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Introduction to Financial Services: The Securities and Exchange Commission (SEC)

To help restore confidence in the securities markets in the wake of the stock market crash of 1929, Congress passed the Securities Exchange Act of 1934, which authorized the creation of the Securities and Exchange Commission (SEC). The SEC is an independent, nonpartisan regulatory agency responsible for administering federal securities laws. It has broad regulatory authority over significant parts of the securities industry, including stock exchanges, mutual funds, investment advisers, and brokerage firms.

The SEC oversees federal securities laws broadly aimed at (1) protecting investors; (2) maintaining fair, orderly, and efficient markets; and (3) facilitating capital formation. These laws provide clear rules for honest dealing among securities market participants, including antifraud provisions, and disclose information deemed necessary for informed investor decisionmaking.

The SEC's budget is set through the congressional appropriations process. Sale fees on stock and other securities transactions that the SEC collects from securities exchanges offset the appropriations. Annual collections, which historically exceeded the SEC's annual appropriations, go directly to the U.S. Treasury's general fund. Over the last few years, the SEC's enacted annual budget has been in the $1.6 billion to $1.7 billion range. The SEC is led by five presidentially appointed commissioners, including a chair, subject to Senate confirmation. Commissioners have staggered five-year terms, and no more than three commissioners may belong to the same political party.

Significant Securities Laws Overseen by the SEC

The SEC oversees an array of securities laws, several of which have been amended over time. Applicable significant securities laws include those described below.

Securities Act of 1933 (Securities Act; P.L. 73-22). This act sought to ensure that investors are given salient information on securities offered for public sale and to ban deceit, misrepresentations, and other kinds of fraud in the sale of securities. The act requires issuing companies to disclose information deemed germane to investors as part of the mandatory SEC registration of the securities that those companies offer for sale to the public. Potential investors must be given an offering *prospectus* containing registration data. Certain offerings are exempt from such registration requirements, including private offerings to financial institutions or to sophisticated institutions.

Securities Exchange Act of 1934 (Exchange Act; P.L. 73-291). In addition to creating the SEC, the act governs securities transactions on the secondary market and gives the agency regulatory oversight over self-regulatory organizations (SROs), including stock exchanges like NASDAQ, that have quasi-governmental authority to police their members and attendant securities markets. Financial Industry Regulatory Authority (FINRA), the principal regulator of broker-dealers, is also an SRO.

Investment Company Act of 1940 (ICA; P.L. 76-768). This act regulates the organization of investment companies, including mutual funds. Investment companies are primarily engaged in investing in the securities of other companies. In an attempt to minimize the potential conflicts of interest that may arise due to the operational complexity of investment companies, the act generally requires investment companies to register with the SEC and publicly disclose key data on their investment objectives, structure, operations, and financial status.

Investment Advisers Act of 1940 (IAA; P.L. 76-768). Investment advisers are firms or sole practitioners that are compensated for advising others about securities investments, including advisers to mutual funds and hedge funds. In general, under the act, advisers managing a certain amount of assets must register with the SEC and conform to the act's regulations aimed at protecting investors.

Sarbanes-Oxley Act of 2002 (SOX; P.L. 107-204). Passed in the aftermath of accounting scandals at firms such as Enron and Worldcom during 2001 and 2002, SOX sought to improve the reliability of financial reporting and the quality of corporate audits at public companies. Among other things, it created the Public Company Accounting Oversight Board (PCAOB) to oversee the quality of corporate accountants and auditors and shifted responsibility for the external corporate auditor from corporate management to independent audit committees.

Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act; P.L. 111-203). Enacted in the wake of the 2007-2009 financial crisis, the 2010 Dodd-Frank Act mandated sweeping financial regulatory changes, many of which affected the SEC. The act required the SEC to adopt rules to help ensure that those who securitize certain debt retain a significant interest in assets that they transfer; reformed the regulation of credit rating agencies; required hedge fund advisers to register with the SEC; and created an interagency financial risk monitoring panel, the Financial Stability Oversight Council (FSOC), with the SEC chair as a member.

Jumpstart Our Businesses Startup Act (JOBS Act; P.L. 112-106). This 2012 act was broadly aimed at stimulating capital formation for companies, particularly newer and smaller firms. It also eases regulatory requirements for certain initial public offerings (IPOs) through the creation of a new entity called an *emerging growth company* and through *Regulation Crowdfunding*, which permits companies to provide securities to retail investors through regulatory exemptions under the Securities Act.

Recent Examples of SEC Regulatory Reform

This section provides examples of recent regulatory actions by the SEC under some of the aforementioned statutes.

Deregulating Fund of Fund Arrangements. A *fund of fund* is a mutual fund that holds an investment in at least one other fund. According to SEC staff estimates, approximately 40% of all registered funds hold an investment in at least one other fund. Total net assets in mutual funds that invest primarily in other mutual funds have grown to $2.54 trillion in 2019. Section 12(d)(1) of the ICA generally limits how much a fund can invest in others.

Over the years, statutory and various exemptions and SEC no-action relief granted to many fund families, have effectively relaxed these restrictions but have led to very similar fund of funds arrangements being subject to varying regulatory requirements. To help address these regulatory disparities, on October 7, 2020, the SEC commissioners adopted Rule 12d1-4 under the ICA. The rule generally codifies existing conditions in the SEC exemptive orders, eliminating the need for SEC exemptive relief for the funds. For many observers, including the mutual fund trade group Investment Company Institute, a major welcome change from the original proposal is that the adopted rule does not restrict a fund from redeeming more than 3% of an acquired fund's total outstanding shares in any 30-day period. The concern was that the restriction would have deprived fund managers of the flexibility needed to act in their investors' best interests.

13F Reform for Asset Managers. In 1978, Section 13(f) of the Exchange Act was added to the Securities Acts Amendments of 1975 as P.L. 94-29. It requires managers of institutional investors, such as mutual funds, hedge funds, trust companies, pension funds, insurance companies, and registered investment advisors, to publically disclose the entity's equity holdings over $100 million on a quarterly basis. On July 20, 2020, the SEC's commissioners approved a proposal that would amend Section 13(f) to raise the threshold for reporting to $3.5 billion.

In doing so, the SEC argued that (1) the updated amount represented the same proportional market value of domestic equities that $100 million did in 1975; (2) the aggregate value of securities reported by applicable managers would represent about 75% of the market value of domestic corporate equities; (3) smaller institutions would no longer risk copycat investors front running their portfolio strategies via the disclosures; and (4) managers of some 4,500 smaller institutions or about 89% of current filers would be exempt from 13(f) reporting compliance costs. The SEC estimated that those costs range between $15,000 and $30,000, figures that some experts and researchers say are overstated. Critical responses to the proposal have come from some both inside and outside of Congress, including from the Consumer Federation of America, the U.S. Chamber of Commerce, NASDAQ, the New York Stock Exchange, and the Management Funds Association, an investor trade group that includes hedge funds. Criticism includes arguments that (1) the proposal would restrict corporate knowledge of their investors, impairing their ability to engage with them; (2) the 1975 statutory mandate for 13(f) disclosures gave the SEC authority to decrease only the $100 million threshold; and (3) the proposal would make it harder for firms to tell whether activist hedge funds are accumulating stakes in them. (There is, however, Form 13d reporting, where within 10 days, investors must report when they have a 5% corporate equity stake.)

The Consolidated Audit Trial (CAT). On May 6, 2010, the Dow Jones Industrial Average stock index (DJIA) fell by roughly 1,000 points (and then rebounded) in intraday trading. The SEC's subsequent attempt to analyze the cause exposed the existence of a critical dearth of available market data. To address these concerns, in 2012, the SEC adopted Rule 613 under the Securities Exchange Act of 1934 to create CAT. CAT is a trading data repository, which enables securities regulators, such as the SEC, to monitor and reconstruct trading activity for stocks and stock options in the National Market System (NMS). The NMS is the domestic system for trading stocks and stock options, including the broker-dealers who fulfill the orders. In 2016, the SEC approved the CAT NMS plan prepared by stock and stock option exchanges and FINRA (all SROs).

CAT has frequently been delayed beyond its initial full implementation goal of March 2019. For example, in February 2019, by the SROs who govern CAT replaced the contractor charged with building the CAT technology with FINRA. CAT's costs are to be paid for by exchanges. CAT inaugurated reporting on stock trades on June 22, 2020, and stock option trades on July 20, 2020. SEC officials have observed that "substantial work remains."

The issues of data security and privacy with respect to CAT have been of critical and widespread concern. On August 2, 2020, to help address such concerns, the SEC approved a proposal to amend the NMS plan governing CAT. The proposal would no longer require CAT to contain the Social Security numbers and taxpayer identification numbers of individual investors. It would, however, collect data elements, including the individual's name, address, year of birth, role in the account, and account type. The proposal earned praise from SIFMA, a major securities firm trade group, but the American Securities Association, a trade group of regional financial service firms, said that the permitted data elements would still benefit cybercriminals.

Related CRS Reports

CRS Report R45957, *Capital Markets: Asset Management and Related Policy Issues*, by Eva Su

Gary Shorter, Specialist in Financial Economics

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