SEC Changes Enforcement Practice for Settlement Offers in Cases Involving Waivers

February 12, 2021

Parties considering whether to settle an SEC enforcement investigation or criminal proceeding have a reasonable expectation that they will know the likely consequences of a settlement. This includes whether they can expect to receive a waiver from certain statutory disqualifications. Yesterday, however, the Acting Chair of the SEC announced that the Enforcement Division will not recommend any settlement offer that is conditioned on the settling party receiving a waiver. If this statement reduces transparency between SEC staff and parties negotiating a possible settlement, the result likely will be a more difficult and protracted process for both sides as it becomes difficult for settling parties to make informed decisions about the full implications of a resolution.

Background of Automatic Disqualifications and Waivers

As discussed in a previous **client alert**, automatic disqualifications in the federal securities laws prevent parties from relying on provisions that offer flexibility and greater efficiency in issuing securities, including disqualifications from:

- Status as a Well-Known Seasoned Issuer ("WKSI") under Rule 405 of Regulation C;
- Eligibility to rely on offering exemptions available under Regulations A, D, and E;
- "Forward-looking statements" safe harbor under the Private Securities Litigation Reform Act;
- Receipt of cash solicitation payments from investment advisers under Rule 206(4)-3 of the Advisers Act; and
- Serving as an investment adviser, depositor, or principal underwriter for registered investment companies under Section 9(a) of the Investment Company Act.

Various enforcement actions can trigger these disqualifications, such as court-ordered injunctions, administrative orders, and criminal convictions that involve violations of particular securities laws, such as the anti-fraud provisions. However, a party that otherwise would be subject to an automatic disqualification may seek a waiver from the Commission.

As previously **discussed**, SEC commissioners have differing views about these disqualifications. In 2014, former Commissioner Kara Stein said they can be a powerful enforcement tool to garner compliance and deterrence.[1] In 2015, however, former Chair Mary Jo White said they should not be used as an enforcement tool, but rather as a "determination [of] whether the entity or individual, going forward, can

[1] Kara M. Stein, Comm'r, SEC, Remarks at the "SEC Speaks" Conference (Feb. 21, 2014), **https://www.sec.gov/news/speech/2014-spch020421kms**.

engage responsibly and lawfully in the activity at issue in the particular disqualification."[2] Also in 2015, former Commissioner Dan Gallagher stated that settlements should "bring finality" and "involve a meeting of the minds on all aspects of the resolution," including waivers, particularly if the Commission considers disqualifications to be sanctions.[3]

More recently, and as discussed in a previous **client alert**, former Chairman Jay Clayton initiated a new waiver approval process in July 2019, in an effort to bring more transparency to the settlement negotiation and waiver request processes. Under this approach, the Commission considered settlement offers and waiver requests together as a package. Former Chairman Clayton stated that this approach "honor[ed] substance over form" and decreased complexity in the negotiation process overall.[4]

Recent Statement

On February 11, Acting Chair Allison Herren Lee announced that the Division of Enforcement will not recommend settlement offers that are conditioned on the granting of waivers.[5] Acting Chair Lee stated that the Commission will revert to a "long-standing practice" of separately considering settlement negotiations and waiver requests, thus "reinforc[ing] the critical separation" between the two processes. Acting Chair Lee further suggested that connecting the settlement negotiation and waiver request processes could result in "structural conflicts or pressures" within the SEC. She also said that instead of being seen as a "bargaining chip" or "obstacle" during settlement negotiations, consideration of waivers must be "forward looking" and focused on the protection of investors, markets, and market participants.

Practical Impact

Transparency is fundamental to a fair settlement process. Parties deciding whether to settle an enforcement investigation have a reasonable expectation that they will know the likely consequences of a potential settlement. Much of the debate over the waiver process has focused on the degree of transparency that SEC staff will give to parties about the likely outcome of a waiver application, while being clear that the decision whether to grant a waiver rests within the authority of the voting Commissioners. If the recent statement reduces transparency between SEC enforcement staff and parties negotiating a possible settlement, the result likely will be a more difficult and protracted process for both sides as it becomes difficult for settling parties to make informed decisions about the full implications of a resolution.

---

[2] Mary Jo White, Chair, SEC, Remarks at the Corporate Counsel Institute, Georgetown University: Understanding Disqualifications, Exemptions, and Waivers Under the Federal Securities Laws (Mar. 12, 2015), **https://www.sec.gov/news/speech/031215-spch-cmjw.html**.

[3] Daniel M. Gallagher, Comm'r, SEC, Remarks at the 37th Annual Conference on Securities Regulation and Business Law: Why is the SEC Wavering on Waivers? (Feb. 13, 2015), **https://www.sec.gov/news/speech/021315-spc-cdmg.html**.

[4] Jay Clayton, Chairman, SEC, Statement Regarding Offers of Settlement (July 3, 2019), **https://www.sec.gov/news/public-statement/clayton-statement-regarding-offers-settlement**.

[5] Allison Herren Lee, Acting Chair, SEC, Statement of Acting Chair Allison Herren Lee on Contingent Settlement Offers (Feb. 11, 2021), **https://www.sec.gov/news/public-statement/lee-statement-contingent-settlement-offers-021121**.

Davis Polk

If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your usual Davis Polk contact.

New York

Greg D. Andres	+1 212 450 4724	greg.andres@davispolk.com
Martine M. Beamon	+1 212 450 4262	martine.beamon@davispolk.com
Angela T. Burgess	+1 212 450 4885	angela.burgess@davispolk.com
Tatiana R. Martins	+1 212 450 4085	tatiana.martins@davispolk.com

Washington, DC

Uzo Asonye	+1 202 962 7057	uzo.asonye@davispolk.com
Robert A. Cohen	+1 202 962 7047	robert.cohen@davispolk.com
Neil H. MacBride	+1 202 962 7030	neil.macbride@davispolk.com
Fiona R. Moran	+1 202 962 7137	fiona.moran@davispolk.com
Paul J. Nathanson	+1 202 962 7055	paul.nathanson@davispolk.com
Kenneth L. Wainstein	+1 202 962 7141	kenneth.wainstein@davispolk.com