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Written Testimony of

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Committee on Financial Services
Subcommittee on Capital Markets

"SEC Enforcement: Balancing Deterrence with Due Process"

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Witness Background

Paul R. Eckert is a Professor of the Practice of Law at William and Mary School of Law at The College of William and Mary in Virginia. He teaches courses on securities regulation and the regulation of financial services firms such as broker-dealers, investment advisers, investment companies, and unregistered hedge funds and liquidity providers.

Professor Eckert is a graduate of William and Mary School of Law, where he served as the Editor-in-Chief of the William and Mary Law Review, was inducted into the Order of the Coif, and received the Lawrence W. I'Anson award. After graduation, he clerked for the Honorable William Lockhart Garwood on the US Court of Appeals for the Fifth Circuit.

Professor Eckert was previously a partner in Wilmer Cutler Pickering Hale and Dorr LLP's Securities Group. He retired from the partnership in 2022. While in private practice at WilmerHale, Professor Eckert represented many of the world's top financial services firms, corporations, and their leaders and executives in mission-critical investigations and enforcement proceedings by the SEC, the DOJ, state attorneys general and securities regulators, and foreign regulatory authorities. Professor Eckert has represented leading securities trading firms (including high frequency electronic market makers and FinTech firms), investment banks, and asset management firms in a variety of matters involving novel issues under federal and state securities laws.

From 1989 through 1993, Professor Eckert served as a US Navy Lieutenant onboard the USS Wasp (LHD-1). In 2006–2007, he served as an Associate Counsel and Special Assistant to President George W. Bush.

For many years Eckert served on the Board of Trustees for the William and Mary Law School foundation, chaired the Investment Committee, and was a board member of the 1693 Partners Fund, the principal endowment vehicle for The College of William and Mary in Virginia.

Chairwoman Wagner, Ranking Member Sherman, and Members of the Subcommittee:

I am pleased to have an opportunity to present my views on several legislative proposals related to the enforcement of the federal securities laws. These proposals address a variety of longstanding concerns widely held and acknowledged by market participants, practitioners, and the Securities and Exchange Commission itself. Each of them endeavors in one way or another to improve the predictability, efficiency, timeliness, fairness, or efficacy of law enforcement investigations and proceedings initiated or conducted by the staff of the Commission's Division of Enforcement.

For more than two decades I represented a variety of corporate and individual clients responding to SEC investigations and related administrative proceedings and civil injunctive actions. I continue to teach and study in this area. A summary of my professional background accompanies my testimony. The views I express in this testimony and during my appearance are solely my own. I am no longer engaged in the private practice of law and am not appearing in a representative capacity.

Introduction

The SEC's Division of Enforcement is the premiere civil law enforcement function in the federal government policing compliance with the federal securities laws. Its staff brings to bear considerable expertise and a devotion to mission to conduct a staggering number of investigations of potential violations of the federal securities laws and to litigate contested enforcement actions in both civil and administrative forums. During the last fiscal year, the Division initiated nearly 1,000 formal investigations and oversaw an existing investigative portfolio of nearly 1,400 matters. Its litigation docket was similarly eye-popping, with a combined number of pending administrative proceedings and civil actions topping 3,000 cases.

The talent and diligence of the Division of Enforcement staff cannot be gainsaid. For decades, the Division has profited from the dedication and outstanding leadership of a series of Directors dating back to its inaugural leaders, Irving Pollack and Stanley Sporkin, and from the talent of its rank-and-file staff that is second to none in the federal workforce. The Division continues to attract legal, accounting, and finance professionals at the top of their game, enabling the agency to maintain and develop relevant expertise necessary to accomplish its mission. For many years, supporters and critics alike have observed accurately that the Division punches above its weight.

And yet, as with any other well-run organization, opportunities for improvement certainly exist. Inefficiencies and delays persist; practices have developed – often incrementally or interstitially over many years – that need to be reexamined and possibly pruned or eliminated; and the exercise of relatively new statutory authority may need to be checked in light of experience. Even expert SEC staff remain subject to the human condition and where practices, or management, or investigative tools are not meeting the task effectively – or are the subject of infrequent but widely-held perceptions of misuse – this Committee is right to examine possible reforms. At no point since its creation has the SEC

or its Division of Enforcement ever had the luxury to rest on its laurels or the improvidence to suggest that its practices could not be improved.

It is in that spirit that I offer my views on certain of the legislative proposals under consideration by the Committee.

Protracted and Indeterminate SEC Investigations Remain a Persistent Challenge.

The SEC has long embraced the goal of filing "enforcement actions in as timely a manner as possible."[1] For many years the Division of Enforcement adopted and tracked progress against a stated performance goal of filing enforcement actions within two years of opening an investigation.[2] Notwithstanding years of efforts to streamline enforcement investigations, engage in risk-based approaches,[3] flatten supervisory structures,[4] and reduce delays associated with internal processes,[5] this goal remains frustratingly elusive. Using the most recent publicly available data, only about half of enforcement actions are filed within two years of the opening of an investigation.[6] These figures are especially disappointing when one considers that of the approximately 800 enforcement actions initiated each year by the Division, approximately 300 are so-called follow-on administrative proceedings or delinquent filings matters for which little investigative effort is required.[7]

In my experience, protracted and indeterminate investigations are indeed a persistent problem with SEC enforcement investigations. Even the most well-founded and efficient SEC investigations can impose considerable costs to public companies and regulated financial services firms and their employees:

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[1] Office of Inspector General, SEC, Report No. 576, Enforcement Investigations: Measures of Timeliness Showed Some Improvement But Enforcement Can Better Communicate Capabilities for Expediting Investigations and Improve Internal Processes (Feb. 15, 2023) [hereinafter "SEC IG Timeliness Report"], at 1.

[2] SEC IG Timeliness Report, at 2.

[3] Mary Jo White, Chair, SEC, Testimony on "Oversight of the SEC's Agenda, Operations and FY 2015 Budget Request," Committee on Financial Services, United States House of Representatives, April 29, 2014 (detailing a variety of risk-based enforcement initiatives, and stating that "we have continued to improve our efficiency and effectiveness by enhancing our technology, bringing in more experts, and deploying more risk-based analytics to allow us to do more with our resources, and to do so more quickly").

[4] Robert Khuzami, Director of Enforcement, SEC, Remarks Before the New York City Bar: My First 100 Days as Director of Enforcement, Aug. 5, 2009 (announcing a reorganization of the SEC's Division of Enforcement that, among other things, eliminated branch chiefs and created specialized units).

[5] Id. (describing changes to internal processes such as the delegation of formal order authority from the Commission to senior officers in the Division of Enforcement and the delegation of the power to approve "all routine case decisions" to regional officers throughout the country).

[6] SEC IG Timeliness Report, at 2 (2016: 53%; 2017: 52%; 2018: 49%; 2019: 56%; 2020: 56%; 2021: 54%). The average number of months between opening an investigation and the commencement of an enforcement action has remained steady at approximately 24 months. Id.

[7] See Division of Enforcement, Addendum to Division of Enforcement Press Release for Fiscal Year 2023, at 2 (Table: Enforcement Actions Filed in Fiscal Years 2018 to 2023).

- They are often expensive. Costs include attorney time as the respondent conducts necessary inquiry into the matter under investigation, searches for and produces documents and information responsive to the staff's information requests and subpoenas, makes current and former officers and employees available for interviews (often requiring separate counsel arrangements), and prepares factual and legal submissions responding to SEC staff questions and concerns. Experts – both subject matter and economic – may be necessary to, for example, evaluate and report on challenged trading practices or accounting practices.
- They are often disruptive. As one would hope and expect, SEC investigations attract the attention of senior management, boards of directors, and business leadership of responsible companies. That attention may lead to the postponement of company initiatives, the suspension or deferral of capital raising and business ventures, and the cessation of the advancement and compensation of key personnel, some of whom may remain on administrative suspension while the investigation is ongoing. Important commercial, client, customer, vendor, and supplier relationships may be affected – especially if investigative requests are sent to these parties.
- They risk reputational injury to those under investigation. SEC investigations are nonpublic by rule, and the SEC has long recognized that publicity around an investigation risks injury to those who may not have committed any wrongdoing. But the longer investigations remain outstanding, the more likely public disclosure may become necessary or prudent. Third parties contacted by the SEC investigative staff may lead to press stories. Individuals similarly may need to disclose SEC investigations on SEC, CFTC, or Finra registration forms. Directors are regularly asked about pending SEC investigations in D&O questionnaires – with "yes" answers often leading to requests that they stand down. Similarly, potential investors in private placements (including hedge funds, private equity vehicles and the like) regularly ask about pending SEC investigations in due diligence questionnaires and delay or avoid investments depending upon the perceived severity of the investigation.

As a general matter, and for sound policy reasons, the federal securities laws recognize that these incidental costs and disruptions may be necessary in service of ensuring well-policed domestic capital markets. But federal law and SEC policy also recognize that a balance must be struck: Sanctions and remedies sought in SEC enforcement actions remain subject to federal statutes of limitation; SEC administrative subpoenas are not self-enforcing; administrative limits are placed on the SEC investigative staff both by rule and by statute; and, in light of the difficulty of contesting SEC charges, a variety of practices have been adopted by the Commission and its staff to ensure pre-complaint opportunities for supervisory and Commission-level review of proposed enforcement actions.

Some delays in an SEC investigation are inevitable. Data collection and production, even in – and often because of – the digital age, can be burdensome and time consuming. And even with computer-assisted discovery tools, the SEC staff needs time to review and analyze the information it gathers. Additional, supplemental requests are to be expected, as

the focus of the investigation narrows and the SEC staff reacts to issues and factual discoveries.

Delays at the end of an investigation – for example, at or after the Wells submission stage – are in my experience not an especially pronounced problem. The SEC staff conducting the investigation has completed its factual review, the company or individual who is the subject of the investigation has submitted its position, and engagement with the supervisory chain of command is ongoing. While occasionally an investigation can enter a loop of supervisory questions and follow-ups, or encounter delays resulting from Commissioner-level review, these deliberative delays ordinarily are short-lived and an inevitable product of affording a modicum of pre-complaint due process.

On the other hand, when an investigation enters an extended "dormant" phase – at times approaching a year or more – problems can arise for respondents as well as the SEC. Knowledge fades. Personnel move on – at the company, at outside counsel, at the audit firm, at retained experts, and on the SEC staff. Risks of unintentional spoliation increase. Projects and opportunities put on hold because of the investigation languish. Talented employees become concerned about the uncertainty and pursue or entertain other employment. The deterrence value of any potential enforcement action fades.

Presumably to address these and other concerns, SEC enforcement supervisors have, to varying degrees over the years, developed systems to track the status of investigative matters and activity. Like good managers in any field, they track progress and engage with their teams, using tools of the modern workplace such as case tracking platforms and periodic assessments. Not every investigation leads to a case; not every conceivable lead can be pursued; some investigations are a higher priority than others. Managers must make decisions. While budgets and funding levels can and should be aligned so that Division of Enforcement resources match the demands placed upon it, history demonstrates that agency leadership cannot reasonably expect to address investigative delays through increases in annual funding.[8]

I believe that the SEC should continue to embrace as a goal a two-year period between the initiation of an investigation and the decision to either initiate an enforcement proceeding or close an investigation without action. It is a goal that it has embraced repeatedly over the years in various forms. It would help address the recurring problem of investigative requests that at times appear designed to show activity more than to result in meaningful, new information. It would reduce the risks and costs of protracted investigations described above while striking a balance that recognizes the need for SEC

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[8] The perceived under-funding of the agency is not a new conceit. James Landis, one of the primary authors of the Securities Act of 1933 and an original SEC Commissioner, urged then President-elect John F. Kennedy to increase appropriations for enforcement in 1960. See Report on Regulatory Agencies to the President-Elect, Committee Print, 86th Cong., 2d Sess., SUBMITTED BY THE CHAIRMAN OF THE SUBCOMMITTEE ON ADMINISTRATIVE PRACTICE AND PROCEDURE TO THE COMMITTEE ON THE JUDICIARY OF THE UNITED STATES SENATE, Dec. 1960, at 45 ("The problems of the Securities and Exchange Commission are relatively simple. Much of the delays that characterize its operation stem from the fact that it, more than any other agency, has been starved for appropriations.").

enforcement investigations. And it should be restored as a performance metric for the agency with concerted efforts to make meaningful, measurable progress over the near term.

How best to accomplish this goal should be left to the Commission in the first instance, recognizing that difficult choices may need to be made: Refining investigative practices to be even more targeted; crafting investigative requests with a goal of obtaining the most pertinent information while demanding prompt responses[9]; initiating subpoena enforcement actions more regularly when there is a reasonable basis to believe that delays by respondents or counsel are abusive; concluding that certain compliance problems may be better addressed by means other than enforcement, such as deficiency letters, interpretive guidance, 21(a) reports, and the like; and both incentivizing prompt actions and evaluating the reasons for unanticipated delays.

Settling Respondents Should Be Able To Provide Context and Explanations about Their Cases without Violating the No-Admit-No-Deny Provisions of 17 C.F.R. § 202.5.

Although I share many of the concerns expressed by critics of this rule,[10] I express no opinion on the constitutional validity of it or on whether its elimination would make it harder for the SEC and potential defendants to reach mutually acceptable settlements. On the former, I am the first to acknowledge that I am not a constitutional scholar – my views have no greater force than those of any other informed citizen. On the latter, it's simply impossible to predict the practical impact of the repeal of this provision on settlements. The current rule, for all its perceived shortcomings, has been a neutral ground of sorts between those who would permit settling firms and individuals to speak freely about their settlements – including issuing denials of factual or legal findings – and those who would insist that defendants admit findings or allegations of fact, dramatically altering the dynamic of an effort to compromise disputed claims without collateral legal or reputational consequences.

Should some form of this rule remain in place, I offer my views on some of the challenges representing clients who remain subject to it, and suggest a proposal that would address a portion of them.

I have helped clients navigate this rule throughout my career in private practice and would support some clarification of this policy to permit settling defendants and respondents greater latitude to provide truthful context about their conduct while continuing to abide by their "no deny" obligation.

In my experience, most clients appreciate the need to avoid denying SEC findings or liability, and understand the stated policy behind the rule that a denial of a factual basis for a settlement risks the integrity of the proceeding. Similarly, in my experience many public

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[9] See Andrew N. Vollmer, Need for Narrower Subpoenas in SEC Investigations, N.Y.L.J., Oct. 9, 2014, at 4 (describing the SEC staff's practice of issuing broad subpoenas and the reasons for them, and observing that they carry substantial costs and delays).

[10] Rodney A. Smolla, Why the SEC Gag Rule Silencing Those Who Settle SEC Investigations Violates the First Amendment, 29 Widener L. Rev. 1 (2023); Hester Peirce, Commissioner, SEC, Unsettling Silence: Dissent from Denial of Request for Rulemaking to Amend 17 C.F.R. § 202.5(e) (Jan. 30, 2024).

companies and market participants understand that the SEC's no-admit-no-deny policy facilitates the compromise of contested allegations in an orderly fashion.

The restriction in Rule 202.5(e), however, tends to chill any non-perfunctory comments by settling firms and individuals – even truthful contextual information that would be helpful to investors, clients, counterparties, and others. For example, explanations about the context in which the conduct occurred, mitigating facts, the perceived clarity or lack of clarity of the normative rule at issue, the absence of investor harm, the need to resolve the matter for business reasons, among other things. Settling parties are reluctant to engage on these points publicly – or even privately – for fear that the SEC staff will treat such comments as the equivalent of a denial and take action as they have with settling firms and individuals in the past. Indeed, it is commonplace for a settling firm on the day of a settlement announcement to receive a call from the SEC staff taking issue with some aspect of the settling firm's description of the settlement in a press release, a Form 8-K filing, or a registration amendment. To illustrate the point, at times the SEC staff has taken the position that the failure to use a preferred term (e.g., "side letter" instead of "undisclosed arrangement") or that ordinary references to litigation costs or delays amount to "denials" under Rule 202.5(e). This can be especially frustrating when the SEC staff may take liberties with descriptions of the settlement and factual allegations or findings in its own press release.

Investors may wish to hear from public companies settling SEC enforcement proceedings about why, for example, they did not settle sooner, or why they settled when they initially disclosed that they believed that no violations occurred. Same for counterparties, customers, and vendors. A mechanism to allow for truthful disclosures addressing these questions should be permitted.

There is a practice engaged in by Finra and certain securities SROs that may be useful here. For instance Finra permits settling firms to submit separate (a) Mitigation Statements, and (b) Corrective Action Statements.[11] The Corrective Action Statement – which accompanies an approved settlement instrument but is authored by the settling party – is allowed to describe steps taken to address problems associated with the disciplinary action. Mitigation Statements describe mitigating circumstances surrounding a violation, but are not generally released to the public. One could imagine a statute, rule, or simply a similar practice adopted by the SEC Division of Enforcement that would permit settling respondents to set forth mitigating, corrective, and contextual information in a document that accompanies the settlement instrument but that does not deny any factual findings or allegations. As with Finra practice, the document could carry a legend stating that the statement was prepared by the settling party and not the SEC, that it does not constitute factual or legal findings, and that it does not reflect the views of the SEC or its staff.

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[11] The practice was first described in a "Regulatory and Compliance Alert" issued by Finra's predecessor, NASD Regulation, in December 1998. NASDR, Regulatory & Compliance Alert, Dec. 1998, at 34-35. The practice, however, predated the Alert and continues to this day. See, e.g., Statement of Corrective Action by Interactive Brokers LLC, Finra Letter of Acceptance, Waiver & Consent No. 2014041809401 (Dec. 22, 2023).

Reforms to SEC Waiver Procedures Would Allow for a More Principled and Predictable Process.

There are a variety of automatic disqualifications that may arise from enforcement actions brought by the SEC, other federal financial or banking agencies, state authorities, disciplinary proceedings brought by the securities self-regulatory organizations such as Finra or the New York Stock Exchange, and even private civil actions in court that involve injunctive relief. For issuers of securities, these disqualifications may foreclose the availability of certain private placement exemptions,[12] or of certain expedited procedures for secondary offerings for seasoned issuers,[13] or from reliance on the safe harbor for forward-looking statements.[14] For regulated financial services firms, enforcement actions may trigger additional disqualifications, such as an ineligibility from acting as an investment adviser or principal underwriter or depositor to a registered investment company,[15] or from acting as placement agent or in other capacities in an exempt offering,[16] or from being a member of an SRO.[17] These and other disqualifications present very serious obstacles for firms settling enforcement actions. When negotiating settlements with enforcement staff, they must assess the need for, and availability of, relief from potentially applicable disqualifications.

These considerations can have serious consequences. If a large financial services firm agrees to settle an SEC injunctive action for, say, misconduct having nothing to do with its investment advisory business, its affiliated investment advisory business would nevertheless be put out of business on the day the injunction is issued absent relief from the SEC.[18] For that reason among others, by statute and rule, the SEC has the authority to issue relief from these disqualifications upon application.

In recent years the issuance of relief waivers has become controversial. I do not propose to weigh in on the merits of the positions taken by those on either side of the debate. But I do believe that modest reforms to the waiver *process* can restore a modicum of certainty while preserving the authority of the SEC to act when necessary to ensure that those involved in enforcement actions do not present an ongoing threat to the investing public in the areas covered by statutory or regulatory disqualifications.

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[12] See, e.g., Securities Act Section 4(a)(7); Securities Act Rule 262 (Reg A); Securities Act Rule 506(d) (Reg D); Securities Act Rule 602(b) (Reg E); 17 C.F.R. Section 227.503 (Reg CF).

[13] Securities Act Rule 405 (ineligible issuer).

[14] Securities Act Section 27A(b); Exchange Act Section 21E(b).

[15] Investment Company Act Section 9(a).

[16] Securities Act Rule 506(d).

[17] Exchange Act Section 3(a)(39); Finra By-Laws Sections 3, 4 (incorporating Exchange Act Section 3(a)(39)).

[18] See, e.g., In re Deutsche Bank AG, Investment Company Act Rel. No. 34025 (Sept. 24, 2020) (ICA Section 9(a) ineligibility arising from a CFTC civil injunctive action "relating to the firm's unintentional failure to meet its responsibilities regarding swap data reporting and its business continuity and disaster recovery plan").

The SEC should restore the policy of permitting a settling entity to request that the Commission consider an offer of settlement that simultaneously addresses both the underlying enforcement action and any related disqualifications. For many years the SEC and its staff followed an informal practice of entertaining settlement offers while simultaneously considering waiver requests in the event that the settlement were to be approved by the Commission. Implicit in this simultaneous consideration was the premise that the Division of Enforcement could not promise any waiver, but would permit the withdrawal of a settlement proposal in the event that a waiver would not be forthcoming – the main concern being a negative recommendation from the staff. That practice addressed the concern that an enforcement settlement would be presented to the Commission for approval, triggering a disqualification with potentially major implications for ongoing operations, but without any accompanying relief.

Over time the Commission's settlement process evolved, with greater uncertainty for settling defendants and respondents as the views of individual Commissioners on the merits of waiver applications changed. In 2019, to address this uncertainty, Chairman Jay Clayton adopted a policy that formally permitted settling defendants to submit "an offer of settlement that includes a simultaneous waiver request negotiated with all relevant divisions (e.g., Enforcement, Corporation Finance, Investment Management) [to be] presented to, and considered by, the Commission as a single recommendation by the staff."[19] The Commission remained under no obligation to accept any such offer and, in the event that the Commission chose to accept the settlement offer but decline to issue a waiver, the settling defendant was to be permitted five business days to consider whether to proceed or withdraw the offer.[20] This remained Commission policy until February 2021, when Acting Chair Allison Herren Lee rescinded the policy in favor of returning to a policy that considered settlement proposals and waiver applications separately.[21]

A return to the Clayton policy would avoid situations in which a surprise denial of a waiver application would result in a disorderly suspension of ongoing operations. The Commission would in no way be committed to approving a waiver application, nor would the consideration of waiver applications be prejudiced by the coordinated consideration of the settlement proposal. If the Commission were to vote to deny a waiver, allowing a settling defendant an opportunity to withdraw a settlement offer would not prejudice Commission options – the agency would remain free to initiate a contested enforcement action and the potential defendant (and its board of directors) would be able to make an informed decision about settlement alternatives and the consequences for its current business operations. This is precisely the type of informed decisionmaking the Commission should want to foster.

For enforcement actions in which the SEC is a party, there should be a presumption that the SEC enforcement action satisfactorily addresses the misconduct. When the Division

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[19] Jay Clayton, Chairman, SEC, Statement Regarding Offers of Settlement (July 3, 2019).

[20] Id.

[21] Allison Herren Lee, Acting Chair, SEC, Statement of Acting Chair Allison Herren Lee on Contingent Settlement Offers (Feb. 11, 2021).

of Enforcement recommends the resolution of an investigation through settlement, as a matter of course it ensures that those involved in wrongdoing will be charged or appropriately disciplined with penalties and other remedies commensurate with the offense. Undertakings, whether voluntary or ordered, provide additional remedial assurance that the settling firm will reform its conduct. Accordingly, there should be an expectation that the terms of the settlement of the enforcement action will address the full scope of the settling firm's securities-related operations and a presumption that unless limited by that action, those operations should be permitted to continue.

When a defendant or respondent is already before the Commission as a settling party, an automatic disqualification is unnecessary to give the agency authority to fashion additional limitations or conditions. The enforcement proceeding itself should be the vehicle through which the adequacy of a remedy is considered. This is neither a novel concept nor one that weakens enforcement.

The earliest and most severe automatic disqualification – the ineligibility provision of Investment Company Action Section 9(a) – was adopted at a time when the SEC lacked the full scope of statutory authority it currently has under Section 9(b) to commence administrative bar proceedings to prevent firms and individuals from serving in certain capacities in relation to a registered investment company if enjoined. The situation was lamented precisely because it was thought that automatic disqualifications swept too broadly and that "an automatic bar [would be] an unduly harsh remedy the application of which as a practical matter might be contrary to the best interests of the investment company's shareholders."[22] Ultimately the desired statutory authority under Investment Company Act Section 9(b) was obtained, but the automatic disqualification remained in place for reasons that are unclear.

Similarly, Exchange Act Rule 19h-1(a)(3)(v) reflects the Commission policy favoring addressing broker-dealer misconduct in a single proceeding. That rule allows securities self-regulatory organizations to continue the membership of certain registered broker-dealers without notice to the SEC if an SEC settlement includes a provision that "the future securities activities of such persons . . . will not be restricted or limited."[23] In both instances, the view was that the best vehicle through which to consider restrictions and limitations on the settling firm was the SEC's own enforcement proceeding.

Accordingly, when settling firms are able to reach a settlement of an investigation with the SEC Division of Enforcement staff, and that staff confirms with the relevant staff in the Divisions of Corporation Finance, Trading and Markets, and Investment Management that the proposed sanctions and other remedies are adequate both to address the alleged

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[22] SEC, Report of the Advisory Committee on Enforcement Policies and Practices (June 1, 1972), at 47 (noting that "[a]lthough the Commission, upon application, can grant an exemption to a person or company disqualified under those sections, during the Commission's consideration of any such application an investment company could be deprived of the services not only of the person enjoined but also of its investment adviser and principal underwriter" and that the ICA §9(a) automatic disqualification "has also impeded prompt settlement of cases which would otherwise warrant such treatment").

[23] Exchange Act Rule 19h-1(a)(3)(v).

misconduct and to ensure that ongoing business operations can continue without presenting a threat to the investing public (either because of additional remedial steps or because the sanctions removed any such threat), any necessary waiver applications would be processed by the SEC staff, and considered by the Commission, with a statutory presumption in favor of granting the requested relief.

The procedures implemented by the SEC for Rule 506 of Regulation D pursuant to Dodd-Frank should be codified and extended to disqualifications arising under Investment Company Act Section 9(a) and Exchange Act Section 3(a)(39)(F). Disqualifications that may arise from enforcement actions away from the SEC present the greatest risk that a settlement by consent may give rise to an unintended disqualification that neither the settling firm nor the responsible governmental enforcement authority believes is necessary or warranted. The risk is especially pronounced in circumstances in which the settling firm is a non-securities affiliate of a financial services firm and the government agency taking the action is unfamiliar with the various disqualifications that may arise from an injunction or certain types of administrative consumer protection actions.

To be sure, firms with experienced regulatory counsel can often navigate this issue – settlement papers can be drafted to avoid certain findings or court-issued injunctive relief. And many state and federal agencies are prepared to include provisions expressing their view that the regulatory action being taken is not intended to, and should not give rise to, any disqualification under the federal securities laws.

The Commission gave force to this practice by rule in connection with its adoption of the "bad actor" disqualification under Rule 506 of Regulation D. That provision permits a "court or regulatory authority that entered the relevant order, judgment or decree [to] advise[] in writing (whether contained in the relevant judgment, order or decree or separately to the Commission or its staff) that disqualification . . . should not arise as a consequence of such order, judgment or decree."[24] This authority, which is self-executing, is regularly included in settlements with non-SEC governmental authorities to prevent a settlement from giving rise to a disqualification under Rule 506 of Regulation D and has worked well in practice. Although such a provision is effective by Commission rule as to the "bad actor" disqualification under Rule 506 of Regulation D, comparable authority does not exist as to other disqualifications.

Extending that procedural tool to two additional disqualifications would be prudent. First, as to Investment Company Action Section 9 ineligibility, there exists and remains a rather serious risk that firms will inadvertently become disqualified because of unexpected injunctive actions and court-ordered relief against non-securities affiliates of investment advisers. Second, given the importance of "well known seasoned issuer" (WKSI) status under Securities Act Rule 405 to capital raising efforts, it seems equally prudent to codify a comparable provision to ensure that large, well-capitalized public issuers are not disqualified by actions occurring away from the SEC, especially those addressing misconduct by non-reporting subsidiaries, when the governmental authority taking action concurs that such a disqualification is unnecessary or unwarranted by the conduct being addressed.

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[24] Securities Act Rule 506(d)(2)(iii).

Extending this provision to a third type of disqualification – a specialized provision addressing broker-dealer membership in securities SROs – would help streamline what has become a rather cumbersome and costly regulatory process involving serial "membership continuation proceedings" that appears to have been an unintended consequence of the Sarbanes-Oxley Act.

After the Sarbanes-Oxley Act amended the definition of "statutory disqualification" in Exchange Act Section 3(a)(39) with respect to membership in a securities SRO to include any "order or finding" of a variety of state and federal enforcement actions, the number of potential membership continuation applications required to be processed by Finra, other securities SROs, and the SEC expanded significantly. The SEC and Finra recognized that many of these events of disqualification do not present any reason to question or prevent a broker-dealer's continued membership in an SRO and have issued several no action letters and regulatory notices providing a type of short form relief.[25]

For certain types of enforcement actions, however, this relief is inapplicable. For example, settlements involving ongoing administrative obligations, settlements nominally arising under state antifraud provisions, and state actions involving the issuance of a court injunction all require the initiation of a formal membership continuation proceeding.[26] These proceedings, which are initially filed with Finra and considered separately by the SEC, can take years to be fully considered by the Finra staff, the relevant Finra membership committees, the Finra National Adjudicatory Council, and the SEC's Division of Trading and Markets. Rarely do the proceedings involve the imposition of additional limitations on the applicant beyond those that were imposed in the first instance by the government entity whose action gave rise to the disqualification (and whose views are invariably solicited). In other words, the applications are costly to prepare,[27] introduce prolonged uncertainty as to a member firm's status, and provide questionable regulatory benefit while consuming valuable time at Finra and the SEC.

Expanding the approach taken in Securities Act Rule 506(b)(2)(iii) to Exchange Act Section 3(a)(39)(F) would prevent the unintended disqualification of a broker-dealer as a result of an enforcement action occurring away from the SEC and avoid the costs and uncertainty associated with prolonged SRO membership continuation proceedings.

Respondents in SEC Administrative Enforcement Proceedings Seeking Fines and Other Sanctions Should Have a Removal Right.

As financial penalties, disgorgement orders, and other sanctions ordered in SEC administrative proceedings have become both more severe and more common, it is appropriate to reconsider the fairness of allowing the SEC to initiate contested proceedings

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[25] See, e.g., Finra Reg. Notice 09-19 (Apr. 2009).

[26] See Finra Rule 9523(a); Finra Reg. Notice 09-19.

[27] See Finra Form MC-400A; Finra Rule 9523; Exchange Act Rule 19h-1.

that do not afford the same procedural protections that Americans have come to expect in other types of government enforcement actions and litigation. These protections include discovery and other procedural rules set by the Federal Rules of Civil Procedure, evidentiary standards governed by the Federal Rules of Evidence, and the right to a jury trial.

The SEC's administrative authority was conceived at a time when even the use of administrative cease-and-desist orders – without any other monetary penalty or sanction – was in its infancy, and the agency's novel authority to issue stop orders to "halt" the effectiveness of an issuer's registration statement needed to be justified as a tool that would bring to bear the expertise of the Commission and afford the expediency necessary to act promptly to avoid the risk of immediate investor harm.[28] For nearly seven decades, the SEC's administrative authority remained largely cabined to core regulatory concerns – oversight of the new issue registration process, issuer reporting and filing obligations, and oversight of regulated investment and trading firms, the securities exchanges, and the securities clearing agencies.

Beginning with the enactment of the Securities Enforcement Remedies and Penny Stock Reform Act of 1990,[29] the SEC's ability to initiate enforcement action administratively has been greatly expanded. The Remedies Act first conferred statutory authority to the SEC to, among other things, impose fines and orders in administrative proceedings against regulated entities such as registered broker-dealers and investment advisers and their associated persons. The Remedies Act refrained from allowing the SEC to impose fines more generally, but did expand its traditional "cease-and-desist authority" – the ability of the SEC to identify a practice as violative of the federal securities laws and to order its cessation – to "any person" which, for the first time, allowed the SEC to sue public companies and individuals alike in its administrative forum. But in order to impose a monetary penalty against a public company (or any other unregulated person) – even by consent – the Commission still needed to initiate a companion civil action and appear before an Article III judge in federal district court.

In the Sarbanes-Oxley Act of 2002,[30] Congress again expanded the administrative jurisdiction of the SEC to include the ability to issue administrative orders prohibiting individuals from serving as an officer or director of any public company in administrative proceedings.[31] Then, with the passage of The Dodd-Frank Wall Street Reform and Consumer Protection Act,[32] Congress further expanded the SEC's administrative authority, conferring for the first time the statutory authority to impose civil money penalties in

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[28] See generally James M. Landis, The Administrative Process (1938 Yale Univ. Press), at 107-08 (defending the early use of the Commission's administrative stop order authority).

[29] Pub. L. No. 101-429, 104 Stat. 931. See generally Ralph Ferrara at al., Hardball! The SEC's New Arsenal of Enforcement Weapons, 47 Bus. Law. 33 (1991).

[30] Pub. L. No. 104-67, 109 Stat. 737.

[31] Sarbanes Oxley Act § 1105, 116 Stat. 809-10; see generally William R. McLucas & Paul R. Eckert, Sarbanes-Oxley and the SEC's Enforcement Program, The Practitioner's Guide to the Sarbanes-Oxley Act (ABA Press 2004), at VII-2-1 to VII-2-34.

[32] Pub. L. No. 111-203, 124 Stat. 1376.

administrative proceedings against "any person" and not just regulated firms and their associated persons.[33]

Cumulatively, these expansions in the Commission's administrative enforcement authority corresponded with a marked increase in reliance on the SEC's administrative forum and, by 2015, roughly 645 of 807 enforcement actions were brought administratively.[34] With this increase in reliance on the administrative forum, calls for a reconsideration of the fairness of the SEC's administrative forum and its reliance on administrative law judges have grown. The Supreme Court's decisions in *Lucia v. SEC*[35] and *Axon Enterprise, Inc. v. FTC*,[36] and the Fifth Circuit's decision in *Jarkesy v. SEC*[37] that is now before the Court, have only heightened those concerns.

I share the concerns of those who worry that the administrative forum no longer reflects the procedural checks and balances that we have come to expect as Americans. What was once fashioned as a flexible tool to be used to exercise agency expertise in certain well-defined areas has grown into a generalized forum that competes with Article III courts. Severed from the need to rely on special agency expertise in securities matters – appointed ALJs are specialists in *adjudication* not securities regulation – it is hard to justify the reduction in procedural rights afforded to litigants. A removal right afforded to administrative respondents would restore the balance, while allowing the SEC to elect its preferred venue in the first instance and permit (but not require) a respondent to consent to a proceeding before an ALJ much in the same way that civil litigants may consent to a trial before a federal magistrate.

I do, however, believe that there remains a reservoir of SEC administrative authority that addresses public rights related to registration (both of the issuance of securities variety and related to the federal licensing of securities firms, professionals, exchanges, and clearing agencies) and the operation of the securities markets that does not implicate procedural fairness in the same way as the use of this authority in ordinary enforcement actions. For example, administrative actions involving stop orders,[38] delinquent filings,[39] and suspension of trading[40] all seem much more in line with the principles that led to the establishment of administrative agencies and present less of a conflict with procedural protections more

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[33] Securities Act Section 8A(g); Exchange Act Section 21B(a)(2).

[34] Philip J. Griffin, Developments in SEC Administrative Proceedings: An Evaluation of Recent Appointment Clause Challenges, the Rapidly Evolving Judicial Landscape, and the SEC's Response to Critics, 19 Univ. Penn.J. Bus. Law 209, 272 (2016); SEC, Summary of Performance and Financial Information, Fiscal Year 2015 (Feb. 11, 2016), at 4.

[35] 138 S. Ct. 244 (2018).

[36] 143 S. Ct. 890 (2023).

[37] 34 F.4th 446 (5th Cir. 2022).

[38] Securities Act Section 8(d).

[39] Exchange Act Section 12(j).

[40] Exchange Act Section 12(k).

commonly associated with governmental actions seeking to fine or sanction individual or corporate misconduct.

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Thank you for the opportunity to present my views on these matters. I appreciate the work that the Subcommittee and the Committee perform in service of our domestic capital markets and investors. I welcome any questions or comments either at the hearing or whenever it would be convenient.