Blogs
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SEC Chair’s Suggested Expansion of Executive Liability Unlikely to Occur

Apparently lost in the news of the impending departure of SEC Chair Mary Jo White is her recent suggestion to expand liability of corporate executives. In a speech on November 18, 2016, Chair White suggested a potential change in federal securities law that would hold executives accountable even if they are not involved in the misconduct and did not know about it. Given recent signals from the new administration in Washington, we believe this potential expansion of liability is unlikely to occur.

Considering a "Senior Manager Regime"

In her speech, given days after she announced she would leave her post in January, Chair White implored regulators to "think outside the box of our current laws" to expand the reach of liability for senior executives. She said there was:

> growing frustration that current law does not more broadly impose responsibility on senior executives, either for fostering a culture that led to the misconduct or for failing to ensure the existence or proper functioning of controls that could have prevented it."

Suggesting a possible solution, Chair White said she was "drawn" to a recently-implemented approach in the United Kingdom, the "Senior Manager Regime," which is "designed to incentivize executives and other senior managers to take greater responsibility for their actions (or non-actions) and the actions of their employees." She said that the U.K. regime makes it easier for the authorities to:

> hold more individuals accountable for offenses that occur in areas of the executives' responsibilities, even if the executive is not involved in the misconduct, does not know about it, and does not directly supervise the offending employees."

The U.K. framework holds senior executives liable for misconduct at their institutions in their areas of responsibility if they did not take "reasonable steps" to prevent the misconduct that occurred. Another provision imposes criminal liability on a senior officer, who makes a decision that "falls far below what could reasonably be expected," which causes the failure of the firm. Chair White noted the U.K. regime is more expansive than the SEC's existing authority. The SEC can charge and sanction a manager at a broker-dealer for failing to reasonably supervise a subordinate who has violated the federal securities laws. However, "that offense often relies on ignored red flags to prove the case, and does not extend to executives of non-registrants like public companies." Moreover, supervisors at broker-dealers can invoke an affirmative defense if compliance procedures were adopted and enforced. Nevertheless, the adoption of an approach comparable to the new U.K. regime would potentially subject executives of public companies and non-registrants to an expansive liability standard approaching strict liability.

Congress Unlikely to Respond

While Chair White advocates a "tough, but fair" approach to enforcement, the current federal securities laws already strike such a balance, by requiring proof that an executive of a public company or non-registrant be involved in the misconduct and have the requisite state of mind (negligence or scienter) before liability is imposed. For this reason, as well as the regulatory scheme that President-elect Donald J. Trump and the new Republican-controlled Congress are contemplating, the adoption of an expansive liability standard for senior executives is unlikely to occur.

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