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February 5, 2020

Federal Securities Laws: An Overview

Securities Act of 1933

The Securities Act of 1933 (Securities Act) governs the process by which companies issue securities. The Act prohibits any person from offering or selling a security to the public unless the offering has been registered with the Securities and Exchange Commission (SEC) or falls under an exemption. The Act's exemptions include private placements, certain small issues, and offerings involving certain classes of securities (e.g., government securities and bank securities). If an exemption does not apply, an issuer must file a registration statement with the SEC that includes detailed information about the issuer's business operations, financial condition, and the nature of the offering. If a company issues securities in violation of the Act's registration requirements, individuals who purchased the securities may sue the company to rescind their purchases or for damages. The Act also allows purchasers to sue issuers and other specified individuals—such as directors, underwriters, and persons who signed the registration statement—for damages for certain material misrepresentations or omissions in connection with the offering. The Trust Indenture Act of 1939 supplemented the Securities Act by adding more requirements for public offerings of debt securities.

Securities Exchange Act of 1934

While the Securities Act governs primary offerings, the Securities Exchange Act of 1934 (Exchange Act) fosters transparency and fairness in secondary securities markets. The Act requires companies with securities traded on national securities exchanges and companies with large numbers of shareholders to register their securities with the SEC and abide by a variety of reporting requirements. The Act also regulates national securities exchanges, broker-dealers, and self-regulatory organizations (SROs); imposes certain requirements on tender offers (i.e., broad solicitations by a third party to purchase a substantial percentage of a company's shares at a specified price, often in an attempt to acquire the company); and governs proxy solicitation (i.e., the process by which a corporation's shareholders can authorize another party to vote their shares).

The Exchange Act also contains an important catch-all fraud provision. Section 10(b), as implemented by SEC Rule 10b-5, makes it unlawful to, "in connection with the purchase or sale of any security," make "any untrue statement of material fact" or to engage in fraudulent schemes. Courts have held that Section 10(b) and Rule 10b-5 apply to a wide range of fraudulent conduct, such as false statements, insider trading, and market manipulation. The Supreme Court has held that Section 10(b) contains an implied private right of action, allowing injured plaintiffs to sue persons who violate its requirements for damages.

Investment Company Act of 1940

The Investment Company Act of 1940 regulates issuers that engage primarily in investing, reinvesting, and trading in securities. Common examples of investment companies are mutual funds and exchange-traded funds (ETFs). According to one estimate, investment companies registered in the United States managed $21.4 trillion in net assets as of 2018. While these vehicles offer investors the benefits of portfolio diversification and expert management, they were also the locus of a range of abusive practices during the 1920s and 1930s, including misleading disclosures, management self-dealing, and embezzlement. To address these problems, the Investment Company Act (1) requires investment companies to register with the SEC, subject to certain exceptions, (2) imposes disclosure requirements for the investment company and its investment policies, (3) prohibits many types of direct transactions between investment companies and affiliated persons, (4) limits an investment company's ownership of shares of other investment companies, and (5) requires investment companies to create shareholder-elected boards of directors to police management conflicts of interest. Private funds, such as hedge funds and private equity funds, typically fall within exceptions to the Act.

Investment Advisers Act of 1940

The Investment Advisers Act of 1940 imposes a range of requirements on persons or firms in the business of advising others about the value of securities or the advisability of investing in securities. Under the Act and associated SEC regulations, investment advisers are fiduciaries, meaning they must act in their clients' best interests, fully disclose any material conflicts of interest, seek best execution for client transactions, and have a reasonable basis for client recommendations. The Act also requires investment advisers to register with the SEC, subject to certain exceptions, and imposes certain disclosure obligations on registered advisers. Under the Dodd-Frank Wall Street Reform and Consumer Protection Act's amendments to the Act and associated SEC regulations, investment advisers to many hedge funds and private equity funds must register with the SEC.

Foreign Corrupt Practices Act of 1977

Congress enacted the Foreign Corrupt Practices Act (FCPA) in response to the SEC's discovery that a large number of U.S. corporations had bribed foreign officials to secure business. The FCPA contains both anti-bribery and accounting provisions. The anti-bribery provisions prohibit making corrupt payments or giving anything of value to a

foreign official to obtain or retain business, and apply to issuers, domestic concerns (i.e., U.S. persons and businesses), and certain foreign nationals and entities who act in furtherance of a corrupt payment while in U.S. territory. The FCPA's accounting provisions require issuers to keep accurate books and records containing a reasonable level of detail and to devise and maintain adequate internal accounting controls. The accounting provisions aim to ensure that corporations do not mischaracterize bribes in their accounts or use corporate funds for improper purposes.

Private Securities Litigation Reform Act of 1995

Congress enacted the Private Securities Litigation Reform Act of 1995 (PSLRA) to minimize frivolous securities litigation. To that end, the PSLRA imposes more stringent pleading standards in certain private securities fraud actions, requires plaintiffs in such actions to prove that a defendant's false statement or omission caused the loss for which they seek damages, and creates a safe harbor for certain forward-looking statements by issuers, provided that they include appropriate cautionary language. The PSLRA also imposes a variety of procedural requirements in private securities class actions, including provisions relating to class formation, discovery stays pending a motion to dismiss, settlement approvals, and damages calculations. To prevent plaintiffs from avoiding the PSLRA's requirements by bringing their claims in state court rather than federal court, Congress enacted the Securities Litigation Uniform Standards Act of 1998 (SLUSA), and required securities class actions meeting certain criteria to be brought in federal court, where they are governed by the PSLRA.

Sarbanes-Oxley Act of 2002

After accounting scandals at a number of major U.S. corporations in the early 2000s, Congress enacted the Sarbanes-Oxley Act (SOX) in 2002. Under SOX and associated SEC regulations, a public company's management must assess and report on the company's internal controls designed to ensure accurate financial disclosures. The Act also (1) requires the CEOs and CFOs of public companies to certify that their annual and quarterly reports do not contain material false statements or omissions, (2) prohibits public companies from exercising improper influence over their auditors, (3) requires public companies to disclose certain off-balance sheet activities, (4) requires public companies to establish procedures for internal reporting of suspected abuses and complaints, and (5) protects whistleblowers from various forms of retaliatory action. Finally, the Act established the Public Company Accounting Oversight Board (PCAOB) to oversee the audits of public companies.

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

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank) effected a number of significant financial regulatory changes in response to the financial crisis of 2008. With respect to securities, Dodd-Frank brought security-based swap agreements under the SEC's jurisdiction. Additionally, Title IX of Dodd-Frank, also known as the Investor Protection and Securities Reform Act of 2010, (1) established the SEC's Office of the Investor Advocate, (2) established a whistleblower award program for reporting violations of the securities laws to the SEC, (3) enhanced regulation of credit rating agencies, (4) required the sponsors of asset-backed securities to retain some credit risk of the assets they securitize, and (5) provided for additional disclosures about and shareholder voting on executive compensation at public companies.

Stop Trading on Congressional Knowledge Act of 2012

The Stop Trading on Congressional Knowledge Act of 2012 (STOCK Act) clarifies that federal insider trading laws apply to Members of Congress, congressional staff, executive-branch employees, and judicial officers and employees. The Act explicitly provides that such persons owe a duty to the U.S. government and citizens not to trade on material, nonpublic information acquired through their positions or from the performance of their official responsibilities. The Act also directed relevant bodies within the federal government to issue interpretive guidance clarifying the prohibition on such officials' use of nonpublic information for personal profit. The Act explicitly prohibits Members of Congress and certain other government officials from acquiring securities in any IPO in a manner unavailable to the public. Finally, the Act amended the Ethics in Government Act of 1978 to require Members of Congress and certain executive-branch officials to report securities transactions within 45 days.

Jumpstart Our Business Startups Act of 2012

Congress enacted the Jumpstart Our Business Startups Act (JOBS Act) in 2012 to boost growth following the 2007–2009 recession and in response to a decline in the number of IPOs since the turn of the century. The JOBS Act allows certain small companies (known as "emerging growth companies") to operate under reduced disclosure requirements and exemptions from certain SOX requirements for five years or until they reach specified financial milestones. The Act also created a registration exemption for some companies that raise up to $1 million through "crowdfunding" and expanded preexisting exemptions in SEC Regulation A (relating to small issues) and Regulation D (relating to private placements). Finally, the JOBS Act increased the number of shareholders who can invest in a private company before triggering registration and Exchange Act reporting requirements.

CRS Related Products

CRS In Focus IF11062, *Introduction to Financial Services: Capital Markets*, by Eva Su

CRS Legal Sidebar LSB10293, *Lies and Schemes: Supreme Court Expands Securities Fraud Liability*, by Jay B. Sykes

CRS Report R45163, *Regulatory Reform 10 Years After the Financial Crisis: Dodd-Frank and Securities Law*, by Nicole Vanatko

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IF11422

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