Overview of Major Federal Securities Laws: In Brief

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Summary

This report discusses in a very general way the major federal securities laws. The major federal securities laws may be grouped into two categories according to the time of their passage: the acts passed in the wake of the stock market crash of 1929 and the acts passed later in the 20th century and early in the 21st century. The acts in the first group include the most important of the federal securities acts: the Securities Act of 1933, which concerns the initial registration of securities, and the Securities Exchange Act of 1934, which requires ongoing disclosure reports. The acts in the second group include laws which specifically prohibit insider trading, restrict the bringing of shareholder derivative suits, and require additional reporting by officers and directors. This report will be updated as warranted.

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The major federal securities laws that form the basis for the regulation of securities in the United States were enacted in the wake of the stock market crash of 1929. These acts include the Securities Act of 1933,[1] the Securities Exchange Act of 1934,[2] the Investment Company Act of 1940,[3] and the Investment Advisers Act of 1940.[4] Other important securities acts were passed late in the 20th century and early in the 21st century. These acts include the Insider Trading Sanctions Act of 1984,[5] the Insider Trading and Securities Fraud Enforcement Act of 1988,[6] the Private Securities Litigation Reform Act of 1995,[7] the Securities Litigation Uniform Standards Act of 1998,[8] the Sarbanes-Oxley Act of 2002,[9] the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank),[10] the Stop Trading on Congressional Knowledge (STOCK) Act of 2012,[11] and the Jumpstart Our Business Startups (JOBS) Act of 2012.[12]

Securities Act of 1933

The Securities Act of 1933 makes it illegal to offer or sell securities[13] to the public unless they have been registered with the Securities and Exchange Commission (SEC or Commission).[14] A registration statement becomes effective twenty days after it is filed with the commission, unless it is delayed or suspended.[15] Registration under the 1933 Act covers only the securities actually being offered and only for the purposes of the offering in the registration statement. The registration statement consists of two parts: the prospectus, which must be provided to every purchaser of the securities, and Part II, which contains information and exhibits which do not have to be provided to purchasers but which are available for inspection. Section 7 of the 1933 Act,[16] referring to Schedule A,[17] sets forth the information which must be contained in the

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[1] 15 U.S.C. §§ 77a *et seq*.

[2] 15 U.S.C. §§ 78a *et seq*.

[3] 15 U.S.C. §§ 80a-1 *et seq*.

[4] 15 U.S.C. §§ 80b-1 *et seq*.

[5] P.L. 98-376, codified in various provisions of 15 U.S.C. §§ 78a *et seq*.

[6] P.L. 100-704, codified in various provisions of 15 U.S.C. §§ 78a *et seq*.

[7] P.L. 104-67, codified in various provisions of 15 U.S.C. §§ 78a *et seq*.

[8] P.L. 105-353, codified in various provisions of 15 U.S.C. §§ 78a *et seq*.

[9] P.L. 107-204, codified in various provisions of 15 U.S.C. §§ 78a *et seq*.

[10] P.L. 111-203, codified in various titles of the U.S. Code, including titles 7, 12, and 15.

[11] P.L. 112-105, codified in various titles of the U.S. Code, including titles 5, 7, and 15.

[12] P.L. 112-106, codified in various provisions of title 15 of the U.S. Code.

[13] The term "security" is defined very broadly in 15 U.S.C. Section 77b(1) as:

> any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any instrument or instrument commonly known as a "security", or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

[14] 15 U.S.C. § 77e.

[15] 15 U.S.C. § 77h(a).

[16] 15 U.S.C. § 77g.

[17] 15 U.S.C. § 77aa.

registration statement. This schedule requires a great deal of information, such as the underwriters, the specific type of business, significant shareholders, debt and assets of the company, and opinions as to the legality of the issue. Section 10(a) of the 1933 Act specifies the information which the prospectus must contain.[18] There are also numerous regulations issued by the commission which provide further details about the registration process under the 1933 Act.[19]

Certain transactions and securities are exempted from the registration process. The exempted transactions include private placements, intrastate offerings, and small offerings.[20] Among the exempted securities are government securities, bank securities, and short-term commercial paper, all securities for which it is believed that other, adequate means of government regulation exist.[21]

Securities Exchange Act of 1934

The Securities Exchange Act of 1934 is concerned with many different areas, one of which is the ongoing process of disclosure to the investing public through the filing of periodic and updated reports with the commission.[22] Any issuer which has a class of securities traded on a national securities exchange or, in certain circumstances, has total assets exceeding $10,000,000 and a class of equity securities held of record by 2,000 shareholders or 500 shareholders who are not accredited investors[23] must register under the 1934 Act with the SEC.[24] Every issuer which must register under the 1934 Act must file periodic and other reports with the SEC.[25] Section 12[26] requires the filing of a detailed statement about the company when the company first registers under the 1934 Act. Section 13[27] requires a registered company to file annual and quarterly reports with the SEC. These reports must contain essentially all material information, financial and otherwise, about the company which the investing public would need in making a decision about whether to invest in the company. Section 14[28] contains information about proxy solicitation. Some exemptions from these reporting requirements are provided.[29] The commission has issued extensive regulations to specify information which these reports must provide.[30]

Failure to disclose material information is actionable. For example, Section 18(a) of the Securities Exchange Act[31] grants an express private right of action to investors who have been injured by reliance upon material misstatements or omissions of facts in reports which have been filed with

[18] 15 U.S.C. § 77j(a).

[19] *See, e.g.*, 17 C.F.R. Parts 230, 231, and 239.

[20] 15 U.S.C. § 77d.

[21] 15 U.S.C. § 77c.

[22] 15 U.S.C. § 78m.

[23] An "accredited investor" is in general an institutional investor or an individual with significant financial means and sophisticated investment knowledge. *See* 17 C.F.R. § 230.501.

[24] 15 U.S.C. § 78*l*. As stated earlier, the 1933 Act requires the registration of a particular *offering* of securities. The 1934 Act requires the registration of a *class* of securities.

[25] 15 U.S.C. §§ 78*l*, 78m, and 78n.

[26] 15 U.S.C. § 78*l*.

[27] 15 U.S.C. § 78m.

[28] 15 U.S.C. § 78n.

[29] 15 U.S.C. § 78*l*.

[30] *See, e.g.*, 17 C.F.R. Parts 240, 241, and 249.

[31] 15 U.S.C. § 78r(a).

the SEC. Section 10(b) of the 1934 Act,[32] the general antifraud provision, and Rule 10b-5,[33] issued by the SEC to carry out the statutory fraud prohibition, provide for a cause of action for injuries which have been caused by omissions, misrepresentations, or manipulations of material facts in statements other than those filed in documents with the SEC.[34]

Investment Company Act of 1940

The Investment Company Act of 1940 was enacted to protect investors who use others to manage and diversify their investments. An investment company that meets the statutory definition of "investment company"[35] and that is not exempted from the act[36] must register with the SEC and file specified information.[37] Unless the investment company complies with the provisions of the act, it cannot participate in certain activities involving securities.[38] Various affiliations and interests of directors, officers, and employees of investment companies are circumscribed.[39] For example, an investment company cannot have a board of directors with more than 60% of the members considered interested persons of the company.[40] Registered investment companies must file specified reports and financial statements.[41]

Investment Advisers Act of 1940

The Investment Advisers Act of 1940 defines an investment adviser as any person who for compensation advises others as to the value of securities or as to the advisability of investing in, purchasing, or selling securities or who for compensation analyzes securities.[42] Unless registered with the SEC, it is unlawful for any investment adviser to make use of the mails or any means or instrumentality of interstate commerce in connection with his business as an investment adviser.[43] An investment adviser may be registered by filing specified information with the SEC.[44]

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[32] 15 U.S.C. § 78j(b).

[33] 17 C.F.R. § 240.10b-5.

[34] *See, e.g., State Teachers Retirement Board v. Fluor Corp.*, 654 F.2d 843 (2d Cir. 1981), and *Goldberg v. Meridor*, 567 F.2d 209 (2d Cir. 1977).

[35] 15 U.S.C. § 80a-3(a).

[36] Exemptions may be found at 15 U.S.C. § 80a-3(b) and (c).

[37] 15 U.S.C. §§ 80a-7 and 80a-8.

[38] 15 U.S.C. § 80a-7(a), (b), and (c).

[39] 15 U.S.C. § 80a-10.

[40] 15 U.S.C. § 80a-10(a).

[41] 15 U.S.C. § 80a-29.

[42] 15 U.S.C. § 80b-2(11).

[43] 15 U.S.C. § 80b-3(a).

[44] 15 U.S.C. § 80b-3(c).

Insider Trading Sanctions Act of 1984 and Insider Trading and Securities Fraud Enforcement Act of 1988

The Insider Trading Sanctions Act of 1984 was enacted because of the belief that

> [i]nsider trading threatens ... markets by undermining the public's expectations of honest and fair securities markets where all participants play by the same rules. This legislation provides increased sanctions against insider trading in order to increase deterrence of violations.
>
> "Insider trading" is the term used to refer to trading in the securities markets while in possession of "material" information (generally, information that would be important to an investor in making a decision to buy or sell a security) that is not available to the general public.[45]

The act provides that, if the commission believes that any person has bought or sold a security while in possession of material nonpublic information, the commission may bring an action in U.S. district court to seek a civil penalty. The penalty may be up to three times the profit gained or loss avoided.[46]

After a number of hearings and considerable debate in the 100th Congress, the President signed the Insider Trading and Securities Fraud Enforcement Act of 1988 (P.L. 100-704). This act expanded the scope of civil penalties to control persons who fail to take adequate steps to prevent insider trading; increased the maximum jail terms for criminal securities law violations and maximum criminal fines for individuals and for corporate persons; initiated a bounty program giving the SEC discretion to reward informants who provide assistance to the agency; and required broker-dealers and investment advisers to establish and enforce written policies reasonably designed to prevent the misuse of inside information.

Private Securities Litigation Reform Act of 1995

The Private Securities Litigation Reform Act of 1995 was enacted to address the perceived problem of an increase in frivolous shareholder lawsuits. The stated reasons for bringing these lawsuits were varied—fraud, mismanagement, nondisclosure of material information—but practically all of the lawsuits involved the loss of money by shareholders of the corporation. Some of the lawsuits had merit because some corporate managers had, according to proponents, misled or defrauded investors. However, some of the lawsuits were deemed frivolous and were brought when, for example, the share value of the stock of a corporation went down for reasons having nothing to do with the culpability of corporate managers.

The act limits shareholder lawsuits in federal courts by such actions as having the court appoint a lead plaintiff determined to be the most capable of adequately representing the interests of class members, prohibiting a person from being a lead plaintiff in any more than five class actions in a three-year period, guaranteeing that plaintiffs receive full disclosure of settlement terms, providing a safe harbor for forward-looking statements, providing for proportionate liability, and providing for auditor disclosure of corporate fraud.

[45] H.Rept. 98-355, at 2 (1984).

[46] 15 U.S.C. § 78u-1(a)(2).

Securities Litigation Uniform Standards Act of 1998

The Securities Litigation Uniform Standards Act of 1998 (SLUSA) was enacted in response to the perceived failure of the Private Securities Litigation Reform Act of 1995 (PSLRA) to curb alleged abuses of securities fraud litigation. PSLRA had set out a framework for bringing securities fraud cases in federal courts. In many instances, plaintiffs circumvented PSLRA by bringing cases in state courts on the basis of common law fraud or other non-federal claims.

SLUSA attempted to make certain that plaintiffs could not avoid the PSLRA requirements by allowing a securities fraud case to be brought only in a federal court and only under a uniform standard if five criteria are satisfied: (1) The lawsuit is a covered class action; (2) The claim is based on state statutory or common law; (3) The claim concerns a covered security; (4) The plaintiff alleges a misrepresentation or omission of a material fact; and (5) The misrepresentation or omission is made in connection with the purchase or sale of a covered security.

Sarbanes-Oxley Act of 2002

The Sarbanes-Oxley Act of 2002 had its genesis early in 2002 after the declared bankruptcy of the Enron Corporation, but for some time it appeared as though its impetus had slowed. However, when the WorldCom scandal became known in late June 2002, Congress showed renewed interest in enacting stiffer corporate responsibility legislation, and Sarbanes-Oxley quickly became law.

The act establishes a Public Company Accounting Oversight Board, which is supervised by the SEC. The act restricts accounting firms from performing a number of other services for the companies that they audit. The act also requires additional disclosures for public companies and the officers and directors of those companies. Among the other issues affected by Sarbanes-Oxley are securities fraud, internal assessment of management controls of the covered corporation, criminal and civil penalties for violating the securities laws and other laws, blackouts for insider trades of pension fund shares, and protections for corporate whistleblowers.

Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010

Dodd-Frank, passed in response to the financial downturn in the early part of the 21st century, effected the most significant changes to financial regulation since laws enacted in response to the Great Depression of 1929. Although making changes to practically all of the financial regulatory agencies, Dodd-Frank affected the securities industry in a number of specific ways.

Title VII of Dodd-Frank concerns the regulation of the over-the-counter swaps[47] markets and sets out general jurisdictional parameters for the Commodity Futures Trading Commission (CFTC) and the SEC. The title requires the CFTC and the SEC to consult with each other in issuing regulations to fill in the details of their jurisdiction in regulating the various kinds of swaps.[48]

Title IX, "Investor Protections and Improvements in the Regulation of Securities," sets out new powers of the SEC. In an attempt to increase investor influence, Title IX creates an Office of the

[47] Very generally, a swap is a contract involving the exchange of financial instruments. http://www.investopedia.com/terms/s/swap.asp

[48] Dodd-Frank, § 722.

Investor Advocate[49] and a whistleblower bounty program for persons who disclose securities fraud.[50] Title IX has a number of other provisions aimed at increasing investor protection, such as expanding the regulation of credit rating agencies,[51] requiring public corporations to submit executive compensation packages to shareholders for nonbinding votes,[52] setting out requirements for the submission of proxy solicitation materials for nominating members to corporate boards,[53] and establishing a Public Company Accounting Oversight Board to oversee public accounting firms.[54]

In the miscellaneous provisions of Title XV, Dodd-Frank requires the SEC to issue rules involving the disclosure by publicly traded companies of various minerals originating near the Democratic Republic of the Congo that are benefiting armed groups in the area.[55]

Stop Trading on Congressional Knowledge (STOCK) Act of 2012

The STOCK Act amends various titles of the U.S. Code, such as titles 5, 7, and 15, to prohibit Members of Congress and employees of Congress from trading stocks based on inside information that they have received as a result of their congressional duties and positions. For example, Section 4 of the STOCK Act amends 15 U.S.C. § 78u-1 to prohibit insider trading by these persons and states that '[t]he purpose of the amendment made by this subsection is to affirm a duty arising from a relationship of trust and confidence owed by each Member of Congress and each employee of Congress."

Jumpstart Our Business Startups (JOBS) Act of 2012

The JOBS Act is intended to encourage the funding of small businesses and startups by easing various securities reporting requirements. Among its seven titles, Title I, concerning emerging growth companies, and Title III, concerning crowdfunding, may be of special note. An emerging growth company, defined to apply to a company with total annual gross revenues of less than $1 billion, is allowed to phase in various SEC regulations over a period of time and may confidentially submit to the SEC a draft registration statement for nonpublic review prior to public filing. Title III exempts certain companies from the 1933 Securities Act's registration requirements if various requirements are met (e.g., the aggregate amount of securities sold to all investors during a 12-month period does not exceed $1 million; the aggregate amount of securities sold to any investor during a 12-month period cannot exceed the greater of $2,000 or 5% of the annual income or net worth of the investor if either the annual income or net worth is less than $100,000 or, if more than $100,000, the greater of 10% of the annual income or net

[49] Dodd-Frank, § 915.

[50] Dodd-Frank, § 922.

[51] Dodd-Frank, Title IX, Subtitle C.

[52] Dodd-Frank, § 951.

[53] Dodd-Frank, Title IX, Subtitle G.

[54] Dodd-Frank, Title IX, Subtitle I.

[55] Dodd-Frank, § 1502. For more information, *see* CRS Report R43639, *Conflict Minerals and Resource Extraction: Dodd-Frank, SEC Regulations, and Legal Challenges*, by (name redacted) and (name redacted) (Oct. 8, 2015).

worth of the investor, not to exceed a maximum aggregate amount of $100,000; and the transaction must be sold through a funding portal, such as a website.

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