

BPI Proposal for a “Nexus” Presumption

Introduction

- Certain statutory and regulatory rights and authorizations under the federal securities laws may become unavailable to an institution if it, or any affiliate (including a foreign affiliate), is subject to a criminal conviction (including, in some cases, under foreign law), a court injunction with respect to certain activities or certain other enforcement actions.
- In the event of such a potential disqualification, the SEC has discretion to issue a waiver.
- These waivers are often vital, because the loss of a statutory authorization could result in a grossly disproportionate penalty related to the underlying conduct, with that penalty serving no or limited investor protection purposes. The disqualification is automatic; only the waiver process can consider questions of fairness and proportionality.
- In addition, the relevant right or authorization may be (and often is) unrelated to the nature of the underlying wrongdoing.
- As discussed at our meeting of July 25, 2018, we believe the question of a nexus between the underlying wrongdoing and the disqualification should be a critical factor in the SEC’s decision to grant waivers.
- The federal securities laws disqualifications are designed to protect the investing public, yet most potential disqualifications would serve no investor protection purpose. Stated differently, the disqualifications were not intended to serve as a secondary, but still severe, form of punishment for a wide variety of offenses, but instead to serve the much more targeted purpose of investor protection.
- In order to create clarity and a meaningful degree of certainty, any potential waiver should focus on any nexus between the underlying misconduct and the purpose of the statute.

Presumption of a Waiver Absent a Nexus

- **Recommendation**: We recommend that the SEC adopt, in the form of a rulemaking or formal guidance, a presumption in favor of a waiver from the disqualifications under Rule 506(d) of Regulation D and Section 9(a) of the 1940 Act where there is no material nexus between the underlying wrongdoing and the relevant securities/advisory activity.
- **Standard for the Application of the Presumption**
 - **Material Nexus**: No material nexus would exist, and, subject to the rebuttal factors described below, the presumption in favor of a waiver would apply, if either:
 - (1) (i) the underlying misconduct occurred in an affiliate of the issuer/adviser subject to the potential disqualification and (ii) the issuer/adviser subject to the potential disqualification was not involved in the underlying misconduct; or
 - (2) (i) the underlying misconduct did not involve a fraudulent offering or sale of securities or a fraud on investment management clients and (ii) no individual involved in or connected with the underlying misconduct has any role in providing the service or product for which a waiver is sought.
 - **Rebuttal**: The presumption would be rebutted only if the Commission determines that there was substantial evidence that either (i) the company’s securities or investment management clients would be at heightened or substantial risk of being defrauded, or subject to similar harm, if the waiver were granted or (ii) the public interest would be harmed or endangered if the waiver were granted. In considering the potential for harm or endangerment to the public interest, the Commission would take into account whether the underlying misconduct demonstrates a firm-wide failure of controls that are also exhibited at the disqualified entity.