

## Securities Regulation Daily Wrap Up, EXCHANGES AND MARKET REGULATION—SEC grants Bank of America waiver from “bad actor” disqualification, (Dec. 1, 2014)

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By Amanda Maine, J.D.

The SEC granted a waiver of disqualification from Regulation D’s “bad actor” provision to entities associated with Bank of America. Absent the waiver, the entities would have been unable to take advantage of Rule 506’s private placement exemption. The waiver is conditioned on the respondents’ retention of an independent consultant to review their policies and procedures related to activities that would be disqualified absent the waiver.

**Background.** Bank of America, N.A. (BANA), Bank of America Mortgage Securities, Inc. (BOAMS), and Merrill Lynch, Pierce, Fenner & Smith Incorporated (Merrill Lynch) (successor by merger to Banc of America Securities LLC (BAS)) (collectively, the respondents) are wholly-owned subsidiaries of Bank of America Corporation (BAC) that entered into a settlement with the SEC in connection with the with allegations made in a complaint that the SEC filed on August 6, 2013, in federal district court. On August 20, 2014, the SEC and the respondents agreed to settle the proceedings. Merrill Lynch and BOAMS agreed to be enjoined from violating Securities Act Sections 5(b)(1), 17(a)(2), and 17(a)(3), and as part of the global settlement, Bank of America agreed to pay disgorgement of nearly \$110 million, pre-judgment interest of over \$6 million, and a civil penalty of nearly \$110 million (see previous coverage in *Securities Regulation Daily*, August 21, 2014).

The SEC had alleged that the respondents underwrote prime residential mortgage-backed securities (RMBS) known as BOAMS 2008-A and failed to comply with its representation that each mortgage underlying the securitization complied with the respondents’ underwriting guidelines. The SEC also alleged that the respondents did not disclose the percentage of loans collateralizing BOAMS 2008-A that were originated by third-party mortgage brokers and the risks carried by those loans. In addition, the SEC alleged that the respondents misrepresented material facts about the underlying loans to rating agencies, and that they disclosed certain information about BOAMS 2008-A to some investors but not others in violation of Section 5(b)(1).

**Request for relief.** According to the request for no-action relief, the injunctions imposed as part of the settlement would designate Merrill Lynch and BANA as “bad actors.” This designation will disqualify Merrill Lynch and BANA from Rule 506’s private offering exemption unless the disqualification is waived under a showing of good cause.

In its request for no-action relief, counsel for Bank of America and Merrill Lynch outlined several arguments in favor of a waiver from disqualification. Counsel noted that the SEC’s complaint alleged violations of civil, non-scienter-based antifraud statutes, so that there was no intent to defraud. Counsel also noted that Merrill Lynch would be subject to the bad actor disqualification as BAS’s successor by merger, even though the SEC did not allege that Merrill Lynch engaged in any of the misconduct. Counsel also argued that the alleged misconduct was limited to a short time period and that the senior personnel involved in the conduct are no longer employed by Bank of America.

Another factor in to support waiver is that remedial steps have been and continue to be undertaken, counsel wrote. Disqualification would also have a significant adverse impact on the firms, their affiliates, sponsored and third party funds, issuers of private placements, customers and clients, according to the requesting letter.

**Relief granted.** The SEC granted the requested waiver from disqualification. However, the relief is conditioned on the respondents’ retention of a qualified independent consultant, who will conduct a comprehensive review of the policies and procedures relating to compliance with Rule 506. The respondents must provide the consultant with books, records, and personnel as reasonably requested for review by the consultant. The consultant must complete its review and prepare a preliminary report within 360 days, and the respondents must adopt and implement all of the preliminary report’s recommendations within 180 days of receipt of the preliminary report, provided that the recommendations are not unduly burdensome or impractical. The final report will be due 180

days after the implementation of the preliminary report's recommendations, after which the respondents may apply for a waiver covering the remaining 30 months of the disqualification period.

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Companies: Bank of America Corporation; Bank of America, N.A.; Merrill Lynch, Pierce, Fenner & Smith Inc.

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