

March 17, 2015

## Securities Alert

### SEC Issues Guidance on Waivers of Disqualification Under Regulation A and Rules 505 and 506 of Regulation D

On March 13, 2015, the SEC's Division of Corporation Finance issued [guidance](#) regarding disqualification waivers under Regulation A and Rules 505 and 506 of Regulation D of the Securities Act of 1933, as amended (Securities Act), the SEC's principal rule-based private-placement exemptions.

The disqualification provisions of Rules 262 and 505 under the Securities Act make the exemptions from registration under Regulation A and Rule 505 of Regulation D unavailable for an offering under specified circumstances.<sup>1</sup> Rule 506 of Regulation D under the Securities Act has disqualification provisions that are similar, though not identical, to those in Regulation A and Rule 505.<sup>2</sup>

<sup>1</sup> Such circumstances include, among other things, where an issuer, any of its predecessors or any affiliated issuer is subject to certain Securities Act proceedings, certain administrative orders, an injunction restraining or enjoining such person from any conduct or practice in connection with the purchase or sale of any security or involving the making of false filings with the SEC, and specified U.S. Postal Service matters, or specified criminal convictions. Disqualification also occurs if any of the issuer's directors, officers, general partners, 10% beneficial owners of any class of the issuer's equity securities, or promoters, underwriters, persons compensated for soliciting purchasers, or any of the underwriters' or paid solicitors' partners, directors, or officers, is subject to specified administrative orders, injunctions (regarding the matters described above or arising out of the conduct of the business of an underwriter, broker, dealer, municipal securities dealer or investment advisor), associational bars or specified convictions.

<sup>2</sup> In Rule 506(d), for example, one of the categories of covered persons includes beneficial owners of 20% or more of an issuer's voting equity securities, whereas in Rule 262 of Regulation A and Rule 505 of Regulation D, the category includes beneficial owners of 10% or more of any class of the issuer's equity securities. Another category of covered persons in Rule 506(d) not included in Rule 262 and Rule 505 is any investment manager of an issuer that is a pooled investment fund and any director, executive officer or other officer participating in the offering of any such investment manager or general partner or managing member of such investment manager. The disqualifying events in Rule 506(d) are also broader in certain respects than the

The SEC has delegated authority to the Director of its Division of Corporation Finance to waive Regulation A or Regulation D disqualifications (under Rule 505 or 506) upon a showing of good cause that it is not necessary under the circumstances that the exemptions be denied. In connection therewith, the Division will consider, among other facts and circumstances,<sup>3</sup> the following factors when it evaluates whether a party seeking a waiver has shown good cause:

- *Who Was Responsible for the Misconduct?* The Division would consider who was responsible for the misconduct and what role the bad actor or actors have or had with respect to the waiver applicant. It would be considered a negative factor if the party seeking the waiver is the same as the party responsible for the misconduct or if an individual, such as an executive officer, director or control person, committed the misconduct and continues to exert influence on the operations of the party seeking the waiver. Depending on the circumstances and the conduct at issue, if misconduct committed by one or more individuals resulted in the waiver applicant's disqualification, and the applicant terminates its association with those individuals, such actions would generally be viewed as favorable to the waiver request. The Division would also consider whether the misconduct reflects more broadly on the entity as a whole (e.g., if warning signs were disregarded or the tone at the top of the waiver applicant condoned, encouraged or did not address the misconduct, or actions or omissions by the waiver applicant, or any of its affiliates, obstructed the regulatory or law enforcement investigation, these factors would weigh against granting a waiver).
- *What Was the Duration of the Misconduct?* The Division would consider whether the misconduct occurred over an extended period (negative factor) or whether it was an isolated instance (positive factor).
- *What Remedial Steps Have Been Taken?* The Division would consider what remedial measures the waiver applicant has taken to address the misconduct (including steps to improve training or improvements to its policies, procedures or practices), when those remedial measures began and whether those measures are likely to prevent a recurrence of the misconduct and mitigate the possibility of future violations. The analysis of such remedial steps would focus on how they relate to the waiver applicant's ability to prevent future misconduct and harm to investors, clients or customers.
- *Impact if the Waiver is Denied.* The Division would consider the severity of the impact on the waiver applicant or third parties, such as investors, clients or customers, if the waiver request

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disqualifying events in Regulation A. In addition to certain administrative orders, industry bars, injunctions involving securities law violations and specified criminal convictions covered under Regulation A and Rule 505, the disqualifying events in Rule 506(d) also include: SEC cease and desist orders involving scienter-based antifraud provisions of the federal securities laws and violations of Section 5 of the Securities Act; and final orders of certain state and federal regulatory authorities.

<sup>3</sup> The SEC has identified other factors, such as a change of control, change of supervisory personnel, absence of notice and opportunity for hearing, and relief from a permanent bar for a person who does not intend to apply to re-associate with a regulated entity, that could, depending on the specific facts, be relevant to the evaluation of a waiver request.

is not granted and weigh any such impact against the facts and circumstances relating to the misconduct to assess whether disqualification would be a disproportionate hardship in the light of the parties involved in, and the nature of, the misconduct. The guidance notes that applicants should submit information concerning whether or how often they have used the relevant exemption in the past, or how they plan to use the exemption in the future, and explain why a waiver is needed.

A waiver, which could include conditions or limitations, may be granted if a review of all the facts and circumstances leads the Division to determine that the waiver applicant has met its burden to show good cause and that it is not necessary under the circumstances that the exemptions be denied. In making this determination, the Division will also consider the nature of the violation or conviction, whether it involved the offer and sale of securities and whether the conduct involved a criminal conviction or scienter-based violation.<sup>4</sup>

No single factor is dispositive, and the burden will be on the waiver applicant to show good cause that it is not necessary under the circumstances that the exemptions be denied. The focus of the analysis will be on how the identified misconduct bears on the applicant's fitness to participate in exempt offerings.

The Division has asked in the past, and will continue to ask where appropriate, that the recipient of a waiver provide disclosure about the disqualifying event to investors a reasonable time before future sales occur in offerings made under Regulation A or Rules 505 or 506 of Regulation D.

In a recent [speech](#) to the Corporate Counsel Institute at Georgetown University given by SEC Chair Mary Jo White, she stated, among other things, that although waiver analyses are made in a "careful, principled manner, applying the applicable rules rigorously and fairly," waiver denials "were never intended to be, and we should not use them as, an additional enforcement tool designed to address misconduct or as an unjustified mechanism for deterring misconduct."

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<sup>4</sup> The party seeking the waiver bears the burden of establishing justification therefor. The guidance notes that in the event of a criminal conviction or a scienter-based violation involving the offer and sale of securities, the burden on the party seeking the waiver would be significantly greater. The fact that the misconduct did not involve the offer and sale of securities, however, does not necessarily mean that a waiver will be granted. In addition, in considering this factor, the Division will consider whether the misconduct involved any offer and sale of securities (not just Regulation A or D offerings).

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