A Shot Across the Bow: Acting SEC Chair Lee Reinstitutes Delegated Authority for Senior Enforcement Leadership and Rescinds Clayton's Waiver Policy

February 16, 2021

During the first week of February, Allison Herren Lee, Acting Chair of the U.S. Securities and Exchange Commission (the "SEC" or "Commission"), announced two significant changes to Commission policy—the first relates to the delegation of authority to issue Formal Orders of Investigation ("Formal Orders"), and the second to the SEC's waiver process. These policy changes are the first tangible signals of the Biden Administration's expected clear return to a more aggressive approach to enforcement and market regulation.

FORMAL ORDERS OF INVESTIGATION

On February 9, Acting Chair Lee restored the delegated authority of Enforcement Division senior officials to issue Formal Orders. The delegation of authority to Senior Officers empowers them to authorize SEC enforcement staff to subpoena documents and take sworn testimony without the need for authority from the full Commission or the Director of Enforcement. The announcement reverses the 2017 decision of then-Acting Chair Michael Piwowar to revoke this delegated authority, which was granted during the Obama Administration. In her statement announcing the policy change, Acting Chair Lee emphasized that the renewed delegation of authority will allow investigative staff "to act more swiftly to detect and stop ongoing frauds, preserve assets, and protect vulnerable investors." With this change, expect to see an uptick in the issuance of subpoenas as enforcement activity accelerates over the coming period.

CONTINGENT SETTLEMENT OFFERS/WAIVERS

On the heels of the policy change regarding Formal Orders, Acting Chair Lee on February 11 announced a reversal of policy related to the Commission's approach to waivers from automatic disqualifications arising from certain violations or sanctions,

including loss of well-known seasoned issuer ("WKSI") status.[1] Under the new policy, the Division of Enforcement will no longer recommend to the Commission a settlement offer that is conditioned on the Commission also granting a waiver from one or more automatic disqualifications.

The announced change reverses the July 2019 policy by then-Chair Jay Clayton that ushered in a new approach to the waiver application process by permitting settling entities to submit simultaneous offers of settlement and waiver applications for Commission consideration, with one explicitly conditioned on the other. This coupling of proposed settlements with waiver applications to the Commission was intended to allow the Commission to undertake a more holistic evaluation of proposed settlements while providing issuers with additional certainty regarding the waiver process before finalizing a settlement.

The new policy—which is really a return to the Commission's long-standing practice on waivers— again de-couples the Commission's enforcement process from its consideration of requests for waivers from automatic disqualifications. Entities seeking waivers will now be required to submit waiver requests to the Division of Corporation Finance or the Division of Investment Management (the Divisions that review such waiver applications) "using standards that are separate and distinct from [the Commission's] law enforcement mandate."

In a joint statement issued on February 12, Republican Commissioners Hester Peirce and Elad Roisman objected to the "abruptly" instituted policy change, stating that the new policy "marks a return to an unwieldy process that treats as completely separate what is in fact interrelated." The two Commissioners expressed support for the Clayton-era contingent waiver policy, noting that the policy did not in any way alter the standards applicable to the evaluation of settlement offers by the Division of Enforcement or the evaluation of waiver applications by the Divisions of Investment Management and Corporation Finance. Moreover, the Republican Commissioners stated that the contingent settlement process recognized "the reality that an entity's willingness to reach a prompt settlement is influenced by its concerns about the

[1] The settlement of an enforcement action can trigger collateral consequences for an entity or its affiliates that may require entities to seek exemptive relief from multiple regulators, including the SEC. The main potential collateral consequences arising under the federal securities laws involving the SEC include: (i) loss of WKSI status for purposes of securities offerings; (ii) loss of eligibility to rely on the offering exemptions set forth under Regulations A, D, and E; (iii) disqualification under Section 9(a) of the Investment Company Act of 1940, which can result in bars for entities and affiliates from serving as an investment adviser, depositor or principal underwriter of registered investment companies; (iv) loss of the safe harbor protection for forward-looking statements under the Securities Act of 1933 and the Securities Exchange Act of 1934, added by the Private Securities Litigation Reform Act of 1995; and (v) the prohibition on registered investment advisers from receiving cash fees for solicitation under Rule 206(4)-3 of the Investment Advisers Act of 1940.

potential collateral consequences of entering into the settlement." The Commissioners ended their statement with a warning that the new policy "re-introduces an artificial separation" between the process of resolving an enforcement matter and obtaining clarity on the collateral consequences of such a resolution that will lengthen the time to resolve enforcement matters, ultimately to the detriment of the agency's mission and investors.

KEY TAKEAWAYS

Expect Closer Scrutiny of Waiver Requests. As a practical matter, the Clayton approach to waivers allowing contingent offers did not alter the reality that parties still viewed waiver determinations as critical to their decision of whether to agree to enforcement settlements, and practitioners in this area have long informally believed that they retain the optionality of withdrawing from a settlement if the Commission approves the settlement yet rejects the related waiver application.

However, the formal reversal of Clayton's policy likely signals a change in approach towards granting waivers more generally. This likely development re-introduces uncertainty and risk for issuers, advisers, and other entities seeking to resolve enforcement matters. This risk is particularly acute given that the soon-to-be Democratic-controlled Commission is likely to take a harder line on enforcement matters and may closely scrutinize waiver requests, especially in high-profile matters, matters involving disclosure violations, and in matters involving recidivist offenders. Because three Commissioner votes are needed to approve both enforcement matters and waivers, the waiver process may become fraught because those Commissioners who approve enforcement settlements may simultaneously seek to punish those settling entities with waiver denials in order to send a message about the severity of the conduct underlying the enforcement resolution. Such a practice would mark a radical departure not only from Republican-appointed Chairman Jay Clayton's approach to waivers, but also from the view on waivers endorsed by Chair Mary Jo White, who stated that disqualifications were not enforcement remedies and "served a very different purpose"—to "guard against future participation in certain capital market activities by entities or individuals whose misconduct suggests that they cannot be relied upon to conduct those activities in compliance with the law and in a manner that will protect investors and our markets."

Importance of Proactive Strategy on Waivers. We advise clients to work closely with counsel to develop a thoughtful and proactive strategy when negotiating settlements that may involve parallel waiver applications in light of the new policy change. Counsel need to be cognizant of all potential disqualification implications during an

investigation so that proactive steps can be taken to attempt to avoid the charges and remedies that trigger automatic disqualification for which waivers will be required. In particular, counsel must be alert to the fact that even seemingly "less serious" enforcement charges and certain remedies (for example, a settlement under Section 206(2) of the Investment Advisers Act of 1940—which only requires a showing of negligence—when coupled with the ordering of an independent compliance consultant) can trigger a cascade of disqualifications, including for affiliated entities that had no involvement in the enforcement matter or its underlying conduct. Disqualification from reliance on WKSI status and on the streamlined and more efficient capital raising options of Regulations A, D and E imposes significant costs that can ripple across an entire entity beyond just the specific operating unit that settles an Enforcement matter. Early and simultaneous engagement with both the Enforcement Division and the operating Division that will review a client's waiver application will be crucial to navigating this newly unsettled landscape.

New Formal Orders Process Likely to Result in More Enforcement Activity. The policy change restoring delegated authority to Senior Officers to issue Formal Orders, while perhaps not as controversial or significant as the change to the waiver process, is nevertheless important because it reflects a clear shift towards loosening the reins on enforcement activity and empowering front-line Enforcement staff.

Together, these two recent announcements are clearly intended to signal a more aggressive approach to enforcement in the new Administration.

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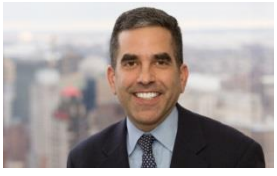
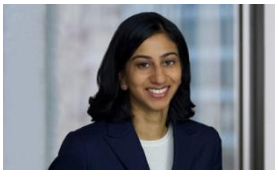


Andrew J. Ceresney
aceresney@debevoise.com

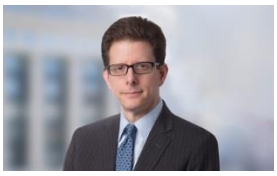


Charu A. Chandrasekhar
cchandra@debevoise.com

WASHINGTON D.C.

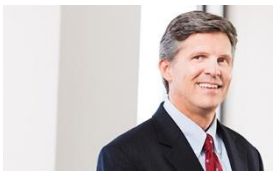
Kara Brockmeyer
kbrockmeyer@debevoise.com

Arian M. June
ajune@debevoise.com



Robert B. Kaplan
rbkaplan@debevoise.com

Julie M. Riewe
jriewe@debevoise.com



Jonathan R. Tuttle
jrtuttle@debevoise.com

Ada Fernandez Johnson
afjohnson@debevoise.com