

February 12, 2021

# SEC Again Separates Consideration of Enforcement Settlements and Waivers of Collateral Consequences

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## The Policy Change Means That the Commission Will No Longer Consider Settlement Offers Conditioned on Granting a Waiver

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### SUMMARY

On February 11, 2021, the Acting Chair of the Securities and Exchange Commission, Allison Herren Lee, announced that the SEC would no longer permit parties to request that the Commission simultaneously consider enforcement settlements and requests for waivers from resulting collateral consequences. The announcement is a reversal of a procedure then-Chair Jay Clayton announced in July 2019. As a consequence of the change, parties that offer to settle SEC enforcement actions will have the terms of their settlements considered separately from their requests for waivers, resulting in renewed uncertainty about the overall consequences of resolving SEC enforcement matters.

### BACKGROUND

The terms of a settlement with the SEC may trigger certain automatic collateral consequences under the SEC's statutes and rules that affect a settling party's businesses and operations.<sup>1</sup> Such collateral consequences may include:

- a prohibition on acting as an investment adviser to, or principal underwriter for, investment companies registered under the Investment Company Act of 1940 pursuant to Section 9(a) thereof;
- loss of private offering exemptions provided by Regulations A, D and Crowdfunding under the Securities Act;
- loss of well-known seasoned issuer (WKSI) status for the purposes of securities offerings;

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- loss of statutory safe harbors under the Securities Act of 1933 (Securities Act) and the Securities Exchange Act of 1934 (Exchange Act) for forward-looking statements (such safe harbors were added by the Private Securities Litigation Reform Act of 1995 (PSLRA));
- loss of the exemption from registration under the Securities Act for securities issued by certain small business investment companies and business development companies provided by Regulation E; and
- a prohibition on a registered investment adviser from paying cash fees for solicitation under Rule 206(4)-3 of the Investment Advisers Act of 1940 (Advisers Act).<sup>2</sup>

Entities often seek waivers from these collateral consequences from the Commission. A waiver, if granted, is typically issued contemporaneously with entry into the settlement so that the operations of the settling firm are not disrupted. Historically, waiver requests have been handled by the SEC's Divisions of Corporation Finance and Investment Management. By contrast, enforcement settlement offers are the subject of negotiation with the SEC's Division of Enforcement.

On July 3, 2019, then-Chair Clayton announced that the Commission would begin considering offers of settlement that simultaneously addressed both the underlying enforcement action and any related collateral consequences.<sup>3</sup> Under this policy formulation, settling entities could make offers of settlement to the SEC that were effectively conditioned on receiving waivers from any disqualifications. If settling entities were denied waivers, they would be permitted to withdraw their offers of settlement. Chair Clayton stated that the simultaneous resolution of settlement offers and waiver requests was often necessary to reduce complexity and achieve the sort of "collective certainty" his Commission sought from settlements.

Acting Chair Lee's recent announcement marks a change in direction for the Commission. Her statement makes clear that the SEC now seeks to eliminate the potential for structural conflict and reaffirm the importance of keeping separate two distinct SEC processes: (i) the negotiation of a settlement; and (ii) the granting or denying of a disqualification waiver. To that end, settlement offers conditioned on the granting of waivers will no longer be considered by the Commission. Acting Chair Lee stated that separating the two processes is intended to deter entities from assuming that collateral consequence waivers can be used as bargaining chips in settlement discussions or will necessarily be issued by the Commission by default. Acting Chair Lee further described the policy change in her statement as essential to preserving the fairness and independence of the two SEC processes and helping to better protect investors, markets, and market participants.

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## IMPLICATIONS

The impact of the announced change to the SEC's policy is threefold:

*First*, the change in policy signals greater skepticism on the part of the SEC with respect to granting waivers to settling entities. We expect that waivers will become more difficult to obtain and, when granted, may include additional, and potentially more burdensome, conditions.

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*Second*, the change in policy creates increased uncertainty for entities settling with the SEC because they can no longer be guaranteed Commission review of the settlement of their enforcement matter simultaneously with their requested waivers. The impact of this change as a practical matter is unclear. If a settling party is denied a waiver and then seeks to withdraw its settlement offer, it remains to be seen whether the SEC will nevertheless proceed to seek judicial approval of the settlement in the face of such attempted withdrawal.

*Third*, the change in policy indicates the SEC's intent to keep waiver discussions substantially separate from enforcement recommendations. Our understanding is that these discussions generally happen separately in any case, so we do not view this as a substantive change.

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### ENDNOTES

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- <sup>1</sup> In addition, a settlement that constitutes a "statutory disqualification" under Section 3(a)(39) of the Securities Exchange Act of 1934 (Exchange Act) results in a prohibition on membership in FINRA. See FINRA By-Laws, Article III, Section 3(a).
- <sup>2</sup> See, e.g., 15 U.S.C. § 80a-9(a); 17 C.F.R. § 227.100 et seq.; 17 C.F.R. §§ 230.262, 230.504(b)(3), 230.506(d), 230.405; 15 U.S.C. § 77z-2(b)(1)(A); 15 U.S.C. § 78u-5(b)(1)(A); 17 C.F.R. § 230.602(b)-(e); 17 C.F.R. § 275.206(4)-3(a)(1)(ii)(C). (Rule 206(4)-3 will be rescinded and its substance incorporated into amended Rule 206(4)-1 this year.)
- <sup>3</sup> Jay Clayton, SEC Chairman, Statement Regarding Offers of Settlement (Jul. 3, 2019), <https://www.sec.gov/news/public-statement/clayton-statement-regarding-offers-settlement>.

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