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The S.E.C.'s Hazy Approach to Cri Punishment

By PETER J. HENNING FEBRUARY 9, 2015 12:15 PM

"Let the punishment fit the crime" is easy to portray on stage, but a bit murkier ir Bengiveno/The New York Times

In Gilbert and Sullivan's "The Mikado," a line expresses the need "to let the punishment fit the crime." The Securities and Exchange Commission is struggling with that notion when it decides whether to grant a waiver to an automatic bar from certain securities trading.

The issue has been nagging the S.E.C. for the last year in settlements with banks and brokerage firms for violations of the securities laws that earns them the label of "bad actor," which results in the automatic bar, which can be costly. Last week, two commissioners, Luis A. Aguilar and Kara M. Stein, issued a dissent from an order that granted a waiver to Oppenheimer & Company despite what they described as "egregious misconduct."

The firm reached a settlement with the S.E.C. and the Treasury

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Joe NYC • 10 February 2015
I find it fascinating to see all of the hand wringing and moral second-guessing when it comes to application of white collar rules on business. Any rule can be analyzed and deconstructed until its meaningless. Pity the same care to see both sides i[...] when a policeman's actions are challenged.

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Another worthless bureaucratic agency that serves little true purpose.

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Fleetwood Allentown, PA • 10 February 2015
The whole system for compliance for corporations in the financial services is like a merry-go-round in a carnival. Their is no such thing as real enforcement, just a few fines which are pocket change compared to the corporations income. There is Broker Check to find out if your broker has been bad over the years, but nothing to check on your Financial Services Company. If we are really being protected, we should be able to go to the SEC or FINRA website and get information on every violation by corporations. It is a joke. even major convictions never follow the corporation except for a few weeks. There is no tracking for the public to follow all the violations. It is not even disclosed; in Prospectus of Merrill Lynch and their funds, that they virtually went bankrupt and had to be salvaged with a government bailout and picked up by another financial institution. In the interest of true disclosure, don't you think that is an event requiring FULL DISCLOSURE?

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Bob Lamm Boca Raton, Florida • 10 February 2015

White Collar Watch

Department's financial crimes enforcement network for improperly executing sales of billions of shares of penny stocks for a client and failing to file suspicious activity reports about the trading. Oppenheimer paid $20 million in penalties for the violations.

Under an amendment to Rule 506 that went into effect in September 2013, those violations would normally mean that the firm could not participate for five years in private placements of securities to so-called accredited investors, which include pension and hedge funds. These investors are viewed as sufficiently sophisticated so that they do not need the usual protections afforded by the disclosure requirements for such transactions. Shutting a firm out of this lucrative corner of the market, which involves hundreds of billions of dollars in sales annually, can inflict significant harm on its bottom line.

The S.E.C. can waive the automatic bar "upon a showing of good cause." What constitutes "good cause" is not spelled out in the rule, and that issue has divided the commissioners.

In their dissent, Mr. Aguilar and Ms. Stein point out that Oppenheimer has been the subject of "at least 30 separate regulatory actions" for securities law violations and that the firm "has a failed compliance culture, from top to bottom." In a letter seeking the waiver, Oppenheimer offered to hire a law firm "not unacceptable" to the S.E.C. to review its policies and procedures for private placements under Rule 506. The dissenting commissioners were critical of this offer, pointing out that there was no requirement that senior management review the firm's compliance or even that the law firm report back to the S.E.C. on what it found.

This is not the first time that commissioners have been divided about granting a waiver. A settlement with Bank of America over the sale of residential mortgage-backed securities before the financial crisis was hung up when the S.E.C. would not waive the automatic bar. The bank finally agreed to a more limited wavier that required it to retain an outside monitor and report back on its compliance with the rules within 30 months before it would be allowed to continue to participate in private placements.

The debate over whether to grant a waiver reflects a broader problem with this type of "one size fits all" penalty for misconduct. The punishment is not tailored to the violation but instead treats every transgression equally.

The misconduct that results in the "bad actor" bar does not have to be related to private placements made under Rule 506. Oppenheimer's violations involved allowing a client to unload huge amounts of penny stocks and not following the money laundering rules, questionable practices but not something that raises issues about its compliance with the rules for selling shares to sophisticated investors.

We are accustomed to harsher penalties for recidivists because they are not responding to the deterrence message. In a large organization, however, misconduct in one area does not necessarily mean other parts are also violating the law. But when an automatic penalty is in place, calibrating the punishment to a firm's particular circumstances is lost.

An automatic bar is a blunderbuss solution to the problem of deterring corporate misconduct. It imposes a potentially severe penalty for even minor transgressions, which leads to waivers to ensure that the prohibition is not too severe. That in turn can give the perception that the rule does not truly apply to most violations because the waiver will be granted almost routinely.

Although the S.E.C. has granted a dozen waivers to the automatic bar since November 2013, DealBook reported that it "rejects most requests." The S.E.C. website lists only the companies whose requests it granted but not any denials "because many companies convey requests in an informal manner," according to people who spoke to DealBook on the condition of anonymity because they were not authorized to comment on this issue publicly.

That raises the broader question of the criteria the S.E.C. uses to determine "good cause" when an informal request is made. When policy is made through back channels, it becomes difficult to determine when waiving the automatic bar is appropriate.

Granting Oppenheimer a waiver may well have been appropriate under the circumstances, though it is arguable whether its history of violations squares with determining good cause to grant the firm's request. What led the S.E.C. to reach its decision remains a mystery.

The firm's letter seeking the waiver — like most such documents submitted by high-powered law firms — is a rather stilted recitation of legal rules that portrays the violations as seemingly minor. The S.E.C.'s order contains no discussion of the reasons Oppenheimer's offer to hire an outside law firm and improve its private placements qualified it for a waiver.

For an agency that pushes for full disclosure by the companies subject to its authority, the S.E.C.'s reliance on informal means to signal when it will grant or deny a waiver is surprising. Without a clearly articulated standard for waiving the automatic bar, the public is left to guess why one firm receives the benefit despite past violations and another does not. When there is no information about which requests have been rejected, it appears that everyone who asks for a waiver receives one, regardless of whether that is the case.

Granting waivers to the "bad actor" prohibition does allow the S.E.C. to fit the punishment to the crime, something we expect when the law is applied. But without greater transparency in the process, it can sow mistrust about whether relieving a firm from a punishment is appropriate.

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