

Securities Regulation Daily Wrap Up, TOP STORY—Gallagher seeks change in SEC’s waiver from disqualification process, (Feb. 17, 2015)

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By Jacquelyn Lumb

In remarks at the 37th annual conference on securities regulation and business law in Dallas, Texas, Commissioner Daniel Gallagher offered his view that the SEC’s automatic disqualification provisions were never intended to be an additional weapon in its enforcement arsenal. He said the SEC should continue to resist the temptation to combine disqualifications and enforcement sanctions, which is inconsistent with the intended purpose of the disqualification provisions. Ideally, Gallagher said the SEC should return to the historical practice of having the expert policy staff consider requests for waivers, absent any inappropriate influence from the enforcement case.

Disqualifications as sanctions. Recently, there has been a debate about how the SEC should approach disqualifications. Gallagher said that recent efforts to treat disqualifications as additional sanctions are inconsistent with their intended purpose and make it difficult for individuals and entities to make rational decisions with respect to their defense strategies and settlements. He pointed to an informal practice, which has not been Commission approved, in which the Enforcement Division does not allow respondents to condition settlements on the granting of waivers.

If a disqualification is a sanction, Gallagher said it must be part of the settlement negotiations, especially for financial firms. If waivers are not granted to financial firms, particularly under Investment Company Act Section 9 or Regulation D, Gallagher said it amounts to a corporate death penalty.

Former approach to waiver requests. Gallagher explained that, historically, the SEC and the staff approached the disqualification and waiver process against the policy goal of reducing recidivism. The relevant staff would consider the waiver requests on their merits, not in conjunction with the enforcement matter that gave rise to the disqualification. Most waiver requests were handled by staff under delegated authority.

Until the SEC officially determines whether disqualifications will be treated as sanctions or whether it will return to treating them apart from the enforcement process, Gallagher said he will condition his vote on enforcement recommendations on an understanding of the planned disposition of requested waivers. In his view, the current practice creates uncertainty for market participants and will ultimately work to the detriment of the SEC and its enforcement program.

Gallagher’s stance. For waiver requests that require a Commission vote, Gallagher said it is no longer possible to separately consider the merits of the enforcement case without also taking into account the impact that a disqualification would have on the settling party. He called for a change in current practice so that waiver requests that come up for a Commission vote are considered together with the enforcement recommendation, which he said unfortunately treats the disqualifications as sanctions in those cases.

Congressional intervention. If the SEC is not able to settle on a sensible and fair approach, Gallagher said Congress may have to step in to provide clarification. If legislative intervention is needed, he said that Congress should clearly draw the lines between disqualifications and enforcement sanctions under the federal securities laws. If that is not possible, he said Congress should remove the automatic triggers from the disqualification provisions and leave their implementation to the discretion of the SEC as part of its sanctioning authority.

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