on offerings under Regulation D, a waiver from a “bad actor” disqualification could be critical to its ongoing business operations.

The Statement reduces the complexity of settlement negotiations, and provides respondents with far greater certainty regarding the likely outcome of waiver requests because a settlement offer and waiver request will be considered at the same time by the full Commission. Most importantly, the new process will effectively allow a respondent to make a settlement offer contingent upon the grant of a waiver request – if a waiver request is rejected, a respondent can pull its settlement offer. Also, each Commissioner must now make a determination whether to grant a waiver in the context of considering the settlement as a whole. A Commissioner who wishes to reject a waiver request will run the risk that doing so will cause the proposed settlement to collapse.

The changes described in the Chairman’s Statement thus will alter settlement negotiations of Commission enforcement actions between respondents as well as the internal dynamics of Commission consideration of settlements. Both should have the effect of creating a more stable process with greater certainty for respondents.

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