Submitted Testimony
of the Securities Industry and Financial Markets Association

before the U.S. House of Representatives

House Financial Services Subcommittee on Investor Protection, Entrepreneurship and Capital Markets

Hearing entitled "Putting Investors First: Proposals to Strengthen Enforcement Against Securities Laws Violators"

June 19, 2019

The Securities Industry and Financial Markets Association ("SIFMA")[1] appreciates the opportunity to provide our input on several of the discussion drafts of bills before the U.S. House of Representatives, House Financial Services Subcommittee on Investor Protection, Entrepreneurship and Capital Markets hearing entitled "Putting Investors First: Proposals to Strengthen Enforcement Against Securities Law Violators."

"The Bad Actor Disqualification Act" would make changes to the Securities and Exchange Commission's ("SEC" or "Commission") process for waiving the automatic disqualifications provisions in the securities laws. Absent waivers, such automatic disqualification provisions – which do not exist in any other country's securities laws –

---

[1] SIFMA is the leading trade association for broker-dealers, investment banks and asset managers operating in the U.S. and global capital markets. On behalf of our industry's nearly 1 million employees, we advocate for legislation, regulation and business policy, affecting retail and institutional investors, equity and fixed income markets and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA).

can have a crippling effect on financial institutions, their clients and employees, and the broader markets.

We have a common goal of maintaining trust in the financial system by targeting and disqualifying bad actors. However, since the financial crisis, the debate has focused on whether large financial institutions were disproportionately granted waivers and were "too big to bar."[2] Unfortunately, this has led to misconceptions about the purpose waivers serve, the waiver process, the ability of the Commission and its staff to assess waiver applications, and the waiver applicants themselves.[3] It has been said that large financial institutions use their corporate structures to insulate themselves from disqualifications; however, the opposite is true.[4] Congress intended for disqualifications to be overly broad but created waivers to give the Commission discretion to address their unintended effects.[5] President Obama's appointee, former SEC Chairwoman Mary Jo White, addressing the "too big to bar" debate, said it best: "(i)n making our decisions, we should and do treat large financial institutions exactly the same as any other firm or person when considering whether a waiver is appropriate, no better, and no worse."[6] Unfortunately, some view the waiver process differently – as a means to deny market participation under the securities laws, such as the WKSI process which provides issuers with a critical means of access to the capital markets, for misconduct, even if, as is very often the case, the misconduct is unrelated to the benefit enjoyed. This turns the waiver process into an extension of the enforcement process – to impose additional sanctions. This is not the purpose of the waiver process.

While SIFMA welcomes improvements to the waiver process that could make it function better, we are concerned that this bill would do the opposite of what is intended. Rather than make the process function better, various provisions of this bill would unduly burden the SEC and are unnecessary given improvements to the process made in

---

[2] SEC Commissioner Kara Stein coined this colloquial term, and we believe it has led in part to misconceptions about the waiver process, including that it has become a rubber stamp for large financial institutions. *See* Dissenting Statement in the Matter of The Royal Bank of Scotland Group, plc, Regarding Order Under Rule 405 of the Securities Act of 1933, Granting a Waiver From Being an Ineligible Issuer (Apr. 18, 2014), https://www.sec.gov/news/public-statement/2014-spch042814kms.

[3] Chairwoman Mary Jo White tried to correct misconceptions about the waiver process while also directing staff to make improvements to it. *See* Understanding Disqualifications, Exemptions and Waivers Under the Federal Securities Laws, Remarks at the Corporate Counsel Institute, Georgetown University (Mar. 12, 2015), https://www.sec.gov/news/speech/031215-spch-cmjw.html.

[4] *See* Financial Services Committee Democrats Summary: The Bad Actor Disqualification Act, https://financialservices.house.gov/uploadedfiles/07.27.2017_bad_actor_disquatlification_act.pdf.

[5] SEC Commissioner Dan Gallagher provides a helpful historical background of waivers. *See* Why is the SEC Wavering on Waivers?, Remarks at the 37th Annual Conference on Securities Regulation and Business Law (Feb. 13, 2015), https://www.sec.gov/news/speech/021315-spc-cdmg.html.

[6] *Supra* note 3.

response to criticism by Congress and SEC Commissioners. In turn, this would have dramatic, unintended consequences not only for the Commission and its enforcement program, but also for the many communities that both large and small financial institutions serve. Below is our input on the bill:

- The Commission operates a rigorous waiver review process and has made significant changes in the past several years in response to criticism not only from Congress but also from individual Commissioners themselves.[7] For example, the Commission now grants conditional waivers in appropriate circumstances – a process supported by various Commissioners – rendering the bill's temporary waiver provision unnecessary for every waiver application.[8] We are also concerned that the bill's provisions for temporary and general waivers procedures would unduly burden the Commission's current process. We believe that the waiver process has room for improvement, and we would welcome a study being conducted prior to any legislation being enacted. Alternatively, the Commission should seek public comment on how the process can be improved.

- The bill would hamper the Commission's ability to "…calibrate the otherwise broad effect of disqualifications."[9] The disqualifying events that trigger the automatic disqualification provisions are exceptionally broad. For example, a broker-dealer affiliate that settles with the Commission for violating its net capital rules could disqualify the entire firm from participating in private placement offerings under Rule 506 – activity unrelated to the misconduct. This is one example of the overly broad and potentially crippling effects of disqualifications that has led to financial institutions seeking waivers in greater numbers than companies with simpler corporate structures. We would welcome a further discussion and potentially Congress amending the securities laws to tailor the broad consequences of the disqualifying events to the activities related to, or those responsible for, the misconduct.

- This bill would detrimentally impact the Commission's enforcement program. A waiver is but one useful tool in the Commission's toolbox. Should this tool become unavailable as a result of this bill's effects, it would hamper the Commission's ability to settle enforcement matters in a timely and resourceful

---

[7] *Id.*

[8] *See* Kara M. Stein, Commissioner, SEC, Statement in the Matter of JP Morgan Chase Bank, N.A., Regarding Order Under Rule 506(d) of the Securities Act of 1933 Granting a Waiver of the Rule 506(d)(1)(iii) Disqualification Provision (Dec. 18, 2015), https://www.sec.gov/news/statement/statement-on-jpmorgan-chase-bank-12-18-2015.html; Luis A. Aguilar, Commissioner, SEC, Enhancing the Commission's Waiver Process (Aug. 27, 2015), https://www.sec.gov/news/statement/aguilar-enhancing-commissions-waiver-process.html.

[9] Remarks at the Corporate Counsel Institute, *supra* note 3.

manner. Defendants, naturally seeking to achieve greater certainty and finality in outcomes, would litigate their cases to the full extent, draining Commission resources.

- We are also concerned with the public comment requirement for each waiver application. First, it would slow the process and introduce greater uncertainty. We believe the process should be left to the Commission and its staff, which have the expertise and the ability to apply the legal standards appropriately. Second, and of greater consequence, it would prejudice waiver applicants. It would provide the opportunity to second-guess the sanctions imposed by a court or the Commission against a waiver applicant and use the denial of a waiver as additional punishment. This would go against all understandings of the original purpose of disqualifications not to serve as additional punitive measures.[10]

- The bill prohibits the Commission from taking the direct costs of a waiver denial into consideration. However, costs, especially the indirect costs that include market disruption, the potential loss of hundreds or thousands of jobs, harm to investors and loss of access to the capital markers, are significant – indeed potentially devastating to core business of our members – and cannot be ignored. The Commission's ultimate objective is for a waiver decision to safeguard the public interest and protect investors, not harm them by hamstringing the Commission's ability to take all relevant factors into consideration. Before moving forward with the bill, there should be careful consideration of the unintended practical consequences from the proposed legislation.

- The bill prohibits the Commission staff from advising a waiver applicant of the recommendation of staff to the Commission or on the likelihood of a waiver being granted or denied. Waiver applicants need to be able to communicate with the staff the facts and nature of the wrongdoing so the staff can properly assess whether a waiver is appropriate given the facts and circumstances.

- It is unclear what happens to the waiver applicant between the expiration of the 180-day temporary waiver and the Commission vote for a general waiver. As drafted, following the 180-day period of the temporary waiver, the Commission must notice a public hearing and after said hearing, vote on the general waiver. Since this must happen after the conclusion of the 180-day period, it is unclear if the waiver applicant may continue to utilize the benefit for which the waiver is sought during the period between the expiration of the temporary waiver and the approval (if that is the case) of the general waiver.

---

[10] *See* Remarks at the 37th Annual Conference on Securities Regulation and Business Law, *supra* note 5.

For the reasons stated about SIFMA opposes the legislation.

SIFMA and its member firms would also like to express concerns with the Discussion Draft "[t]o establish a statute of limitations for certain actions of the Securities and Exchange Commission [(the "SEC")] …."

We understand the purpose of the bill is to address the U.S. Supreme Court's decision in *Gabelli v. SEC*, 568 U.S. 442 (2013)[11] which held that the an SEC enforcement action against a financial advisor for alleged securities fraud that seeks civil penalties must be brought "within five years from the date when the claim first accrued"[12] – and not from the (usually later) date the fraud was discovered. The bill would increase the limitations period in §2462 from five years to ten years for civil monetary penalties, thereby giving the SEC *ten years* after the alleged fraud occurred to bring an action seeking civil monetary penalties.

We strongly oppose the bill, consistent with the reasons stated in our amicus brief in *Gabelli*,[13] as follows: SIFMA represents businesses for which the fair and efficient application of the securities laws is of great consequence. Appropriate exercise of the investigatory and enforcement powers afforded by Congress to the SEC plays an important role in the regulation of the nation's financial markets to the benefit of investors and other market participants.

At the same time, however, belated enforcement efforts risk undermining the health and stability of our capital markets and the financial services industry. Pursuit of old and stale claims poses a particularly acute threat of governmental overreaching, as Congress has previously recognized in establishing the existing statutes of limitations and repose for actions involving alleged violations of the securities laws. Accordingly, evenhanded adherence to in §2462's existing five-year limitations period – *without extension* – will best ensure fairness and efficiency and investor protection.

It would undermine the due process rights of defendants and the interests of justice to extend the limitations period for civil penalties beyond five years. An action filed more than five years after a claim has accrued will likely not got to trial for another one or two years. When claims are "allowed to slumber" for that long, often "evidence has been lost, memories have faded, and witnesses have disappeared."[14] This concern is particularly acute in the securities industry which experiences high employee turnover

---

[11] Available at https://www.scotusblog.com/case-files/cases/gabelli-v-securities-and-exchange-commission/. .

[12] 28 U.S.C. 2462.

[13] SIFMA amicus in *Gabelli v. SEC* (November 16, 2012), available at https://www.sifma.org/resources/submissions/gabelli-v-sec/.

[14] *Order of R.R. Telegraphers v. Ry. Express Agency*, 321 U.S., 342, 349 (1944). *See also United States v. Kubrick*, 444 U.S. 111, 117 (1979).

and cyclical downsizing. Five or more years after an event has occurred, the relevant employees are less likely than employees in other industries to be performing the same job function with the same employer, making the investigation and trial more difficult and costly to defend.

In addition, trials conducted so long after the underlying events took place breed disrespect for the legal process because they lead to less predictable results and a greater risk of injustice.[15] "As the SEC … bring[s] cases that are increasingly distant from the time of the alleged violation, faded memories and the disappearance of evidence may make it harder for some innocent defendants to demonstrate their blamelessness)."[16]

A longer limitations period would also detract from the agency's effectiveness. The SEC's primary enforcement mission is remedial in nature – the cessation of ongoing misconduct and the prevention of recurring offenses that lead to investor losses – not punitive.[17] Although Congress decided in 1990 to provide the SEC with the ability to seek civil penalties in order to punish and deter violators, those punitive pursuits were intended to be only a supplement to existing punitive, criminal enforcement of the securities laws, and not a substitute for the SEC's primary civil remedial authority.[18]

Having a firm, short-term end date for enforcement actions seeking punitive sanctions encourages the SEC to focus its resources on its core remedial mission— pursuing fresh cases that, if urgently investigated, might prevent investor losses. Extending the limitations period in §2462 from five years, on the other hand, would induce the SEC to expend more enforcement resources seeking civil penalties in old and stale cases.[19]

The pursuit of older cases would also result in delay in the imposition of sanctions, which is "generally thought to reduce the effectiveness of deterrence against other offenses, both by the offender (who sees no immediate sanction for his misconduct) and by others (who see the offender appearing to get away with his misconduct)."[20] Indeed,

---

[15] See Tyler T. Ochoa & Andrew J. Wistrich, *The Puzzling Purpose of Statutes of Limitations*, 28 Pac. L.J. 453, 481-83 (1997)

[16] Arthur B. Laby & W. Hardy Callcott, *Patterns of SEC Enforcement Under the 1990 Remedies Act: Civil Monetary Penalties*, 58 Alb. L. Rev. 5, 52 (1994) *cf. SEC v. Bartek*, No. 11-10594, 2012 WL 3205446 (5th Cir. Aug. 7, 2012) (per curiam) (affirming dismissal of SEC suit as untimely).

[17] *See* SEC Enf. Manual at 1.

[18] *See* S. Rep. No. 101-337, at 11 (1990) ("The Committee anticipates that the SEC will not seek or impose a civil money penalty in every case"); *see also id.* at 11−12; Securities Law Enforcement Remedies Act of 1989: Hearings on S. 647 Before the Subcomm. on Sec. of the S. Comm. on Banking, Hous., & Urban Affairs, 101st Cong., 2nd Sess. 44−45 (1990) (statement of Richard C. Breeden, Chairman, SEC) ("[W]here the defendant in a Commission action is also the subject of a criminal prosecution, the imposition of a civil money penalty in the Commission's action may not be needed to achieve deterrence").

[19] *See* Laby & Callcott, supra, at 51−52.

[20] Laby & Callcott, *supra*, at 52.

a former Director of Enforcement, noting his disapproval of agreements to toll the statute of limitations, stated that delay can "impose a significant cost . . . and may undermine our message of prompt accountability for wrongdoing."[21]

Moreover, given the SEC's extensive resources and powers, the five-year limitations period provided by Section 2462 is sufficient for the SEC to uncover fraud and file an enforcement action. Five years is already as long as or longer than the statute of repose provided for every cause of action under either the Securities Act or the Exchange Act.[22] It equals – and often exceeds – the amount of time that victims of securities fraud (who do not have investigative powers) have to file private enforcement actions under Section 10(b).[23] And, in an unusual case where the SEC does need more time to file an enforcement action, the agency can (and often does) ask the subject of the investigation to consent to a tolling agreement.[24] Or the agency can commence a civil action and use federal civil discovery to obtain the evidence needed to prove its claims.[25]

The SEC has not shown that any broad category of cases is escaping detection or punishment as a result of Section 2462's five-year statute of limitations. Indeed, the SEC's statistics show that the "average number [of] months between the opening of an investigation and the filing of the first enforcement action arising out of that investigation" is only 20 months— less than 2 years.[26]

In short, an extension of §2462's limitations period from five years to ten years for civil monetary penalties is unnecessary for the SEC to accomplish its securities enforcement goals, unhelpful for compensating the victims of securities fraud, fundamentally unfair to defendants, and subversive to the interests of justice.

SIFMA also has concerns with the Discussion Draft "[t]o amend the Securities Exchange Act of 1934 to allow the Securities and Exchange Commission [(the "SEC")] to seek and Federal courts to grant restitution to investors and disgorgement of unjust enrichment." We recognize this is a discussion draft and our concerns below outline why we do not support it.

---

[21] Robert S. Khuzami, Dir., SEC Div. of Enforcement, *My First 100 Days as Director of Enforcement* (August 5, 2009), available at https://www.sec.gov/news/speech/2009/spch080509rk.htm; *see also ibid.* (announcing the SEC's intention to be "strategic . . . swift, . . . smart . . . [and] successful" by establishing specialized enforcement units, streamlining management and internal processes, analyzing tips and data to focus on those with the greatest potential for wrongdoing, and creating incentives for individuals to cooperate with the enforcement program).

[22] *See Lampf*, 501 U.S. at 359–61.

[23] *See Merck*, 130 S. Ct. at 1790 (citing 28 U.S.C. § 1658(b)).

[24] *See* SEC Enf. Manual at 39.

[25] *See, e.g., SEC v. Banca Della Svizzera Italiana*, 92 F.R.D. 111, 112–13 (S.D.N.Y. 1981) (lawsuit to enjoin transfer of allegedly illegal proceeds pending discovery of the identity of the perpetrators).

[26] SEC Cong. Just. at 28.

We understand the purpose of the bill is to address the U.S. Supreme Court's decision in *Kokesh v. SEC*, 137 S. Ct. 1635 (2017)[27] which held that because disgorgement sought by the SEC operates as a penalty under 28 U.S.C. § 2462, any claim for disgorgement in an SEC enforcement action must be commenced within five years of the date the claim accrued.

The bill would grant the SEC statutory authority to seek any form of equitable relief, including: (i) restitution to investors in the amount of their losses; (ii) disgorgement in the amount of any unjust enrichment; (iii) injunctions, including officer and director bars; and (iv) additional equitable relief that may be appropriate or necessary. The bill further provides that any such equitable relief shall *not* be construed to be a *penalty*.

First, we agree that equitable relief, particularly disgorgement, should not be construed or characterized as a penalty.

However, we oppose granting the SEC statutory authority to seek restitution in SEC enforcement cases. The SEC does not require formal statutory authority to seek restitution as it frequently negotiates restitution funds on behalf of investors in SEC settlements in the form of a "voluntary undertaking" by the registrant.

Moreover, restitution is currently available to (and actively sought by) litigants in private securities actions. The creation of parallel authority shared by both private litigants and the SEC creates the opportunity for uncertainty, confusion, inconsistent verdicts and a (potential) duplication of defense costs for registrants. If the bill grants the SEC statutory restitution authority, then it should also preclude private actions seeking the same relief and/or offset the restitution by the amount of "damages" paid in any parallel private securities action. In sum, the bill's restitution provision should be stricken. If it is not, the bill should be amended to offset restitution by any amounts paid in parallel private litigation.

SIFMA appreciates the opportunity to explain our views related to several important measures under consideration by the Subcommittee.

---

[27] Available at https://www.scotusblog.com/case-files/cases/kokesh-v-securities-and-exchange-commission/.