

## 'Bad Actor' Waivers Spark Opposing Views Within SEC

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Recent speeches by U.S. [Securities and Exchange Commission](#) commissioners have shed further light on the ongoing debate among the commissioners about how the SEC should exercise its discretion when deciding whether to grant waivers from the statutory disqualification provisions of the federal securities laws.

Many federal securities statutes include provisions that can allow firms in good standing to avoid burdensome registration requirements and certain limitations on the types of statements the firms can make about their products. These statutes also automatically disqualify a firm from gaining these benefits if the firm is found to have violated a federal securities law. However, the statutes allow the firm to request a “waiver” from automatic disqualification.



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Not obtaining these waivers can severely restrict a firm's operations. For example, if a firm agreed to settle a case with the SEC, related to potential violations of certain securities laws, and was not able to obtain a waiver from the automatic statutory disqualification, the firm would be unable to rely on the private-placement safe harbor provisions of Rule 506 of Regulation D, which permit the sale of securities that are not registered with the commission. Likewise, unless a firm obtained a waiver, it could be an “ineligible issuer” that would not be able to rely on the flexible securities registration process afforded to well-known seasoned issuers.

Until fairly recently, the SEC granted waivers in most cases as a matter of course. However, the commission's use of waivers became the subject of increased scrutiny beginning in January 2015, when Commissioners Luis Aguilar and Kara Stein dissented from the commission's decision to grant a financial services firm a waiver from the automatic disqualification provisions contained in Rule 506 of Regulation D. The dissent challenged the commission's usual practice of granting waivers from the automatic disqualification provisions, when the conduct at issue in the enforcement action was not related to the business or activity that would be affected by the automatic disqualification. The dissenting commissioners expressed their belief that disqualification was appropriate, regardless of the alleged underlying violation, when the circumstances lead the commission to question the firm's overall compliance culture. They explained that refusing to grant a waiver from automatic disqualification was a “powerful tool,” above and beyond other sanctions, that would send “a clear message that there are meaningful consequences for firms that repeatedly and deliberately flout applicable laws and rules.”

Since that dissent, which challenged the settled expectations of regulated entities and the enforcement bar, there has been increased uncertainty about how the waiver process will operate in practice before the commission. In recent speeches, some of the commissioners have presented their opinions on how the commission should treat waiver requests.

In mid-February, Commissioner Daniel Gallagher stated, in remarks to the 37th Annual Conference on Securities Regulation and Business Law, that he continued to believe the commission's past practice with regard to granting waivers was correct. He explained his view that the common theme among the various disqualification provisions is the goal "of keeping so-called 'bad actors' out of the industry and thereby preventing fraud." In a thinly veiled reference to Aguilar and Stein, he cautioned that some considered disqualifications to be "sanction enhancements" that would be applied on top of more traditional sanctions the commission could seek. He objected to this approach, noting that in his view "automatic disqualifications are not, and were never intended to be, either remedial or punitive in nature." He contended that "[t]reating the waiver consideration process like the enforcement sanctions process effectively, and inappropriately, conflates automatic disqualifications with remedial and punitive sanctions."

A few days later, at the Practising Law Institute's "SEC Speaks in 2015" conference, Commissioner Michael Piwowar appeared to agree with Gallagher's approach. Piwowar stressed the need for the commission to apply a consistent approach to its consideration of waivers. Referring to the hurdles that arose in negotiations between the commission staff and entities under investigation following the recent dissent, he explained that a consistent approach was "particularly important in the context of settlement negotiations" because a predictable process would allow a party to determine if it would be able to obtain a waiver if it agrees to settle. Given the effect an automatic disqualification may have on a firm's business, uncertainty over whether the commission would grant a waiver request threatened to bring negotiations to an impasse.

Stein also addressed the matter of waivers at SEC Speaks. Adhering to the position she took in her dissent, she rejected as a "red herring" the argument "that automatic disqualifications should not be considered a sanction or an enforcement tool." Rather, she thought the commission should be concerned with determining "whether automatic disqualifications are being applied appropriately and effectively." Commissioner Stein expressed her belief that automatic disqualification is "a forward-looking or prophylactic tool" that is "designed to deter and prevent recidivism and restore trust in the markets." Unlike Gallagher and Piwowar, Stein appeared less troubled with automatically disqualifying a firm from activity that was completely unrelated to the firm's alleged misconduct. To her, "the argument that that we should grant a waiver whenever the reason for the automatic disqualification is 'unrelated' to the waiver defies common sense." Yet, like Piwowar, Stein stressed the need for a transparent process that would provide market participants with "a clear sense of the rules of the road."

In another recent speech, SEC Chairwoman Mary Jo White attempted to provide just such transparency. Delivering an address to the Corporate Counsel Institute titled "Understanding Disqualifications, Exemptions and Waivers Under the Federal Securities Laws," White made clear that her "bottom line" differed sharply from that of Stein. White explained that she thought "waivers were never intended to be, and we should not use them as, an additional enforcement tool designed to address misconduct or as an unjustified mechanism for deterring misconduct." To White, the commission should grant a waiver request if the party seeking the waiver can demonstrate that "the entity or individual, going forward, can engage responsibly and lawfully in the activity at issue in the particular disqualification."

White noted that the automatic disqualifications impose severe firmwide consequences that may be triggered by misconduct involving “a relatively limited number of a firm’s employees or a specific business line, [that] is wholly unrelated to the activities that would be the subject of the disqualification.” Moreover, White explained her belief that the automatic disqualification provisions could be triggered even in instances where no misconduct was alleged, but simply because a firm agreed to certain undertakings, like hiring a consultant.

As these speeches demonstrate, unless or until the SEC provides further “official guidance,” firms should be cognizant that the waivers that were once viewed as a foregone conclusion may prove more contentious.

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