Chapter 6
Securities Market in USA and UK
An Overview

In the previous chapters we have discussed how securities market works and who makes them work. A discussion on the regulatory framework of securities trading and market in India has also been discussed.

Presently, the securities markets are regulated in various western as well as Asian countries but this chapter only deals with the regulation of securities market in USA and UK that have most highly developed example of regulatory mechanism related to securities market. The British law on the point will also be discussed because of the connection it has with the Indian law.

A. Position in USA

The securities markets of the US provides mechanism for the purchase and sale of instruments i.e. known as securities, which represent claims of contractual nature against the company which sells or issues the instrument. Equity and debt instruments that can have standardized characteristics, and thus can be widely traded by the public, are used by business enterprises as a

1 Most business enterprises in the US, which issue securities to fund operation, are organized in corporate form. However, there is no requirement that an issuer of securities to the public should be a corporation, and many issuers are not in corporate form, for example, trusts or limited partnership. Under the various state corporate laws, shareholders are the owners of the corporations, and the value of their interest fluctuates with the fortunes of the company. This is in contrast to debt-holders, where interest in the issuer is fixed by contract. The market value of debt generally varies by the interest rate it bears (as compared to the rate of return available on other investments) and the credit-worthiness of the issuer.

The state statutes also provide for limited liability for shareholders. Since the holder of common stock are the residual claimants in a corporation’s capital structure without limited liability the price and characteristics of common stock could not be as easily standardized. Different shareholders with differing levels of wealth, which without limited liability would be fully exposed to the debts of the corporation, would demand different prices and different safeguards in exchange for their investment. Without standardized prices and terms, public trading of these instruments would be
source of funds. There are different types of public markets for securities in the U.S. but stock exchanges are the oldest public securities markets. The issuer of the securities, which are to be traded on stock exchange, must meet the listing requirements of the exchanges and enter into a contract, called listing agreement, with the exchanges. The New York stock exchange (NYSE) is the largest stock exchange in the US.

Transactions in securities off the exchanges are done in the over the counter (OTC) market. The principal OTC market in the US is the National Association of Securities Dealers Automated Quotation System (NASDAQ). The NASDAQ is run by the NASD, which is a trade association composed of virtually all the brokers and brokerage houses in the U.S. For smooth functioning of securities market every country needs an effective regulating framework. In US, both federal as well as state laws regulate securities market. There are three types of regulations in US which mainly regulates the securities market they are as follows:

- Federal regulations (Laws)
- State-regulations (Laws)
- Self-Regulations


2 Hellen S Scott, Federation Regulation of Securities, Introduction to the Securities Market
(a) Federal Laws

(i) Historical Development

In US there were no specific laws regulating the securities market before 1933. It may be said that the stock exchanges were regulated by their own rules and the state’s criminal and civil laws. The statute of New York and the court decisions of that state related to the stock market were particularly important at that time. Control of such markets was not considered within the jurisdiction of the United States Government. There are following acts and events which serve as a background for the Securities Act of 1933 and Securities Exchange Act of 1934 which are presently the major federal statutes regulating the securities market in US.

(1) Gold Speculation Act of 1864

The Gold Speculation Act of 1864 was passed in U.S. following the speculation in Gold in that period. At that time the US off the gold standard and the US notes or “greenbacks” were fluctuating at various fractions of face value. As a result, gold was selling at substantial premiums in terms of paper currency. Much speculation took place in currency and gold that was bought and sold on the exchange by brokers and dealers. Therefore, the purpose of passing the Gold Speculation Act was to forbid the practice of speculation in Gold.

\[1\] Farewell Leffler- The Stock Market, 3rd Edition 1963
(2) The Hughes Commission Report of 1909

In this period the investigation of stock market received a prime importance and wide attention. The then Governor of New York Mr. Charles Evans Hughes, appointed a commission to investigate securities and commodities speculations. This commission was headed by Horace White, a noted authority on money and banking. The report of the commission extensively dealt with the operations of the New York stock exchange. The report criticised a number of practices of the exchange and for its correction suggested self-regulations irrespective of any other method. There was no suggestion in report for federal control in this regard.

(3) The Pujo Money Trust Inquiry of 1912

The Congress authorized a committee to investigate Wall Street but the investigation centered largely in the concentration of economic control by a system of interlocking directorates of banks and corporation. Whatever, investigation of the stock exchanges was made during the period, received little or no public attention.

(4) The Market Decline of 1929-33

The market decline in U.S. during the period of 1929-33 was the main reasons for the passing of Securities Exchange Act 1934. In that period declines in industries stock prices of 89 percent were registered by the

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4 Ibid
5 New York State, Report of Governor Hughes Committee on Speculation in Securities and Commodities, June 7, 1901
Dowjones average and 87 percent by that of the New York Times. This sharp decline in the prices resulted in the huge losses to thousands of small speculators and investors. These events raised a strong need for investigation and regulation of securities marked. As a result, during the 72nd and 73rd sessions of congress, the Senate Committee on Banking and Currency made a very thorough investigation of manipulation in the securities market.

History, thus, shows that the most important reason for passing of the Securities Act 1933 and securities exchange Act 1934 was the market crash in U.S. during the 1929-33. Through, the first federal Act that was passed in 1864 i.e. Gold Speculation Act was not very successful and was repealed in 15 days.7

(ii) Present Position

At present there are following federal laws which regulates the securities market in US.

- Securities Act of 1933
- Securities Exchange Act of 1934
- Public Utility Holding Company Act of 1935
- Trust Indenture Act of 1939
- Investment Company Act of 1940
- Investment Advisors Act of 1940

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6 Supra note 3
7 Ibid
Here we will have a brief discussion on these acts

(1) Securities Act of 1933

This Act sometimes referred as “truth in securities” Act.\(^8\) The Securities Act primarily regulates the new securities offered to the public. The Act requires that all offers or sales of securities will be made pursuant to a registration statement.\(^9\) The main purpose of the Act is to make certain that the new securities offered to the public are fully and clearly described in the registration statement and prospectuses. Thus, this Act is essentially disclosure statute. Though, the Act provides that no security is to be issued to the public, unless it has been registered with Securities Exchange Commission (herein after referred as SEC) there are many exemptions from the registration requirement. Some of them are as follows:

- Private offering to a limited number of persons or institutions
- Offering of limited size
- Intrastate offerings and
- Securities of municipal, state and federal governments.

The main object of registration of securities with SEC is to ensure that the disclosures made in the registration statement are accurate and correct. But the SEC does not guarantee its correctness. The registration statement filed to

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\(^8\) Edward R. Willet, Fundamentals of Securities Market, Edition 1968

\(^9\) Section 5 of the Securities Act 1933
the SEC automatically becomes effective after 20 days of its filing. But if a statement on its face appears incomplete or inaccurate, the SEC may refuse to allow the statement to become effective. A misstatement or omission of a material fact may result in the registration's suspension.

The Act also provides for civil liability for damages arising from misstatements or omission in the registration statement or for offers made in violation of the law. Further, the Act provides for civil liabilities for misstatement or omission in any offer or sale of securities, whether or not the security is registered to SEC.

The registration statement has two parts, first- the information that eventually forms the prospectus and second- information that does not need to be furnished to purchasers but is available for inspection within SEC files. Full disclosure in this regard includes management's aims and goals, the number of shares the company is selling, what the issuer intends to do with the money, legal standing such as pending suits, income and expenses and inherent risks of the enterprise.

(2) Securities Exchange Act of 1934

As discussed, that the Securities Act 1933 mostly regulates the new securities issued to the public. The Securities Act 1934 (herein after referred as Act 1934) extended to regulate all phases of trading in existing securities. The

10 About the SEC' from Internet
main objective of the Act 1934 is to prevent unfair and inequitable practices and to bring trading on stock exchanges and in the over the counter market under the federal control.

This Act 1934 established SEC that will be discussed ahead. The Act 1934 provides that the issuers, subjects to certain exemptions, must register with the SEC if they have a security traded on a national exchange. This requirement is distinct from the requirement of registration under Act 1933. Securities registered under the Act 1933 act for a public offering may also have to be registered under the Act 1934. The companies with publicly traded stocks; issuers of securities registered under this act must file various reports with the SEC. Since 1964 this disclosure requirement has applied not only to companies with securities listed on national securities exchange but also to companies with more than 500 shareholders and more than $5 million in assets. False and misleading statements in any documents required under the Act 1934 may result in liability to persons who buy or sell securities in reliance on these statements.

(I) Prohibition of manipulation of securities prices

The significant part of the Act 1934 prohibits the manipulation of securities prices. This provision applies not only to brokers, dealers but also to any persons who directly or indirectly use the mails or the other facilities of

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12 Supra note 11
13 Ibid
14 Ibid
15 Section 9 & 10 of the Securities Exchange Act of 1934
any national securities exchange. The Act 1934\textsuperscript{16} particularly prohibits the following transactions/manipulations in securities by the persons, dealers and the brokers.

* The transactions made only for the purpose of creating false or misleading appearance of active trading in any security registered on national securities exchange, or a false and misleading appearance with respect to the market for any such security.

* The transactions made for the purpose of raising or depressing the prices of securities to induce the other persons for purchase or sale of such securities.

* It prohibits the dissemination of false and misleading information made for the purpose of raising or depressing the prices of the securities by the dealers, brokers or the persons selling or offering for sale or purchasing or offering to purchase the securities.

* It prohibits the brokers, dealers and the persons selling or offering for sale or purchasing or offering to purchase the securities to make any statement which was at the time and in the light of the circumstance under which it was made, false or misleading with respect to any material fact, and which he knew or had reasonable ground to believe was so false or misleading regarding the securities.

\textsuperscript{16} Section 9 (a), \textit{Ibid}
• It prohibits the transactions made for the purpose of pegging, fixing or stabilizing the prices of securities in contraventions of the rules and regulations prescribed by SEC.

Further, the Act 1934 has authorized SCE to make rules about any other manipulative or deceptive device in the public interest. Section 9 of the Act 1934, thus, broadly prohibits any type of manipulations of securities prices by the dealers, brokers and other persons.

(II) Prohibition of insider trading

In order to prevent corporate officials from using inside information for the purpose of speculating in securities of their corporation the Act 1934 provides three checks that are as follows:

- Each officer, director and beneficial owner of more than 10% of any listed class of stock must file with the SEC and the exchange an initial statement of his holdings and there after monthly reports that reflect any changes in his holding.

- Profits obtained by insiders from transactions in the corporation’s stock within any six months period may be recovered by the company or by any security holder on its behalf.

- Insiders are prohibited from engaging in short sales of their companies stock.

17 Section 16, Ibid
18 Supra note 12
19 Section 16 (a) of Securities Exchange Act 1934
20 Section 16 (b), Ibid
It is submitted that the above provisions afford investors a valuable protection against the abuses by the insiders. Each provision has a different aim and purpose. The first provision deals with the disclosure requirements. It will reduce the chances of dealing in securities for selfish ends by those insiders.

The second provision is very mechanical in nature. Section 16 (b) provides that the profit obtained by an insider from transaction completed within six months in equity securities of the corporation with which he is associated may be recovered by the company or on its behalf by the security holder. The intention in this regard whether he acted in good faith or otherwise is irrelevant. Thus the insiders become liable to the company solely on the basis of their insider status and regardless of their motive or use, if any of inside information.

The last provision prohibits certain sales absolutely by insiders. The short selling by insiders are absolutely prohibited by the Act 1934. A short sale means the selling of security that the seller does not own or has ownership but does not want to deliver it. The short sellers are usually considered as speculators.

Thus, these are the main provisions of the Act 1934, which prohibits the insider trading. The SEC has also been given wide powers to deal with insider trading under the Act 1934.

21 Section 16 (c), Ibid
(III) Regulation of Proxy Solicitation

The Act 1934 also regulates proxy solicitation, which is information that must be given to a corporation’s shareholders as a prerequisite to soliciting votes. Prior to every shareholder meeting, a registered company must provide each shareholder with a proxy statement containing certain specified material, along with a form of proxy on which the security holder may indicate approval or disapproval of each proposal expected to be presented at the meeting. The copies of the proxy statement and form of proxy must be filed with the SEC when they are first mailed to security holders. A misstatement in proxy statement may incur liabilities. Therefore, this provision deprived officers, directors and substantial shareholders of any incentive to abuse their position by trading in securities of their companies on the basis of information not known to the public.

(IV) Regulation of use of credit in securities transactions

The Act 1934 prohibits the excessive use of credit for the purchase or carrying of securities. The Act 1934 authorised Board of Governors of the Federal Reserve System to prescribe rules and regulations with respect to the amount of credit that may be initially extended and subsequently maintained on any security. For the initial extension of credit, such rules and regulations shall be based upon the following standard:

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23 Section 7 & 8 of Securities Exchange Act of 1934
24 Security other than an exempted security or a security futures products
25 Section 7 (a) of Securities Exchange Act of 1934
• 55 per centum of the current market price of the security or

• 100 per centum of the lowest market price of the security during the proceeding thirty six calendar months, but not more than 75 per centum of the current market price.

However, the Act 1934 gives wide powers to Board of Governors of the Federal Reserve to prescribe such lower and higher margin requirements, as it may deem necessary or appropriate to prevent the excessive use of credit to finance transactions in securities. 26

The Act 1934 further prohibits any member of national securities exchange of any broker or dealer directly or indirectly to extend or maintain credit or arrange for the extension or maintenances of credit to or for any customer in contravention of the rules and regulations prescribed by the Board of Governors of the Federal Reserve System on any security. 27

Therefore, it is submitted that the Act 1934 not only regulates the amount of credit but also places severe restriction on the source of such credit. In general the Act 1934 seeks to prevent such credit from being extended by others than members banks of the Federal Reserve System, by non-member banks signing agreements with the board, and by brokers and dealers under such rules and regulations as may be prescribed by Board of Governors. 28

26 Section 7 (b), Ibid
27 Section 7 (c), Ibid
28 Supra note 3
The aim of the above provisions is to help in curbing the speculative markets. The margin means the amount that the investor has to deposit with the dealer or broker while purchasing security and the remaining amount or the difference between this amount and the purchase price of the securities can be borrowed by the investor. The margin amount in the security, which is subjected to more speculation, is increased generally. Accordingly, if the market drops and appears to have little appeal to investors, the amount of margin is likely to be reduced.

(3) Public Utility Holding Company Act of 1935

This Act is very specific in its application. It regulates the interstate holding companies engaged, through subsidiaries, in the electric utility business or in the retail distribution of natural or manufactured gas. These companies are required to submit reports containing information regarding organizations, financial structure, and operations of the holding company and its subsidiaries. The matters such as acquisitions, business combinations, the issues and sale of securities and financial transactions of holding companies are subjects to the SEC regulation in this regard.

(4) Trust Indenture Act of 1939

This Act basically regulates the transactions in bonds, debentures and notes. The public offerings of these securities are subject to this Act. The formal agreement between the issuer of bonds and the bond holder i.e. known

29 'Laws and Regulations' from Internet
as ‘trust indenture’ must comply with the requirements under this Act. These securities may not be offered to the public for sale in spite of the fact that the securities are registered under the securities Act\(^3^0\) unless the requirements under this Act have not been complied with.\(^3^1\)

(5) Investment Company Act of 1940

This Act regulates the investment companies. Investment companies are those companies, which engaged primarily in the business of investing, reinvesting or trading in securities. They may also be companies with more than 40 percent of their assets consisting of investment securities.\(^3^2\) Investment companies also include open-end companies commonly known as mutual funds.\(^3^3\) The Act requires that the investment companies have to disclose their financial condition and investment policies to investors at the initial stage i.e. when the stock is sold and subsequently on a regular basis. Therefore the focus of this Act is on disclosures to the investing public of information about the funds and its investment objectives, as well as, on Investment Company’s structure and its operations.\(^3^4\)

Subject to certain exemptions the investment companies must be registered with SEC. The registration includes a statement of the company’s

\(^{3^0}\) Securities Act 1933
\(^{3^1}\) Supra note 29
\(^{3^2}\) Securities other than securities of majority owned subsidiaries and govt securities
\(^{3^3}\) Supra note 11
\(^{3^4}\) Supra note 29
investment policies. Further, they must file annual reports with SEC and should maintain certain accounts and records.\textsuperscript{35}

(6) \textit{Investment Advisors Act of 1940}

This Act regulates the activities of the investment advisors. The Act requires that the firms or sole practitioners engaged in advising others about securities investment must be registered with SEC. Thus, no firm and person can be engaged in the business of advising others about the securities to be sold or bought or otherwise unless such firm and person are registered with the SEC. But the above act has been amended in 1996 that requires that only advisors who have at least $25 million of assets under management or advise a registered investment company must be registered with the SEC.\textsuperscript{36}

Now the amended Act does not require that every advisor should be registered with SEC but only the advisors, which fulfill following conditions, must be registered with SEC. The conditions are as follows:

- If the advisors have at least $25 million of assets under management or
- If the advisors advice a registered investment company.

(7) \textit{Sarbanes-Oxley Act of 2002}

The major corporate scandals involving the Enron Corporation (world's largest energy, commodities and service companies) in US in 2001 resulted the

\textsuperscript{35} Supra note 11
\textsuperscript{36} 'The Investor's Advocate' from internet.
enactment of the above Act. The Act introduced number of reforms to enhance corporate responsibility, enhance financial disclosures for the purpose of preventing the corporate and accounting fraud. The Act made it mandatory that the SEC, by rule, requires the principal executive officer and principal financial officer to certify in each annual or quarterly report the accuracy and completeness of the information in the report. A knowing violation of this section is punishable by up to 10 years in jail and a $5 million fine. The Act has also created a board i.e. “Public Company Accounting Oversight Board” to oversee the auditing profession. The Board shall file annual report with the SEC.

Thus, it was the general idea of the federal laws governing the securities market in U.S. It is not possible here to give the details of all the acts, as they are very lengthy statutes. But from the above it is clear that the Securities Act 1933 and the Securities Exchange Act 1934 is general in their application. They are the major federal laws, which mainly focus on the disclosure requirements to be made by the issues of the securities. The Act 1933 mainly regulates to the new issue of securities offered to the public and the Securities Exchange Act 1934 regulates that existing securities to be sold or bought the stock exchanges or on the OTC market. The other Acts are specific in their applications. Apart from these acts the market is also regulated by the rules and regulation laid by SEC in this regard.

37 Also known as the Public Company Accounting Reform and Investor Protection Act
(b) State Laws

The state laws regulating the securities are not uniform in all the states. However they provide some common or basis requirements that are as follows:\(^38\):

- They require the registration of individuals and firms who intend to engage in securities market.

- The registration of information regarding securities to be offered for sale subjects to certain exemptions like securities listed on national exchanges, federal, state, municipal securities etc.

- State laws refer to the prevention of fraudulent securities sales as:
  - State antifraud provisions are usually quite broad.
  - The sale of a security at a price, which is not reasonable related to the current market price, may constitute fraud.
  - There are also provisions in the state laws for the prosecution of those individuals who are guilty of fraud.

For the purpose of administering the above laws the state generally establishes commission. The state securities laws are commonly known as "Blue Sky Laws" because of an early judicial opinion that described the

\(^{38}\) Supra note 8
purpose of the laws as preventing speculative schemes, which have no more basis than so many feet of blue sky.\textsuperscript{39}

(c) Self-Regulations

The Securities Exchange Act 1934 has introduced the new principle of self-regulation that is very strong in the USA. This principle has its roots in statute. The self-regulations for stock exchanges have also been suggested by Hughes Commission in its report in 1909. The registered stock exchanges can adopt and enforce any law that is not inconsistent with the other laws. Thus, the stock exchanges in U.S. are effective self-regulatory organisations, their rules are designed to prevent fraud and manipulative acts and practices and also regulate the activities of their members and provide the appropriate discipline to them.

The Congress later extended federal registration to non-exchange, or OTC, markets in 1938 and authorized the establishment and registration of national securities association with SEC. Further in 1975 Congress expended and consolidated SEC authority over all self-regulatory organisations.\textsuperscript{40}

(d) Securities Exchange Commission: Its powers and Functions

The SEC is a federal agency primarily responsible for administering and enforcing the federal laws. The SEC is established under the Securities

\textsuperscript{39} Hall Vs Geiger-Johns, 242 US 539, 372, S. Ct.217, 61 L.Ed. 480 (1917)
\textsuperscript{40} Supra note 11
Exchange Act 1934. It is composed of five commissioners who are appointed by the president with the advice and consent of the senate. Their term of office is five years, which is set in such a way that one commissioner’s term ends on June 5 of each year. The president also designates one of the commissioners as chairman, the SEC’s top executive. The Act 1934 provides that not more than three of such commissioners shall be member of the same political party and that members of different political parties shall be appointed alternately as nearly as is practicable. This provision is made for the purpose of reducing the risk of political dominance and keeping the SEC as impartial.

The SEC has four divisions and 18 offices for the purpose of performing its duties effectively. These divisions and offices have been entrusted different tasks. The divisions and offices of the SEC are as follows:

(i) Divisions of SEC

(1) Division of Corporate Finance

This division basically keeps a close watch over the disclosure requirements to be made by the corporations at different stages. The division checks that the corporations are complying with the requirements of laws. The division also assists to the companies by interpreting the SEC’s rules and can also recommend to the SEC to adopt the new rules for the purpose of improving the quality of disclosures.

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41 Section 4 of Securities exchange Act 1934
42 "The investor’s Advocate" from Internet
This division reviews the following documents, which are required to be filed with the SEC by the companies.

- Registration statements for newly offered securities.
- Annual and quarterly filings
- Proxy materials sent to the shareholders before an annual meeting.
- Annual reports to shareholders
- Filing related to merger and acquisitions etc.

The division, thus, checks that the information disclosed in the registration documents are accurate. But as discussed earlier its does not in any way guarantee the correctness of the information made in the documents. This division also monitors the activities of the accounting profession. Moreover, the division also provides guidance and counseling to public, registered companies etc. for the purpose of helping them in complying with the laws.

(2) Division of Market Regulation

This division establishes and maintains standard for fair, orderly and efficient markets. For this purposes the division regulates the activities and operations of the market participants which includes broker-dealer firms, self-regulatory organizations such as stock exchanges and the National Association of Securities Dealers (NASD) Municipal Securities Rule Making Board (MSRB), clearing agencies and transfer agents etc. The division also carries out
the SEC's financial integrity programs for broker-dealers. It reviews and approves the new rules and also proposed changes to existing rules of the SROs. It also monitors the operations of the securities market.

Thus, the division monitors that the market is operating in a fair and healthy manner and the participants in it are complying with the laws.

(3) Division of Investment Management

This division regulates the $15 trillion investment management industry and administers the securities laws effecting investment companies and investment advisers. The division reviews investment companies and investment adviser's filings with SEC. This division also regulates the public utility holding companies. It examines their annual reports, periodic reports etc.

Therefore, this division regulates the operations of the investment companies, advisors and the holding companies.

(4) Division of Enforcement

This is the most important division of SEC. The division investigates possible violations of securities laws and recommends actions in appropriate matters either in federal courts or before an administrative law judge. The division works closely with various criminal law enforcement agencies throughout the country to develop and bring criminal cases when the misconduct is more severe.
This division is mainly responsible for the enforcement of securities laws. The SEC has the following offices for its assistance.

(ii) Offices of SEC

(1) Office of Administrative Law Judges

Administrative law judges are independent judicial officers. They conduct hearings and rule on allegations of securities law violations initiated in most cases by the SEC’s enforcement division. The SEC can seek a variety of sanction through the administrative law judge. The possible sanctions include imposition of a cease and delist order, suspension and revocation of a broker-dealer or investment adviser registration, payment of civil monetary penalties and disgorgement of ill gotten gains etc.

(2) Office of Human Resources and Administrative Services

It implements and evaluates the commission’s program for human resources and personnel management such as pay administration, recruitment, placement etc.

(3) Office of the Chief Accountant

The chief accountant is the principal advisor to the SEC on the matters related to accounting and auditing. An audit is an examination of a company’s financial books and records to ensure that it keeps fair consistent documents in accordance with SEC regulations.
(4) Office of compliance Inspections and Examination

The office conducts inspections for the purpose of detecting the violation of law throughout the nation and also examines the working of market participants like broker-dealers, SROs, investment companies etc. and report to SEC in this regard.

(5) Office of Financial Management

This office administrators the financial management and budget functions of the SEC.

(6) Office of Economic Analysis

This office analysis the potential impacts and benefits of proposed regulations, conducts studies on specific rules and engages in long-term research and policy planning. It advises to SEC in this regard.

(7) Office of Equal Employment Opportunity

Any organisation’s employees are important resources. SEC has created this office for the protection of its employees from any prejudice. This is an independent office. Its primary mission is to prevent employment discrimination including discriminatory harassment. Therefore this office creates an environment in which the employees of SEC could work efficiently. It monitors internal policies regarding the employees and reports to chairman in this regard.
(8) Office of the Executive Director

This office develops and executes the management policies of the SEC.

(9) Office of Filings and Information Services

The office supports the SEC’s full disclosure, supervision and regulation of securities market and investment management regulations programs.

(10) Office of the General Counsel

This is the legal office of SEC. General counsel of SEC represents it in civil, private or appellate proceedings. He also prepares legislative material and also provides independent advice to SEC division and other offices.

(11) Office of Information Technology

It supports the SEC and its staff in all aspects of information technology.

(12) Office of the Inspector General

It conducts internal audits and investigation of SEC programs and operations for the purpose of identifying and mitigating operational risks and improving the efficiency and effectiveness of the programs.

(13) Office of International Affairs

It assists SEC in developing and implementing its international enforcement and regulatory initiatives etc.
(14) Office of Investor Education and Assistance

It assists the investors in various ways. The office serves individual investors by assuring that their problems and concerns are known throughout the SEC and considered by it. It also organizes various programs for investors awareness.

(15) Office of legislative affairs

This office maintains the coordination between SEC and the members of the Congress.

(16) Office of Public Affairs, policy evaluation and Research

This office coordinates SEC media relations and monitors media coverage of issues related to SEC and the securities market.

(iii) Powers and Functions

The SEC has responsibility to administer and enforce the federal laws, rules and regulations that is not an easy task. As discussed for the purpose of performing this task the SEC has a well-defined organizational set up. It has various divisions and offices and their responsibilities are very much divided so that there would be no confusion regarding their responsibilities and the functions. As discussed, SEC has various functions, responsibilities that have been entrusted to it under different federal laws. It is not possible to enumerate all the functions, responsibilities that it has to perform for regulating the
securities market and preventing the abusive corporate activities in the securities market. In brief, it has the following main functions.

- Registration and regulation of securities under Securities Act\textsuperscript{43}
- Registration and regulation of securities under Securities Exchange Act\textsuperscript{44}
- Registration and regulation of dealers, brokers, transfer agents, clearing agencies etc.
- Registration and regulation of investment advisors under Investment Advisors Act\textsuperscript{45}
- Registration and regulation of investment companies under Investment Companies Act\textsuperscript{46}
- Registration and regulations of self-regulatory organisations.
- Regulation of holding companies under public Utility holding companies Act\textsuperscript{47}

In general, the SEC has responsibility to enforce all the federal acts, rules made there under and the regulations. It has a duty to prevent the violation of such acts, rules and regulations by the issuers of the securities and the persons associated with the securities market. For the

\textsuperscript{43} Securities Act 1933  
\textsuperscript{44} Securities Exchange Act 1934  
\textsuperscript{45} Investment Advisors Act 1940  
\textsuperscript{46} Investment Companies Act 1940  
\textsuperscript{47} Public Utility Holding Companies Act 1935
purpose of enforcing these acts, rules and regulations it has various
powers under the acts some of them are as follows:

(1) Power to investigate violation

The SEC has very broad powers to investigate the violations in the
securities market. The SEC conducts many kinds of investigation to
determine violations of rules and practices. It may investigate to determine
whether a person has violated or is violating.

- Any provisions, rules or regulations under the Acts.
- Any rules of a national securities exchange or registered securities
  association.
- Any rules of a registered clearing agency.
- Any rules of public company accounting oversight board and
- Any rules of municipal securities rule making board.

The SEC not only enforces the federal Acts but also the rules of various
other organisations. These investigations may be started by SEC on its own
initiative, either on routine checks or because of evidences of violation; which
may come from enquiries or complaints by customers, brokers or dealers, the
records of brokers or dealers may also bring the irregularities to light.

Generally, the SEC initially conducts an informal inquiries, including
interviewing witnesses. This stage does not usually involve sworn statements

48 Section 21 (a) Of Securities Exchange Act 1934
49 Supra note 3
or compulsory testimony. But if it appears in inquiry that any violation has occurred it can conduct a formal inquiry or investigation.

(2) Power to compel attendance of witnesses

While investigating, the SEC or its officers may compel the attendance of witnesses for the purpose of taking evidences. It has power to issue subpoenaed to the witnesses and also to testify them. It may also compel witnesses for production of any records such as books, papers etc. which SEC deems relevant or material to the inquiry. For the purpose of enforcing these powers it has assistance of US courts. Any person who fails or refuses to attend testify, or to answer any lawful inquiry or to produce records in his power in obedience of the subpoena will be guilty of misdemeanor and upon conviction shall be guilty of fine up to $1,000 or to an imprisonment of a term up to one year on both.

If after the investigation the SEC finds that any violation has been occurred it may bring an action before administrative judge or in any other appropriate court.

(4) Assistance of US courts

If any person has refused to obey subpoena issued by SEC it can seek the assistance of any U.S. court within the jurisdiction of which the investigation or proceeding is carried on or where such person resides or carries on business. In

50 Supra note 11
51 Section 21 of Securities Exchange Act 1934
52 Section 21 (c), Ibid
such case the court may issue an order requiring such person to appear before the SEC and failure to obey such orders shall be punishable as the contempt of court. In many other matters also the SEC can seek the aid of the US courts.

(5) **Power to bring action against defaulters**

If after the investigation it appears to SEC that any person has violated any provision of acts, rules or regulation it can bring two types of actions.

- Administrative actions
- Civil actions

The administrative proceedings are initiated before the administrative law judge (hereinafter referred as ALJ). The ALJ as discussed earlier, is an independent officer of SEC. The ALJ presides over the hearings and considers the evidences presented by the parties. Following the hearings the ALJ issues an initial decision in which he makes findings of fact and reaches legal conclusions. He can impose many types of sanctions as discussed.

The SEC can also file a complaint with appropriate US court which describe the misconduct, identifies the laws and rules violated, and identifies the sanction or remedial action that is sought by it. SEC may asks the court to issue injunctions prohibiting the acts or practices violating the law, rules and regulations. The court may bar persons from serving as officers and directors in appropriate cases. The court may also impose civil penalties to be paid by the persons violated the laws, rules and regulations. The amount of penalty will be
determined by the court in light of the facts and circumstances. The Securities Exchange Act\textsuperscript{53} provides the maximum limit of penalties which is as follows:

- The amount of penalty will not exceed the greater of $5,000 for a natural person or $50,000 for any other person\textsuperscript{54} or

- The gross amount of pecuniary gain to such person (defendant) as a result of the violation for each violation.

However, where the violations involved fraud, deceit, manipulation or deliberate or reckless disregard of regulatory requirements the amount of penalty will be as follows:

- The amount of penalty will not exceed the greater of $50,000 for a natural person $250,000 for any other person or

- The gross amount of pecuniary gain to such person (defendant) as a result of violations.

Apart from the above powers the SEC has full quota of administrative, legislative, judicial and enforcement powers for the purpose of preventing unreasonable fluctuation, excessive speculation and maintaining orderly market. But the most important authority of SEC is its enforcement authority as without this it was not possible to exercise the other powers and seek the compliance of those powers. Making the laws, rules and regulations serve no

\textsuperscript{53} Section 21d3B, \textit{Ibid}

\textsuperscript{54} Includes natural persons as well as artificial persons
purpose until and unless they are enforced or implemented properly and effectively.

The SEC, thus, has vast powers in this regard, which includes power to investigate, power to issue subpoenas, to testify witnesses, to bring actions against defaulters etc. It not only has those powers but also exercises those powers very effectively in appropriate cases. It brings between 400-500 civil enforcement actions against individuals and companies that break or violate the laws, rules and regulations.\textsuperscript{55} These violations include insider trading, accounting fraud, providing false and misleading information about securities and the companies that issue them. It may also refer persons to the justice Department for criminal prosecutions.

**B. Position in UK**

In UK there are many statutes and non-statutory\textsuperscript{56} codes which regulates the securities market. But here we will discuss the newly enacted Financial Services and Markets Act 2000 (hereinafter referred as FSM Act). It broadly deal with market abuses, penalty etc. A regulatory authority i.e. Financial Services Authority has also been constituted under FSM Act for the regulation of securities market in UK. The goal of this authority is to maintain efficient, orderly and clean financial markets and help retail consumers in achieving a fair deal.\textsuperscript{57} Therefore, a part from maintaining a healthy and orderly market the

\textsuperscript{55} 'Introduction-The SEC: Who We Are, What We Do,' from Internet
\textsuperscript{56} Non-Statutory Codes are the Stock Exchange Model Code, The City Court on Takeover and Mergers, The Substantial Acquisition Rules
\textsuperscript{57} Supra note 55
The aim of authority is to help the retail consumers in achieving the fair deal. Here, the focus is on retail consumers as they need more protection against the abuses like price manipulations, insider leading etc. The disclosure and the publicity are the two most important means of controlling abuses under this FSM Act.

(a) Financial Services and Markets Act, 2000

This Act has replaced the Financial Services Act 1986 and introduced more transparency in securities transactions. It has constituted a single regulator in U.K. i.e. Financial Services Authority which is mainly responsible for the regulation of securities market and the enforcement of the laws, and rules though there are many other organizations which are entrusted with related responsibilities.\(^58\)

(i) Authorised persons to carry business activities

The persons are prohibited from carrying on a regulated activity in the UK unless and until they are one authorized by Authority to carry on such activities. The Act provides that... “No person may carry on a regulated activity in the United Kingdom, or purport to do so unless he is (a) an authorized person or (b) an exempt person.”\(^59\)

The persons thus for the purpose of carrying on the business of regulated activities must be authorized to do so or may be the persons who are exempted from seeking such authorization.

\(^{58}\) Other organisations such as HM Treasury, The Bank of England, The Department of Trade and Industry, the Department for Works and Pensions, The Office of Fair Treading, the Serious Fraud Office, National Criminal Intelligence Service etc

\(^{59}\) Section 19 (1) of FSM Act 2000
The regulated activity means an activity of 'specified kind' that is carried on by way of business and is 'related to an investment of a specified kind'. The investment includes any asset, right or interest. Specified means specified by order of treasury. Thus the regulated activities include the business of investment of a specified kind. What is specified kind would be specified by the order of Treasury. These prohibitions are very general in nature and are referred as general prohibition. The persons authorized to carry on such activities will do so in accordance with permission given to them by the authority. They will not contravene any terms and conditions imposed to them by the authority. However, such persons contravening these terms and conditions will not be guilty of an offence and such transactions may not be void or unenforceable. But an affected party may bring an action against them for the loss, other party suffered by such contraventions.

But if a person contravenes the general prohibition i.e. if he has neither been authorized to carry on regulated activities nor exempted from such authorization he will be guilty of an offence and such person may be liable:

- on summary conviction to imprisonment for a term not exceeding six month or a fine and
• on a conviction on indictment, to imprisonment for a term not exceeding two years or fine.

However, this is not the hard and fast rule, there are certain defences available to the accused like if the accused shows that he took all reasonable precautions and exercised all due diligence to avoid the offence.

(ii) Listing of Securities

Listing of securities in UK means the admission of securities in the ‘Official List.’ This list is maintained by the Authority. The Authority is authorized under the Act to make listing rules. Before enactment of this Act it was the Board of Directors of London Stock Exchange who was authorized to make listing rules66. Therefore, this is the most important change taken place after the enactment of this Act. An independent authority now has been entrusted with this task to regulate the listing procedure.

An application for listing must be made in the manner required by the listing rules. However, an application for listing can not be made without the permission of the issuers of securities67 and no application may be made in respect of securities issued by a body of prescribed kind (private company).

The Authority may refuse an application to list securities if the requirements of listing rules or any other requirements imposed by Authority are not complied with by the concerned person.68 It may also refuse an

66 Financial Services Act 1986, part IV
67 Section 75 (2) of FSM Act 2000
68 Section 75 (4), Ibid
application if the authority considers that admission of security in official list would be detrimental to the interest of investment or in case of securities which are already listed in another EEA state and the issuers fail to company with the obligations imposed by that listing.\textsuperscript{69} The Authority must notify the applicant of its decision on the application within six months of receiving application\textsuperscript{70} and a failure to inform within this time will be taken as a refusal of application.\textsuperscript{71}

Apart from this the listing particulars containing the information which is reasonably required by the investors and their advisor for the purpose of making the informed assessment regarding the assets and liabilities, financial position, profits and losses, and the prospectus of issuing company and the rights attaching to such security must also be submitted to the Authority.\textsuperscript{72} This requirement is in addition to the other requirements under listing rules as well as the requirements imposed by the Authority. The securities of issuers may not be admitted in the official list unless these particulars are submitted and approved by the Authority. Such particulars must also be published unless exempted by Authority.\textsuperscript{73} If there is any significant change subsequently it must also be submitted to the Authority.\textsuperscript{74}

Thus, the most significant provision under listing rules is the publication of listing particulars that is very useful for investors. They need not to go to the

\textsuperscript{69} Section 75 (5) and (6), Ibid
\textsuperscript{70} Or within six months of issuing any further information it has requested
\textsuperscript{71} Section 76 (1) (a) of FSM Act 2000
\textsuperscript{72} Section 80, Ibid
\textsuperscript{73} Section 79 (1), Ibid
\textsuperscript{74} Section 81, Ibid
Authority to check information. Moreover, if there were any omission from mentioning any information as required, in listing particulars or if there is any untrue, misleading statement in the particulars the person responsible would be liable to pay compensation to the other person who has suffered loss due to such statements.\textsuperscript{75} The Authority may also impose fine on the issuers of securities or on an applicant for listing.\textsuperscript{76}

Regarding issue of new securities\textsuperscript{77} a prospectus must also be submitted to Authority and published before listing of securities in official list.\textsuperscript{78} Therefore, these are some important provisions regarding the listing of securities in U.K.

(iii) **Regulation of market abuses**

The Act prevents market abuses such as insider trading, price manipulations etc. But these words are not used in the Act then a question arises what are the market abuses? The Act provides that market abuse is a behaviour which\textsuperscript{79}:

- Is based on information that is not generally available to those using the market but which, if available to a regular user of the market would or would be likely to be regarded by him as relevant when deciding the

\textsuperscript{75} Section 90, *Ibid*
\textsuperscript{76} Section 91 (1) (a) and (b), *Ibid*
\textsuperscript{77} New securities meant securities which are to be offered to public in UK for the first time before admission to official list
\textsuperscript{78} Section 84 (1) of FSM Act 2000
\textsuperscript{79} Section 118 (2) (a), (b) and (c), *Ibid*
terms on which transactions in investments of the kind in question should be affected.

- Is likely to give a regular user of the market a false or misleading impression as to the supply of or demand for, or as to the price or value of investment of the kind in question and

- Is behaviour that a regular user of the market would regard the behaviour as behavior that would, or would be likely to distort the market in investment of the kind in question.

(b) Financial Services Authority

After the enactment of the FSM Act, the Financial Services Authority is a single regulator for financial services in U.K. The aim of the Authority is to maintain market confidence, promote public understanding of the financial system, secure appropriate consumer protection and reduce financial crime. In discharging these functions it required to observe certain principles of good regulation. These principles include economy and efficiency in the use of its resources, the position of the UK as an international center and need to be proportionate in its regulatory responses.

(i) Powers of Financial Services Authority

For the purpose of regulating the securities market the FSM Act entrusted various powers to the Authority, some of them are as follows:

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80 Regulatory Approach, from Internet
The Authority has power to discontinue and suspend listing of securities if it satisfied that there are special circumstances that preclude normal, regular dealings in securities. The Authority while doing so must give written notice to the issuer of securities, informing him on the details of suspension and discontinuance such as its reasons, date on which the discontinuance or suspension took effect etc. The Authority must also inform the issuer about his rights. It gives Authority vast powers to suspend and discontinue trading where there are “circumstances which preclude normal regular dealing in them. What are those circumstances will be decided by the Authority itself.

The Authority has power to investigate the contraventions of the listing rules and laws of the Act. For this purpose it may appoint one or more persons to conduct an investigation on its behalf.

The Authority has power to impose penalty in cases of price abuses upon the person if it is satisfied that such person is or has engaged in market abuse or encouraged any other person/persons to engage in market abuses. The Authority instead of imposing the penalty on such person may publish a statement to the effect that he has engaged in market abuse.

The Authority has power to regulate the investment firms like investment banks, large UK stockbrokers, independent financial

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81 Section 77 (1) of FSM Act 2000
82 Section 97 (1) and (2), Ibid
83 Section 123, Ibid
advisors etc. It also regulates the activities of professional firms such as lawyers and accountants who carry on mainstream investment business like providing direct advice on investment products. Thus, not only the investment firms but also the professional firms come under the preview of its regulatory framework.

- It also regulates and supervises the market and exchanges including clearing and settlement houses and other market infrastructure providers. It conducts market surveillance and monitors transactions in securities markets. Presently, it recognizes and supervises eight recognized investment exchanges.85

As discussed regarding listing of securities the Authority has been entrusted wide powers.

Recapitulation

From the above discussion, it is clear that in USA before 1933 there was no specific statute regulating the securities market. It was only after the market decline between 1929-33, the Securities Act 1933 was enacted which basically regulates the new issue of securities to public. The Securities Exchange Act 1934 broadly prohibits and prevents the abusive corporate activities such as price manipulation, insider trading etc. in securities market. It regulates the trading of securities in stock exchanges or off the exchanges in over the counter market. These two acts are major federal laws regulating the securities market

84 Supervision from Internet
85 Ibid
in USA, apart from these there are five other federal laws for the purpose of regulating the securities market as discussed. Beside these laws the states laws and SROs also regulates the securities market.

For the administration and implementation of the federal laws there is a strong regulatory body i.e. SEC. It has four divisions and different officers. Their functions and duties are clearly divided. SEC has wide powers for the purpose of performing its duties however the functions are very balanced. SEC has power to investigate the violations of the laws in the securities market and if SEC finds any violations after investigation it can bring actions before ADJ or in any other appropriate court. ADJs are independent officers of SEC. On the other hand in India if SEBI satisfies after investigation it can suspend or cancel registration of the defaulters or it may appoint any person as adjudicating officer who is authorized to impose monetary penalties on the defaulters. Thus, SEBI has discretionary power to appoint any person as Investigating Authority or as adjudicating authority however, any officer below the rank of division chief cannot be appointed as adjudicating authority. In USA it is the courts, which describe the misconduct, identify rules and laws violated. The amount of penalties has also been decided by the courts.

In UK recently enacted the Financial Services and Market Act, 2000 is a principal Act that deals broadly with market abuses, penalties etc. The Financial Services and Market Act, 2000 established regulatory authority i.e. Financial Services Authority. The goal of the regulatory authority is to
maintain efficient, orderly and clean financial markets and help retail consumers. The FSA has power to regulate the investment firms like investment banks, large UK stockbrokers and independent financial advisors. It also regulates the activities of professional firms such as lawyers and accountants who carry on mainstream investment business. It has power to investigate violations, to impose penalties etc. It also regulates and supervises the markets and exchanges including clearing and settlement houses and other market infrastructure providers. It conducts market surveillance and monitors transactions in securities market. At present, it supervises eight recognised investment exchanges. In UK FSA is the single regulator that regulates securities market, banking, insurance etc.