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More Bite, Less Bark at the SEC?

With Fewer No-Admit Settlements, Enforcement May Be Getting New Teeth

By Scott R. Foglietta

In June, newly appointed SEC Chair Mary Jo White announced that the Commission will no longer maintain a blanket policy permitting defendants to enter settlements without admitting wrongdoing.

The U.S. Securities and Exchange Commission (the "SEC" or the "Commission") is finally taking a tougher stance against corporate executives who violate the federal securities laws. For decades, when the SEC leveled charges of securities fraud, a fine was paid and there was no admission of guilt — a way for both the SEC and corporations to claim victory. But all that may be changing. On June 18, 2013, newly appointed SEC Chair Mary Jo White announced that the Commission will no longer maintain a blanket policy permitting defendants to enter settlements without admitting wrongdoing, known as "no-admit settlements." Going forward, the SEC has vowed to take a more aggressive attitude toward securities settlements by being "bold and unrelenting." According to Chair White, the SEC will require defendants in civil enforcement actions to admit to wrongdoing whenever it is "important to have that public acknowledgment" of accountability, and when the Commission wants to send a "tough, deterrent message."

The SEC's shift away from no-admit settlements is already taking shape. On August 19, 2013, the SEC extracted its first admission of fraud from hedge-fund advisor Philip A. Falcone and his firm Harbinger Capital Partners LLC for market manipulation and misappropriating client assets. In order to settle the SEC's claims, Falcone and Harbinger admitted their guilt, agreed to a five-year securities-industry ban, and paid an $18 million fine. These landmark admissions came just one month after the SEC — in a rare move — overruled its own enforcement staff's recommendation to accept admission-free deals.

SEC Chair Mary Jo White discussing the Commission's new "tough cop" approach to policing the securities markets, emphasizing that the SEC will be "pursuing all types of violations of federal securities law, big and small."

The Honorable Victor Marrero, a U.S. District Judge for the Southern District of New York, has noted that other federal judges are following Judge Rakoff's lead and casting skepticism on no-admit settlements — in some cases, demanding greater accountability before approving them. Judge Marrero aptly remarked, "the ground [beneath no-admit settlements at the SEC] is shaking, let's admit that."

In another round of headline-making news, on September 19, 2013, the SEC announced that it obtained yet another admission of wrongdoing from the nation's largest bank, JPMorgan Chase & Co., in connection with the multi-billion dollar trading losses resulting from improper derivatives wagers placed by the so-called "London Whale" and other executives. JPMorgan has agreed to settle the SEC's charges by paying a $200 million penalty, admitting to certain facts underlying the Commission's charges, and publicly acknowledging that it violated the federal securities laws. These developments indicate that Chair White intends to stand by her promise to strengthen the SEC's enforcement function and that the SEC is, in fact, adopting a tougher policy against corporate fraudsters.

The SEC's departure from its longstanding approach to securities settlements is a victory for investors, regulators, and judges across the country, all of whom have increasingly criticized the effectiveness of the no-admit policy. The pendulum began to swing against the SEC's policy in November 2011, when the Honorable Jed S. Rakoff, a U.S. District Judge for the Southern District of New York, shone a spotlight on the inadequacies of the no-admit practice when he rejected a proposed $285 million securities fraud settlement between the SEC and Citigroup, Inc. In rejecting the settlement, Judge Rakoff explained that without an admission of wrongdoing or a trial on the merits, public investors would be "deprived of ever knowing the truth in a matter of obvious public importance." Even though the SEC has appealed Judge Rakoff's decision and the Second Circuit Court of Appeals has issued a preliminary stay of Rakoff's ruling pending its ultimate findings, Judge Rakoff's opinion sparked a critical public debate about the SEC's ability and willingness to meaningfully protect investors.

Following Judge Rakoff's opinion, jurists across the country immediately caught what the media dubbed "Rakoff Fever," with at least six other judges questioning whether no-admit settlements proposed by federal agencies actually serve the public interest. For instance, in May 2013, the Honorable Victor Marrero, another U.S. District Judge for the Southern District of New York, questioned the appropriateness of the SEC's record-setting $600 million settlement in the insider trading case against hedge-fund giant Steven A. Cohen's SAC Capital Advisors L.P., because it did not require an admission of guilt. Judge Marrero explained that there is "something counterintuitive and incongruous about settling for $600 million if [the defendant] truly did nothing wrong." While Judge Marrero conditionally approved the settlement pending the outcome of the appeal in Judge Rakoff's Citigroup case, he specifically noted that other federal judges had been following Rakoff's lead and casting skepticism on no-admit settlements — in some cases, demanding greater accountability before approving them. Judge Marrero aptly remarked, "the ground [beneath no-admit settlements at the SEC] is shaking, let's admit that."

In fact, shortly after Rakoff's ruling, the SEC itself adopted a minor revision to the no-admit policy, announcing that it would no longer allow defendants to avoid admissions in civil cases when they

already have admitted wrongdoing in parallel criminal cases. But aside from that small step, before Chair White's June 18, 2013 announcement, the SEC still insisted that no-admit settlements were the Commission's bread and butter and that companies simply "wouldn't settle… if they had to admit" wrongdoing. Unyielding criticism and Congressional calls for heightened accountability, however, have helped drive further policy changes.

Most notably, U.S. Senator Elizabeth Warren (D-MA) was instrumental in ending the SEC's wholesale prescription to no-admit settlements. On May 14, 2013, Senator Warren sent a poignant letter to Chair White stressing the importance of strong regulatory enforcement to ensure compliance with the federal securities laws. Senator Warren noted that "if a regulator reveals itself to be unwilling to take large financial institutions all the way to trial — either because it is too timid or because it lacks resources — the regulator has a lot less leverage in settlement negotiations and will be forced to settle on terms that are much more favorable to the wrongdoer." Senator Warren further cautioned that "[i]f large financial institutions can break the law and accumulate millions in profits and, if they get caught, settle by paying out of those profits, they do not have much incentive to follow the law." Senator Warren has since requested a quantitative analysis detailing the costs of settling an enforcement action without requiring a guilty admission.

On the heels of Senator Warren's letter and related Congressional hearings, Chair White announced that the SEC will require admissions of wrongdoing in certain cases. Chair White also distributed a

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memorandum to SEC staff setting forth initial parameters for when "heightened accountability or acceptance of responsibility through the defendant's admission of misconduct may be appropriate." The memorandum provides that the Commission will seek admissions whenever alleged misconduct (i) harms a large number of investors and/or places investors at risk of potentially serious harm, (ii) is egregious or intentional, or (iii) includes the obstruction of the SEC's investigative processes. Although the memorandum also noted that most civil enforcement actions will still be allowed to settle using the standard "no admit" formula, the tide at the SEC has clearly shifted.

Further, in the wake of the SEC's pursuit of greater corporate accountability and harsher penalties for wrongdoers, other federal regulatory agencies are following suit. For instance, the U.S. Commodity Futures Trading Commission ("CFTC") has already started to question its own no-admit settlement policy (akin to the SEC's), with top administrator Bart Chilton indicating that the "default position should be that people who violate the law should admit wrongdoing." The CFTC is now pushing for defendants to admit wrongdoing before settling fraud charges — including in the recent civil enforcement action against JPMorgan.

The SEC's bold policy break not only has the potential to affect public enforcement matters, it could also make a significant difference in private securities litigation — depending on the structure of the SEC's settlements. For instance, if the SEC continues to follow Chair White's harder-line approach by requiring corporate wrongdoers to admit fault, it may provide additional leverage to private litigants. However, questions remain about the extent to which an admission in an SEC case can be utilized in private litigation, and it may be too soon to tell whether private litigants will be able to take advantage of such admissions at all. Indeed, the fine print in the documents used by the SEC to settle with Falcone and Harbinger permitted those defendants to take contrary "legal or factual positions in litigation or other legal proceedings."

Despite the unknowns about the reach of the SEC's new policy, Chair White has clearly taken a step in the right direction to protect investors. The SEC now has made clear that it wants enforcement actions to be understood as serious tools that halt serious fraud, not just a bunch of bureaucratic compliance. If the SEC and other federal regulators continue to sharpen their teeth, investors may just get the public watchdogs they deserve. ◆

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