



CRS Report for Congress

Overview of Major Federal Securities Laws

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Summary

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 twentieth century and in 2002. 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.

The major federal securities laws which 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 twentieth century and in 2002. 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

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 a number of provisions of 15 U.S.C. §§ 78a *et seq.*

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

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

the Securities Litigation Uniform Standards Act of 1998,⁸ and the Sarbanes-Oxley Act of 2002.⁹

Securities Act of 1933. The Securities Act of 1933 makes it illegal to offer or sell securities¹⁰ to the public unless they have been registered with the Securities and Exchange Commission (SEC or Commission).¹¹ A registration statement becomes effective twenty days after it is filed with the Commission, unless it is delayed or suspended.¹² 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 by the public at the Commission. Section 7 of the 1933 Act,¹³ referring to Schedule A,¹⁴ sets forth the information which must be contained in the 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.¹⁵ There are also numerous regulations issued by the Commission which provide further details about the registration process under the 1933 Act.¹⁶

Certain transactions and securities are exempted from the registration process. The exempted transactions include private placements, intrastate offerings, and small offerings.¹⁷ Among the exempted securities are government securities, bank securities,

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

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

¹⁰ 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.

¹¹ 15 U.S.C. § 77e.

¹² 15 U.S.C. § 77h(a).

¹³ 15 U.S.C. § 77g.

¹⁴ 15 U.S.C. § 77aa.

¹⁵ 15 U.S.C. § 77j(a).

¹⁶ *See, e.g.*, 17 C.F.R. Parts 230, 231, and 239.

¹⁷ 15 U.S.C. § 77d.

and short-term commercial paper, all securities for which it is believed that other, adequate means of government regulation exist.¹⁸

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.¹⁹ Any issuer which has a class of securities traded on a national securities exchange or, in certain circumstances, has total assets exceeding \$1,000,000 and a class of equity securities with at least 500 shareholders must register under the 1934 Act with the SEC.²⁰ Every issuer which must register under the 1934 Act must file periodic and other reports with the SEC.²¹ Section 12²² requires the filing of a detailed statement about the company when the company first registers under the 1934 Act. Section 13²³ 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 14²⁴ contains information about proxy solicitation. Some exemptions from these reporting requirements are provided.²⁵ The Commission has issued extensive regulations to specify information which these reports must provide.²⁶

Failure to disclose material information is actionable. For example, section 18(a) of the Securities Exchange Act²⁷ 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 the SEC. Section 10(b) of the 1934 Act,²⁸ the general antifraud provision, and Rule 10b-5,²⁹ 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.³⁰

¹⁸ 15 U.S.C. § 77c.

¹⁹ 15 U.S.C. § 78m.

²⁰ 15 U.S.C. § 78l. 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.

²¹ 15 U.S.C. §§ 78l, 78m, and 78n.

²² 15 U.S.C. § 78l.

²³ 15 U.S.C. § 78m.

²⁴ 15 U.S.C. § 78n.

²⁵ 15 U.S.C. § 78l.

²⁶ See, e.g., 17 C.F.R. Parts 240, 241, and 249.

²⁷ 15 U.S.C. § 78r(a).

²⁸ 15 U.S.C. § 78j(b).

²⁹ 17 C.F.R. § 240.10b-5.

³⁰ 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).

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 which meets the statutory definition of “investment company”³¹ and which is not exempted from the act³² must register with the SEC and file specified information.³³ Unless the investment company complies with the provisions of the act, it cannot participate in certain activities involving securities.³⁴ Various affiliations and interests of directors, officers, and employees of investment companies are circumscribed.³⁵ For example, an investment company cannot have a board of directors with more than 60% of the members considered interested persons of the company.³⁶ Registered investment companies must file specified reports and financial statements.³⁷

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.³⁸ 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.³⁹ An investment adviser may be registered by filing specified information with the SEC.⁴⁰

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.⁴¹

³¹ 15 U.S.C. § 80a-3(a).

³² Exemptions may be found at 15 U.S.C. § 80a-3(b) and (c).

³³ 15 U.S.C. §§ 80a-7 and 80a-8.

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

³⁵ 15 U.S.C. § 80a-10.

³⁶ 15 U.S.C. § 80a-10(a).

³⁷ 15 U.S.C. § 80a-29.

³⁸ 15 U.S.C. § 80b-2(11).

³⁹ 15 U.S.C. § 80b-3(a).

⁴⁰ 15 U.S.C. § 80b-3(c).

⁴¹ H.Rept. 98-355, at 2 (1984).

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 United States district court to seek a civil penalty. The penalty may be up to three times the profit gained or loss avoided.⁴²

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 from five years to ten years, with maximum criminal fines for individuals to be increased from \$100,000 to \$1,000,000 and for corporate persons from \$500,000 to \$2,500,000; 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, eliminating coverage of securities fraud by the Racketeer Influenced and Corrupt Organizations Act, providing a safe harbor for forward-looking statements, providing for proportionate liability, and providing for auditor disclosure of corporate fraud.

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 the bringing of 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

⁴² 15 U.S.C. § 78u-1(a)(2).

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, the 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 which 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.