U.S. Regulation of the International Securities and Derivatives Markets, § 1.01, KEY SECURITIES LAW ELEMENTS—HISTORICAL EVOLUTION

U.S. Regulation of the International Securities and Derivatives Markets
1 Edward F. Greene, Alan L. Beller, Edward J. Rosen, Leslie N. Silverman, Daniel A. Braverman, Sebastian R. Sperber, Nicolas Grabar & Adam E. Fleisher, U.S. Regulation of the International Securities and Derivatives Markets § 1.01 (11th and 12th Editions 2014-2017)
11th and 12th Editions

p. 1-3

Much of the legislation discussed in this book was enacted in response to market excesses and abuses in the 1920s that were thought to have contributed to the market crash of 1929. This legislation reflected a broad tendency toward intervention in the economy that characterized the New Deal, and included the Securities Act of 1933 (the "Securities Act"), [1] the Securities Exchange Act of 1934 (the "Exchange Act"), [2] the Trust Indenture Act of 1939 (the "Trust Indenture Act"), [3] the Investment Advisers Act of 1940 (the "Advisers Act") [4] and the Investment Company Act of 1940 (the "Investment Company Act"). [5] In this book, we focus on the applicability of this legislation and the rules and regulations promulgated thereunder to foreign companies. [6]

These securities statutes have been amended frequently to adapt to changes in the market, but their policy underpinnings and their regulatory framework remain substantially the same. However, in the early 2000s they were thought to be deficient in light of the Enron, WorldCom and other accounting scandals and corporate governance abuses, and, in 2002, then President Bush signed into law the most sweeping legislation affecting public companies since the 1930s—the Sarbanes-Oxley Act of 2002 (the "Sarbanes-Oxley Act"). [7] The Sarbanes-Oxley Act and the rules adopted thereunder significantly amended the Exchange Act and the rules and forms thereunder and under the Securities Act. With the goal of strengthening corporate governance standards, these provisions included, among other measures, requirements for more stringent corporate governance controls than previously existed. [8] Several of the rules adopted under the

p. 1-3

---

p. 1-4

Sarbanes-Oxley Act imposed more detailed public disclosure requirements, although notably with greater applicability to domestic issuers than to foreign private issuers, [9] combined with stricter penalties for wrongdoing. In addition, the Sarbanes-Oxley Act established the Public Company Accounting Oversight Board (the "PCAOB"), a separate private entity subject to oversight by the Securities and Exchange Commission (the "SEC"), to supervise the registration and regulation of firms that audit public companies. Audit firms previously had not been subject to substantive federal regulation.

We discuss compliance with the corporate governance requirements established by the Sarbanes-Oxley Act and the rules adopted thereunder in detail in Chapter 5 and note other changes to the regulatory structure that were effected by the Sarbanes-Oxley Act throughout this book.

In 2010, in response to the global financial crisis, Congress felt it had to make even more radical changes to the regulatory structure than were incorporated in the Sarbanes-Oxley Act. Thus, it enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). [10] The Dodd-Frank Act marked the most significant legislative change in the regulatory framework for bank and non-bank financial institutions since the 1930s. [11]

p. 1-4

---

p. 1-5

Fundamental changes have also been made pursuant to the Dodd-Frank Act in the regulation of derivatives, [12] credit rating agencies and hedge and private equity fund advisers.

As a result of lingering concerns over corporate governance practices even after the changes imposed by the

Sarbanes-Oxley Act, the Dodd-Frank Act included various corporate governance provisions that are generally applicable to public companies listed in the United States, especially regarding executive compensation and compensation committees, although in most cases foreign private issuers are excluded from these requirements. [12.1]

The Dodd-Frank Act also imposed several additional disclosure requirements on U.S. public companies. These included specialized disclosure relating to (a) conflict minerals, (b) mine safety and (c) payments to governments by companies engaged in resource extraction. These disclosure-related mandates were unrelated to the broader financial regulatory purposes of most of the Dodd-Frank Act and presented special challenges for the SEC, because Congress sought to use the SEC disclosure system to promote public policy objectives that were not directly related to traditional concepts of investor protection. [14.1]

The Trump administration has moved quickly to reverse this approach, as discussed in detail in Chapter 4 with respect to conflict minerals and resource extraction payments, and Chapter 14 with respect to a rule recently promulgated by the Department of Labor regarding the fiduciary duty of financial advisors under certain circumstances. More generally, President Trump has stated publicly he intends to undertake a thorough reexamination of the Dodd-Frank Act, [14.2] and it remains to be seen whether he will achieve a significant scaling back of Dodd-Frank, in the form of modification or repeal of existing rules, enforcement priorities or otherwise, during the course of his administration.

Although the primary purpose of the securities statutes when enacted was to protect the retail investor in the domestic markets, their prohibitions and requirements also extended, by the scope of their language, to transactions involving only sophisticated institutions (with the exception of certain exemptions to the registration requirements of the Securities Act and, as discussed

p. 1-5

---

p. 1-6

below, the Investment Company Act). In other words, the statutory structure of the securities legislation when enacted generally failed to include any concept of differential regulation that might impose fewer rules in situations where the only participants are major institutions or professional investors. Because of this omission, the SEC, the statutory body created by the Exchange Act to oversee the application of the statutes, has resorted to administrative creativity to overcome the rigidity of the original statutory structure. Perhaps the best example of that creativity is Rule 144A, discussed in Chapter 7.

Institutional investors are dominant market participants, and they and the financial intermediaries with whom they principally deal have typically been at the forefront of those urging the SEC to take liberalizing steps. Although these investors have been willing to maximize investment opportunity by waiving the protections the structure is designed to afford them, the limited exemptive authority of the SEC that existed until 1996 sometimes made accommodation difficult. In 1996, Congress amended the Securities Act and the Exchange Act to grant to the SEC for the first time the authority to exempt any person, security or transaction, or any class or classes thereof, from the provisions of each act. [15] In this regard, the Securities Act, the Exchange Act and the Investment Company Act were also amended to provide that whenever the SEC is engaged in rulemaking and is required to consider or determine whether an action is necessary or appropriate in the public interest, it must also consider, in addition to the protection of investors, whether the action will promote efficiency, competition and capital formation.

Relying in part on this exemptive authority, in 1998 the SEC proposed major changes to the rules governing offerings, embodied in what came to be called the "Aircraft Carrier Release." [16] While the SEC largely withdrew the major restructuring contemplated by the Aircraft Carrier Release in light of extensive criticism, the SEC adopted significant reforms to the U.S. public offering process in July 2005 (the "Securities Offering Reforms"). [17] The Securities Offering Reforms (i) expanded permissible communications outside the prospectus in connection with registered offerings, (ii) clarified the liability framework applicable to registered offerings under the Securities Act, and (iii) streamlined the securities registration process. [18] Prior to the adoption of these significant reforms, the SEC also adopted some of the reforms proposed by the Aircraft

p. 1-6

p. 1-7

Carrier Release, such as rules relating to integrating public and private offerings. [19] The SEC has also used this exemptive authority to adopt exemptions from the registration provisions of the Securities Act applicable to securities issued in certain cross-border rights offerings and business combinations. In addition, the Investment Company Act was amended to establish exemptions for private investment companies whose securities are held by an unlimited number of "qualified purchasers" and for swap dealers and similar "market intermediaries." [20] Qualified purchasers include institutional investors and individuals owning at least $5 million in investments. [21]

In 2012, the Jumpstart Our Business Startups Act (the "JOBS Act") [22] was signed into law. The JOBS Act was intended to facilitate capital formation in a variety of ways—including by making the IPO process less burdensome for "emerging growth companies" ("EGCs"), a new class of issuer created by the JOBS Act. Although the provisions of the JOBS Act were designed to facilitate access to the U.S. capital markets for domestic companies, several provisions affect foreign companies as well. The JOBS Act allows an EGC to take advantage of significant regulatory concessions (the so-called "IPO on-ramp" provisions) in carrying out a common stock IPO and for up to five years after an IPO or until an issuer loses EGC status. [23] In late 2015, then President Obama signed into law the Fixing America's Surface Transportation Act (the "FAST Act"), which, among other legislation, included several bills designed to facilitate the offer and sale of securities by providing additional accommodations related to the SEC registration process for EGCs. [24]

The JOBS Act also directed the SEC (a) to amend Rule 144A under the Securities Act to eliminate any restriction on offers of securities sold under Rule 144A, including by means of general solicitation or general advertising, provided that only qualified institutional buyers ("QIBs" or persons the seller, or any person acting on the seller's behalf, reasonably believes to be QIBs) purchase the securities, [25] and (b) to revise its rules to remove the prohibition on general solicitation or general advertising for offerings under Rule 506 of Regulation D under the Securities Act in which all purchasers are accredited investors and the issuer

p. 1-7

p. 1-8

takes reasonable steps to confirm their accredited investor status. [26] The SEC's new rules enacting these changes went into effect on September 23, 2013. [27]

Footnotes

1 Securities Act of 1933, 15 U.S.C. §§ 77a–77aa, *as amended*.

2 Securities Exchange Act of 1934, 15 U.S.C. §§ 78a–78pp, *as amended*.

3 Trust Indenture Act of 1939, 15 U.S.C. §§ 77aaa–77bbbb, *as amended*.

4 Investment Advisers Act of 1940, 15 U.S.C. §§ 80b-1–80b-21, *as amended*.

5 Investment Company Act of 1940, 15 U.S.C. § 80a-1–80a-64, *as amended*.

6 Unless otherwise indicated, references to foreign companies or foreign issuers in this book refer to "foreign private issuers" as such term is defined in Rule 3b-4 under the Exchange Act.

7 Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002). The Gramm-Leach-Bliley Act, enacted in 1999, also resulted in significant changes in the structure of the securities regulatory framework, particularly with respect to the regulatory regime governing the provision of financial services in the United States.

8 Among other measures, these include the requirements that: (i) CEOs and CFOs certify the accuracy and completeness of their company's periodic reports (with criminal liability for false certifications) and establish and periodically evaluate disclosure controls and procedures and internal control over financial reporting designed to ensure the timely collection and processing of information required to be reported to the SEC and for preparation of financial statements in accordance with generally accepted accounting principles, (ii) all listed companies establish an independent audit committee to hire their auditors and oversee their audits, (iii) CEOs and CFOs disgorge their compensation following a restatement of financial statements resulting

from misconduct, (iv) officers and directors refrain from trading in their company's equity securities during retirement plan blackout periods, (v) no company extend or maintain loans or credit to its executive officers or directors. For further discussion of these requirements, *see* Chapter 5.

9 For example, the Sarbanes-Oxley Act required the SEC to adopt rules requiring companies to rapidly disclose material changes in their financial condition and results of operations. In response to this requirement, the SEC in 2004 significantly expanded the list of items that U.S. issuers must disclose on Form 8-K (which requires domestic issuers to report certain material corporate events on a current basis) and generally shortened the deadline for U.S. issuers to file reports on Form 8-K to four business days after the occurrence of the event requiring disclosure. *See* SEC Release No. 33-8400 (Mar. 16, 2004). Although the SEC did not amend Form 6-K (which requires foreign private issuers promptly to disclose in a submission to the SEC material developments already disclosed publicly outside the United States), foreign private issuers should consider the list of items in Form 8-K in deciding whether particular press releases or home-country filings are material (and thus covered by Form 6-K) and which Form 6-K reports should be incorporated into their Securities Act registration statements. *See* § 4.02[3][c][iii] for a discussion of the Form 6-K requirements.

10 Pub. L. No. 111-203, 124 Stat. 1376 (2010).

11 Pursuant to the Dodd-Frank Act, existing and newly established regulators acting through the Financial Stability Oversight Council have enhanced powers to oversee and control the activities of systemically important financial institutions ("SIFIs"), including setting capital and leverage requirements, restricting activities that threaten the institutions or markets and overseeing compensation and governance practices. All banks and bank holding companies with $50 billion or more of U.S. assets are SIFIs. Proprietary trading by U.S. banks and bank holding companies also has been heavily regulated under the so-called "Volcker Rule," and consumer protection has been heightened with the establishment of the Consumer Protection Bureau. Although outside the scope of this Treatise, for a detailed discussion of the current regulation of the financial services industry in the United States, including the impact of the Dodd-Frank Act, *see* Robert L. Tortoriello, Derek M. Bush, Hugh C. Conroy, Jr., GUIDE TO BANK UNDERWRITING, DEALING AND BROKERAGE ACTIVITIES (21st ed. Thomson, 2016) Part I.

12 *See* U.S. REGULATION OF THE INTERNATIONAL SECURITIES AND DERIVATIVES MARKETS, TWELFTH EDITION, DERIVATIVES MARKETS.

12.1 *See* Chapter 5.

13 [Reserved.]

14 [Reserved.]

14.1 Similarly in an effort to promote public policy, the Iran Threat Reduction and Syria Human Rights Act of 2012 added § 13(r) to the Exchange Act, under which any issuer of securities that is required to file quarterly or annual reports must make specific disclosure in its public filings if it or an affiliate has knowingly engaged in certain activities or transactions involving Iran or other countries or entities specified in § 13(r). *See* § 4.07[14] for a discussion of this requirement.

14.2 On February 3, 2017, President Trump signed a Presidential Executive Order outlining his core principles for regulating the U.S. financial industry. Executive Order No. 13,772 (Feb. 3, 2017).

15 National Securities Markets Improvement Act of 1996, Pub. L. No. 104-290, 110 Stat. 3416 (1996) (the "NSMIA").

16 SEC Release No. 33-7606 (Nov. 3, 1998).

17 *See* SEC Release No. 33-8591 (July 19, 2005).

18 For a more in-depth description of these rules as adopted, *see* Chapter 3.

19 *See* § 7.02[6] for further discussion of Rule 155 under the Securities Act, which provides a safe harbor for a registered offering following an abandoned private offering and for a private offering following an abandoned registered offering.

20 *See* § 15.06 for further discussion of the rules governing private offerings by foreign investment companies.

See also U.S. REGULATION OF THE INTERNATIONAL SECURITIES AND DERIVATIVES MARKETS, TWELFTH EDITION, DERIVATIVES MARKETS.

21 *See* § 2(a)(51)(A) of the Investment Company Act.

22 Pub. L. No. 112-106, 126 Stat. 306 (2012).

23 JOBS Act § 101(a). *See generally* Chapter 3 for further discussion of the accommodations available to EGCs.

24 Pub. L. No. 114-94, 129 Stat. 1312 (2015).

25 JOBS Act § 201(a)(2).

26 JOBS Act § 201(a)(1).

27 SEC Release No. 33-9415 (July 10, 2013). *See* Chapter 7 for further discussion of the elimination of the prohibition on general solicitation and general advertising for certain private placements. Acknowledging that allowing general solicitation in private offerings represents a major change in how Rule 506 and Rule 144A offerings can be conducted, the SEC directed its staff to monitor market practices in offerings conducted with general solicitation and proposed a series of additional rule changes that would, if adopted, impose significant new requirements on Rule 506 offerings, particularly those that are conducted with general solicitation. As of January 1, 2017, these rules had not yet been adopted. SEC Release No. 33-9416 (July 10, 2013).

U.S. Regulation of the International Securities and Derivatives Markets, § 1.02, THE SECURITIES ACT

U.S. Regulation of the International Securities and Derivatives Markets
1 Edward F. Greene, Alan L. Beller, Edward J. Rosen, Leslie N. Silverman, Daniel A. Braverman, Sebastian R. Sperber, Nicolas Grabar & Adam E. Fleisher, U.S. Regulation of the International Securities and Derivatives Markets § 1.02 (11th and 12th Editions 2014-2017)
11th and 12th Editions

Click to open document in a browser

The Securities Act was designed to regulate at the federal level offerings of securities to the public; subsequent trading of those securities in secondary market transactions was to be regulated by the Exchange Act. The primary method of federal securities regulation is through disclosure, not administrative approval of the merits of the offering.

The Securities Act requires that every offer and sale of a security involving U.S. jurisdictional means be registered with the SEC unless an exemption is available. [28] There are exemptions for certain types of securities and transactions, including secondary market transactions. A major exemption covers offers and sales not involving a "public offering"—an undefined term. [29] If the security being sold is not registered, the seller has the burden of establishing eligibility for an exemption. A failure to do so allows the buyer to rescind the transaction if it acts within the prescribed period. [30] This ability to rescind solely on the grounds of failure to register, as opposed to misleading disclosure, gives the statute an *in terrorem* effect. For this reason, registration raises critical issues not only for domestic transactions but also for overseas offerings that might flow back into the United States, and many international financings not in fact registered with the SEC are conditioned on receiving an opinion of U.S. counsel that registration is not required.

Registration of public offerings requires preparing and filing a registration statement for review and comment by the staff of the SEC. The registration statement consists essentially of a prospectus, which must remain accurate in all material respects during the offering and, in certain cases, for a period thereafter. The prospectus also must be accurate in all material respects at the time of every sale of a security underwritten by or allotted to an underwriter or dealer, whenever the sale occurs.

p. 1-9

The Securities Act provides a statutory framework for the disclosures an issuer must make to conduct a public offering in the United States. There are detailed rules concerning the type and level of disclosure about the registrant's business that must be provided. The disclosure that must be included in the prospectus does not depend on the nature of the intended audience. Similar rules cover the scope and presentation of financial statements and other financial information. [31] In recognition of the periodic disclosure to the trading markets that reporting companies are required to make pursuant to the Exchange Act, many prospectuses are now allowed to incorporate information by reference to other SEC filings; and "shelf registration" procedures permit securities to be registered in advance and distributed at any time without additional action by the SEC staff. [32]

The SEC historically has been urged to allow well-known foreign companies to use their home-market documents when financing in the United States. In 1991, the SEC and Canadian regulators agreed, in an initial implementation of this approach, on a multijurisdictional disclosure mutual recognition system that benefits substantial Canadian issuers making U.S. offerings. [33] Following its adoption of that system, the SEC shifted away from mutual recognition as such, but modified the disclosures required for foreign private issuers in two significant respects. First, the SEC revised Form 20-F, the principal disclosure form used by foreign private issuers, to replace almost all of the former Form 20-F requirements with international disclosure standards adopted by the International Organization of Securities Commissions ("IOSCO"). Second, the SEC permitted foreign private issuers to present financial statements prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the IASB. [34]

One of the vexing questions under the Securities Act is determining when a distribution is complete. Investors are entitled to rely on a complying prospectus at the time of any sale that is part of the distribution, while no such prospectus requirement exists for subsequent sales in the secondary market. This problem was especially acute for securities issued outside the United States, using a prospectus that does not meet SEC requirements. Years ago, the SEC and

p. 1-9

p. 1-10

the private bar established mechanisms to permit offshore offerings to be made free of the U.S. registration provisions. However, there was at the time no consensus about when the offshore distribution was complete so that the securities distributed could be resold in the United States in transactions exempt from prospectus requirements as secondary market sales. [35] This uncertainty was troublesome because every transaction in a security, no matter how remote from its initial sale, must have an exemption from the registration provisions of the Securities Act. [36] The SEC's adoption of Regulation S has virtually eliminated this uncertainty. [37]

Footnotes

28 *See* §§ 3.01 and 3.02.

29 *See* § 4(a)(2) of the Securities Act; § 7.02[1].

30 *See* § 12(a)(1) of the Securities Act; § 11.02[2].

31 *See* § 3.02[1][b] and Chapter 4.

32 *See* Rule 415 under the Securities Act; § 3.02[2]. For a description of changes to shelf registration procedures introduced by the Securities Offering Reforms, *see* Chapter 3.

33 *See* Chapter 13.

34 *See* SEC Release No. 33-7745 (Sept. 28, 1999) (revised 20-F); SEC Release No. 33-8879 (Dec. 21, 2007) (acceptance of IFRS); *see also* the discussions of Form 20-F in §§ 3.03[1][b] and 4.04 and of the SEC's acceptance of IFRS from foreign private issuers in § 4.05[1]. Today, there are approximately 525 foreign private issuers that apply IFRS in filings with the SEC. *See* Wesley R. Bricker, Chief Accountant, SEC, Keynote Address before the 2016 AICPA Conference on Current SEC and PCAOB Developments, Working Together to Advance High Quality Information in the Capital Markets (Dec. 5, 2016).

35 *See* § 8.01.

36 *See* § 5 of the Securities Act.

37 *See* the discussion of Regulation S under the Securities Act in § 8.02.

U.S. Regulation of the International Securities and Derivatives Markets, § 1.03, THE EXCHANGE ACT

U.S. Regulation of the International Securities and Derivatives Markets
1 Edward F. Greene, Alan L. Beller, Edward J. Rosen, Leslie N. Silverman, Daniel A. Braverman, Sebastian R. Sperber, Nicolas Grabar & Adam E. Fleisher, U.S. Regulation of the International Securities and Derivatives Markets § 1.03 (11th and 12th Editions 2014-2017)
11th and 12th Editions

Click to open document in a browser

The Exchange Act generally requires any company with (i) a security listed on a U.S. exchange [38] or (ii) 2000 or more record holders of a class of equity security, unless fewer than 500 holders are not accredited investors, and $10 million or more in assets to register that class of securities with the SEC, and thereafter, in the case of U.S. companies, to file annual and quarterly reports. [39]

Foreign companies that are not listed on a U.S. exchange but are nonetheless subject to a registration requirement under § 12(g) are obliged to file annual reports, unless they have fewer than 300 U.S. shareholders or they publish specified information in English on their website, so long as in either case their securities are not listed on a U.S. exchange or quoted on the OTC Bulletin Board. [40] In addition, every company, U.S. or foreign, making a public offering of debt or

p. 1-11

equity securities in the United States must file periodic reports for one year and for so long thereafter until the securities offered are held by fewer than 300 persons (or in the case of a foreign company, held by fewer than 300 U.S. persons or, in the case of a class of equity of a foreign company, until U.S. trading volume comprises less than 5% of the class's worldwide trading volume and certain other conditions are met). [41]

The Exchange Act provides the framework for the disclosures an issuer must make in connection with both (i) an initial registration of securities that are listed on a national (U.S.) securities exchange or of equity securities that are otherwise publicly held as described above, and (ii) periodic reports following initial registration or a public offering as described above. The disclosure required for initial Exchange Act registration and subsequent reporting is substantially the same as the disclosure that would be made if the company were making a public offering under the Securities Act—reflecting a judgment by the SEC that there should be little difference between the information needed to make an informed decision to purchase securities in a distribution and that needed to make an informed decision to purchase securities in the secondary market. [42]

The Exchange Act also regulates a wide variety of market activities and participants. It requires disclosure of ownership in excess of 5% of any class of voting equity securities registered under the Exchange Act and sets out rules applicable to tender and exchange offers where, after consummation of an offer, the bidder would be the direct or indirect beneficial owner of more than 5% of any class of registered equity securities (whether or not entitled to vote). [43] These rules are applicable whether or not they conflict with those of another jurisdiction, which may also apply, for example, because the target is a non-U.S.

p. 1-11

p. 1-12

company. [44] In addition, the Exchange Act regulates all persons acting in the United States as broker-dealers, clearing agents, information processors or securities depositaries. [45] While only the entity performing the service, not its holding company, if any, is regulated, the SEC has been empowered to require a registered broker-dealer to provide certain financial information about its unregulated affiliates and to restrict upstream distributions of capital by the broker-dealer in certain instances. [46]

In addition, the Exchange Act regulates securities exchanges and contains broad rules barring manipulative market conduct on or off the floor of an exchange. [47] These market manipulation rules are also applied in certain circumstances to activities on markets outside the United States. [48] The principal markets for foreign securities in the United States are the New York Stock Exchange, Inc. (the "NYSE") and Nasdaq. [49] These and the other national securities exchanges, as well as FINRA, are industry self-regulatory organizations, or "SROs." [50] The SROs are required to regulate their member broker-dealers in the

p. 1-12

---

p. 1-13

public interest, and their rules are subject to review and approval by the SEC. Virtually every broker-dealer must be a member of FINRA. [51]

The Exchange Act also requires each issuer that has registered a class of equity securities or otherwise has a periodic reporting obligation under the Exchange Act and its subsidiaries (domestic or foreign) to maintain accurate books and records and an adequate system of internal controls. [52] It bars certain foreign corrupt payments by any company, U.S. or foreign, whose securities are registered, and it prohibits any officer or director from lying to the firm's auditors. [53]

"Insider trading" in connection with transactions in securities and securities-based swaps is also made unlawful by the Exchange Act, although the Congress and the SEC have never defined the offense. Its contours have been established through the application by the courts—sometimes in actions brought by the SEC (in its enforcement capacity) or the Department of Justice and sometimes in suits brought by private parties—of a broad general prohibition against fraud to particular fact patterns involving trading while in possession of material nonpublic information. [54] As a result, the penalties are severe, while the conduct prohibited is sometimes uncertain. [55]

The approach followed in dealing with "insider trading" reflects an important characteristic of the regulation of U.S. financial markets. Often the rules regulating these markets are general in scope and must be fleshed out through interpretation by the SEC staff and through litigation by both the government and the private bar. For this reason, many of the rules about market conduct have their origin in decisional law construing the statutory and regulatory framework.

Footnotes

38 § 12(b) of the Exchange Act. The NASDAQ Stock Market LLC ("Nasdaq") became an independent registered national securities exchange in August 2006. Prior to that time, it had been operated by the National Association of Securities Dealers, Inc. ("NASD," now known as "FINRA") as an interdealer quotation system. *See* SEC Release No. 34-53128 (Jan. 13, 2006). As a result of this change, the securities of issuers listed on Nasdaq automatically became registered under § 12(b), instead of § 12(g), of the Exchange Act. Nasdaq rules had required registration under § 12(g) for the quotation of securities, even though § 12(g) itself would only have required registration if the total assets and number of shareholders of the issuer exceeded the thresholds specified in that section.

39 § 12(g) of the Exchange Act and Rule 12g-1 thereunder. The JOBS Act amended § 12(g) of the Exchange Act to increase the previous holder of record threshold from 500 persons to 2,000 persons. The JOBS Act also created a separate holder of record threshold for banks and bank holding companies, which is 2,000 persons with no limit on the number of investors that are not accredited investors. For all companies, the holder of record threshold was amended to exclude securities held by persons who received the securities pursuant to employee compensation plans in transactions exempt from Securities Act registration.

40 Subject to certain exceptions, the OTC Bulletin Board rules require issuers to be subject to the periodic reporting requirements of the Exchange Act. *See* FINRA Rules, Rule 6530, FINRA MANUAL. *See also* § 4.02[3], for a discussion of Rule 12g3-2(b) under the Exchange Act, which sets out the circumstances in which foreign issuers may publish specified information in English on their website in lieu of registering under the Exchange Act.

41 In 2007, the SEC adopted rules that substantially liberalize the ability of foreign private issuers to terminate their Exchange Act reporting obligations. *See* SEC Release No. 34-55540 (Mar. 27, 2007); § 4.11.

42 Prior to the Securities Offering Reforms, the Securities Act required that the information actually be

delivered to the investor in some form, while under the Exchange Act the investor had to obtain the information itself—the issuer's only obligation being to file it with the SEC. Recognizing investors' increasing ability to access information through the Internet, the reforms adopted "access equals delivery" rules, which permit the electronic filing of a prospectus to qualify as delivery of the prospectus for Securities Act purposes in certain circumstances. *See* Rules 172 and 173 under the Securities Act. *See also* § 3.02[1][e].

43 *See* §§ 13(d) and 14(d) of the Exchange Act; §§ 6.04, 4.07[9] and 9.07. In addition, there are some provisions that apply to a tender offer for any securities held by a U.S. person, whether or not they are equity securities registered under the Exchange Act. *See* § 14(e) of the Exchange Act and Regulation 14E thereunder; §§ 9.05[4] and 6.04[2].

44 *But see* § 9.05[9] for a discussion of rules exempting from the U.S. tender offer regulations and registration requirements of the Securities Act certain tender and exchange offers for securities of foreign issuers.

45 *See* §§ 15(a) and 17 of the Exchange Act. The Gramm-Leach-Bliley Act eliminated an exemption for banks acting as broker-dealers subject to a number of important, but narrow, exceptions. *See* Robert L. Tortoriello, Derek M. Bush, Hugh C. Conroy, Jr., GUIDE TO BANK UNDERWRITING, DEALING AND BROKERAGE ACTIVITIES (21st ed. Thomson, 2016), Part II.D.3.b.

46 Rules have been adopted by which distributions to the holding company are subject to certain notice requirements, as well as other restrictions. *See* § 14.08[3][b]. If the holding company is designated as a SIFI under the Dodd-Frank Act by the FSOC, it would be subject to regulation by the Federal Reserve Board.

47 *See* § 9 of the Exchange Act.

48 These circumstances have been limited in the context of U.S. private litigation by *Morrison v. National Australia Bank*, 130 S. Ct. 2869 (2010) and subsequent cases, discussed in Chapter 11, though the Dodd-Frank Act granted the SEC explicit power, in response to the limitations of *Morrison*, to take action with respect to conduct outside the United States having a significant effect on U.S. markets.

49 Technological developments have spawned a growing number of alternative trading systems ("ATSs") that furnish services traditionally provided solely by registered securities exchanges. Due to concerns that overly burdensome regulation in the United States has been driving ATSs offshore, the SEC adopted more flexible rules that do not require ATSs to register as "exchanges." *See* SEC Release No. 34-40760 (Dec. 8, 1998). Similar concerns over trading being driven offshore resulted in the relaxation of broker-dealer registration requirements for certain dealers in over-the-counter derivatives, or so-called "broker-dealer lite." *See* SEC Release No. 34-40594 (Oct. 23, 1998).

50 In order to register as a broker-dealer with the SEC, a broker-dealer must become a member of a national securities association, except in certain very limited circumstances. The only existing national securities association is FINRA—formerly known as the "NASD" until it was renamed in 2007, at which time it also absorbed the member regulation, arbitration and enforcement functions of the NYSE. *See* SEC Release No. 34-56145 (July 26, 2007). FINRA is now responsible for regulating all securities firms that do business with the public in the United States, including with respect to professional training, testing and licensing of registered persons, arbitration and mediation. FINRA is also responsible, by contract, for regulating Nasdaq, the American Stock Exchange LLC and the International Securities Exchange, LLC. *See* § 14.06[1], Note 249.

51 *See* § 15(b)(8) of the Exchange Act.

52 *See* § 13(b) of the Exchange Act. In addition, § 404 of the Sarbanes-Oxley Act went further by requiring the monitoring and affirmation of internal controls (which it called internal control over financial reporting), and the rules adopted thereunder require that such issuers' annual reports include an internal control report stating that management is responsible for establishing internal control over financial reporting, containing management's evaluation of its effectiveness, and providing the auditor's attestation as to that assessment. *See* §§ 5.03 and 5.04. Lastly, when the SEC implemented the CEO/CFO certification requirement pursuant to § 302 of the Sarbanes-Oxley Act, it also adopted a prior SEC proposal to maintain and certify annually as to the effectiveness of the issuer's disclosure controls and procedures (a broader concept than internal control over financial reporting). *See* § 5.04[3]. SEC Release No. 34-46300 (Aug. 2, 2002) (summarizing the

differences between the SEC proposals and the statutory requirements).

53 Rule 13b2-1 under the Exchange Act; *see* § 5.04[1].

54 *See* § 10(b) of the Exchange Act and Rule 10b-5 thereunder; § 11.05[2].

55 The enactment of Regulation FD, which prohibits selective disclosure by U.S. issuers, was intended to provide greater certainty in this area. *See* SEC Release No. 33-7881 (Aug. 15, 2000); § 3.02[3][c][vi].

U.S. Regulation of the International Securities and Derivatives Markets, § 1.04, THE INVESTMENT COMPANY ACT

U.S. Regulation of the International Securities and Derivatives Markets
1 Edward F. Greene, Alan L. Beller, Edward J. Rosen, Leslie N. Silverman, Daniel A. Braverman, Sebastian R. Sperber, Nicolas Grabar & Adam E. Fleisher, U.S. Regulation of the International Securities and Derivatives Markets § 1.04 (11th and 12th Editions 2014-2017)
11th and 12th Editions

Click to open document in a browser

p. 1-14

The Investment Company Act, the principal source of U.S. regulation of collective investment vehicles, was designed to address through a detailed regulatory scheme specific industry abuses that occurred in the 1930s and earlier. As a result, it is one of the most complex of the U.S. securities laws.

The Investment Company Act covers a wide range of companies. Every "investment company" is subject to regulation, unless expressly exempted or excluded. An "investment company" is defined either in terms of its purpose or in terms of the assets it holds, to minimize the possibility that an entity could inappropriately escape regulation. [56] Thus, the term "investment company" encompasses not only every entity that holds itself out as being engaged primarily in "investing, reinvesting or trading in securities," [57] but also any entity that is engaged in the business of investing, reinvesting, owning, holding or trading in securities (a concept that the SEC staff has interpreted expansively) if securities (excluding U.S. government and agency securities and securities of majority-owned subsidiaries that are not themselves investment companies) represent 40% or more of the value of its assets. [58]

Moreover, in view of the Investment Company Act's remedial purposes, the SEC has applied an expansive interpretation to the definition of "security" in the Act. While the text of that definition is virtually identical to the definitions found in the other securities laws, the staff of the SEC has consistently taken the position that a variety of instruments and items that are not "securities" under those other statutes—such as commercial bank loans, affiliate loans, certain insurance instruments, commercial and other ordinary-course credit arrangements and the like—are "securities" for the purposes of the Investment Company Act. [59]

Any investment company that is not excluded or exempted not only must register with the SEC but also must be structured to fit within the definition of one of three categories of investment companies: a unit investment trust, a face amount certificate company or a management company. Unit investment trusts are entities, organized under a trust indenture or similar instrument without a board of directors or similar body that only issue securities redeemable at net asset value at any time at the option of the holder. Unit investment trusts are therefore generally fixed and unmanaged pools of securities in which the holders have an undivided interest. Face amount certificate companies are extremely rare now. Management companies comprise the rest and are divided into open-end

p. 1-14

p. 1-15

and close-end companies. Open-end companies, the investment vehicles commonly referred to as "mutual funds" in the U.S. market, are defined as those having securities redeemable at any time at the option of the holder for the net asset value of the underlying securities; closed-end companies include all others. The requirements applicable to a registered investment company depend in part on its classification. If a company does not fit within one of these categories, it cannot register and therefore cannot do business unless an exemption is available under the statute or granted by the SEC. Exchange-traded funds, one of the most popular types of investment vehicles introduced in recent years, are an example of a structure operating only as a result of SEC-granted exemptions. [60]

There is no doubt that conventional mutual funds and investment companies are intended to be the primary subjects of Investment Company Act regulation. However, the combination of the asset-based definition of investment company and the broad interpretation of the definition of security has also brought within the regulatory range of the Investment Company Act other sorts of entities, sometimes referred to as "inadvertent investment companies," for which the appropriateness of Investment Company Act regulation is far less obvious. These companies include holding companies that own controlling, but less than majority, interests in other companies, as is customary in many markets outside the United States, and finance subsidiaries whose assets consist of loans to their parents and affiliates (although Rule 3a-5 under the Investment Company Act provides that finance subsidiaries meeting certain conditions are excluded from the definition of "investment company"). [61]

A registered investment company is subject to very significant regulatory requirements under the Investment Company Act. [62] While disclosure to investors and potential investors is an important part of the Investment Company Act's scheme, the primary focus is on substantive regulation, including regulation of the following: the make-up and conduct of the board of directors; transactions between an investment company and its promoters, underwriters, advisers and

p. 1-15

p. 1-16

other affiliated persons; issuance of debt or other "senior" securities and other borrowings (including certain derivative transactions) that create leverage; investment in other companies; and securities custody arrangements. The extent of these regulations makes the management of an operating company that did not intend to be an investment company, but "inadvertently" fell within the definition, impossible for all practical purposes.

The Investment Company Act and the rules thereunder contain a number of provisions excluding particular types of entities either from the definition of investment company or from the operation of the Act. [63] In addition, the Act grants authority to the SEC to exempt entities either from specific provisions or from its provisions generally, where such exemption is "necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions" of the Act. [64] While this exemptive authority provides necessary flexibility to a rigid statute, in recent practice such exemptions have been both expensive and time-consuming to obtain; other than in cases of routine relief identical to previously granted exemptions, this process now typically requires months and often longer where novel issues are presented.

While the types of companies specified in the Investment Company Act might have been accurate descriptions of the types of investment companies that were in existence when the Investment Company Act was adopted over 70 years ago, they are now proscriptive and limiting because they require investment companies to meet requirements that may be inconsistent with business objectives. Even without the Act's general restriction on offerings in the United States by foreign funds, these mandatory classifications would prevent registration and compliance by foreign funds that operate consistently with legal requirements in the jurisdictions in which they are organized or their securities are offered. For example, offshore-unmanaged pools can be established without redeemable securities, yet such entities are inconsistent with the Investment Company Act's typology.

As another important example of the Investment Company Act's restrictive typology, many entities have been established both in the United States and offshore to hold and "securitize" various types of financial instruments, *e.g.*, mortgages, receivables of various sorts and fixed income securities, such as noninvestment grade bonds. These entities issue securities the payments on which are structured to produce particular cash flows based on payments made on the underlying financial instruments. Often the issuing vehicles issue two or more classes of securities, with different levels of seniority or subordination or different predicted maturity ranges. These "asset-backed arrangements" ("ABAs"), if

p. 1-16

p. 1-17

they are not exempt from regulation under the Investment Company Act, do not neatly fit into any of the classifications thereunder or satisfy the resulting requirements. A rule exempting most ABAs from registration under the Act and an amendment to the Act permitting an unlimited number of "qualified purchasers" to invest privately in any vehicle without requiring the vehicle to register as an investment company have helped reduce, but not eliminate, uncertainty with respect to offerings by ABAs. [65]

The Investment Company Act regulates foreign investment companies by restricting their offerings of securities in the United States. A foreign investment company is prohibited under the Act from making a public offering in the United States unless it has received an order from the SEC registering it as an investment company, which generally would impose conditions that parallel the provisions of the Act. Foreign investment companies must apply for such an order through a special process with the SEC rather than following the procedures applicable to U.S. investment companies. [66] The requirements that must be met to obtain such an order are such that, with the exception of a few Canadian investment companies, U.S. public offerings by foreign investment companies are effectively prohibited. While the Investment Company Act does not explicitly address private offerings by foreign investment companies, the SEC staff has attempted to place stringent limitations on such offerings that are derived from the rules applicable to U.S. private investment companies (including restricting U.S. investors to "qualified purchasers" or limiting the number of U.S. beneficial owners to 100). [67] As a result of these restrictions, offerings by foreign investment companies that would be considered private offerings for purposes of the Securities Act may not be deemed private offerings for purposes of the Investment Company Act.

Footnotes

56 § 3(a) of the Investment Company Act.

57 § 3(a)(1)(A) of the Investment Company Act.

58 §§ 3(a)(1)(C) and 3(a)(2) of the Investment Company Act.

59 *See* §§ 15.02 and 12.01.

60 *See*, *e.g.*, *Foreign Fund Inc.*, SEC Release No. IC-21737 (Feb. 6, 1996) (notice of application), SEC Release No. IC-21803 (Mar. 5, 1996) (Order). In March 2008, however, the SEC proposed a rule that would exempt exchange-traded funds from certain provisions of the Investment Company Act and the rules thereunder. *See* SEC Release No. IC-28193 (Mar. 11, 2008); *see also* § 15.03. As of January 1, 2017, this rule had not yet been adopted.

61 In 2007, a number of private equity firms, including Fortress Investment Group LLC and Blackstone Group L.P., carried out initial public offerings in the United States but avoided the need to register under the Investment Company Act principally because the general partnership interests they held in their funds typically are not considered "securities" for purposes of the Act, and their business was considered to be the management of the funds' assets for a fee, rather than investing. *See* § 15.02.

62 In addition, any investment company, such as a large mutual fund or related group of funds designated as a SIFI by the FSOC created under the Dodd-Frank Act, would also be subject to regulation by the Federal Reserve Board.

63 *See* § 15.05.

64 § 6(c) of the Investment Company Act; *see also* § 15.05[7][a].

65 *See* § 15.05[3].

66 *See* §§ 15.03 and 15.04.

67 *See* § 15.06.

U.S. Regulation of the International Securities and Derivatives Markets, § 1.05, THE ADVISERS ACT

U.S. Regulation of the International Securities and Derivatives Markets
1 Edward F. Greene, Alan L. Beller, Edward J. Rosen, Leslie N. Silverman, Daniel A. Braverman, Sebastian R. Sperber, Nicolas Grabar & Adam E. Fleisher, U.S. Regulation of the International Securities and Derivatives Markets § 1.05 (11th and 12th Editions 2014-2017)
11th and 12th Editions

Click to open document in a browser

The Advisers Act generally requires registration of those in the business of giving advice about securities (other than as an incident to a brokerage business) unless one of the few exemptions from registration is available. [68] The Dodd-Frank Act amended the Advisers Act to eliminate the exemption used by most

p. 1-18

hedge and private equity fund advisers to not register as advisers under the Advisers Act, which applied if the adviser had fewer than 15 clients and did not hold itself out to the public as an adviser. [69] As a result, most advisers must now register, although limited exemptions under the Dodd-Frank Act allow certain advisers to private funds to remain unregistered or to file with the SEC as "exempt reporting advisers." [70] The Dodd-Frank Act did not subject these funds themselves to a registration requirement. [71] While there are no financial or other eligibility requirements for registration, there are rules applicable to, among other activities, the fees that can be charged to clients, dealing as principal with a client, advertising and marketing materials, disclosure of conflicts of interest, information that must be given in advance of establishing a client relationship, and political contributions by the adviser and certain of its personnel. [72] Certain conduct is also prohibited whether or not an adviser is required to register. [73]

Each registered adviser is subject to periodic inspection by the staff of the SEC and must maintain detailed books and records about transactions on behalf of its clients. [74] Regulatory responsibility for oversight and periodic inspection of investment advisers is divided between the SEC and the states, primarily based on the criterion of assets under management. In 1996, the Advisers Act was amended to preclude advisers from registering with the SEC unless they had at least $25 million of assets under management. [75] The Dodd-Frank Act raised that threshold to $100 million of assets under management. It also created a new category called "mid-sized" advisers for advisers with assets under management of between $25 million and $100 million. A mid-sized adviser is generally required to register in the state where it maintains its principal office and place of business instead of with the SEC, unless the adviser advises registered investment companies or business development companies, or is not subject to examination by a state securities authority. [76] However, the antifraud prohibitions of the Advisers Act continue to apply to all advisers.

p. 1-18

p. 1-19

The SEC staff had historically applied the Advisers Act and related rules to a registered adviser's dealings with all of its clients—even where the adviser and its clients were located outside the United States and even if the U.S. rules conflicted with the rules in the jurisdictions where they were located. As a consequence, most foreign intermediaries registered separate affiliates as advisers. [77]

Since 1992, the SEC staff has implemented the conclusions that the SEC reached in a comprehensive report that evaluated the Advisers Act, including the staff's extraterritorial application of the act to foreign advisers and their non-U.S. clients. [78] In a series of no-action letters in the 1990s, the staff took the position that a registered foreign adviser is not required to comply with the substantive provisions of the Advisers Act and related regulation with respect to its non-U.S. clients. [79] The letters have also relaxed the criteria necessary to establish the "independence" of a registered adviser subsidiary or affiliate from its parent or other affiliates, so that the parent or other affiliate adviser is not also required to register as an investment adviser. [80]

Footnotes

68 There is a limited exemption for advisers solely to private funds with less than $150 million in assets under management in the United States, and for certain foreign advisers without a place of business in the United States and that (i) during the preceding 12 months had in total fewer than 15 clients and investors in the United States in private funds advised by the foreign adviser, (ii) had assets under management attributable to clients and investors in the United States of less than $25 million, and (iii) do not manage registered investment companies or hold themselves out generally to the public in the United States as an investment adviser. *See* § 16.03.

69 *See* § 16.03.

70 Section 619 of the Dodd-Frank Act, commonly referred to as the "Volcker Rule," limits the ability of bank holding companies ("BHCs"), foreign banking organizations treated as BHCs, and their subsidiaries and affiliates to sponsor or invest in hedge funds and private equity funds.

71 *See* § 16.03[3].

72 *See* §§ 16.05, 16.06, 16.07 and 16.08.

73 *See* §§ 16.07 and 16.08.

74 *See* § 16.11.

75 *See* § 16.02[1][a].

76 *See* § 16.01[1][a]. Notably, mid-sized advisers in New York are required to register with the SEC because New York does not conduct compliance examinations.

77 *See* § 16.01.

78 SEC, Division of Investment Management, *Protecting Investors: A Half Century of Investment Company Regulation* (May 1992); *see also* SEC Release No. IC-17534 (June 15, 1990), the concept release preceding the 1992 Report.

79 *See* § 16.01.

80 *See* § 16.01.

U.S. Regulation of the International Securities and Derivatives Markets, § 1.06, THE SECURITIES AND EXCHANGE COMMISSION

U.S. Regulation of the International Securities and Derivatives Markets
1 Edward F. Greene, Alan L. Beller, Edward J. Rosen, Leslie N. Silverman, Daniel A. Braverman, Sebastian R. Sperber, Nicolas Grabar & Adam E. Fleisher, U.S. Regulation of the International Securities and Derivatives Markets § 1.06 (11th and 12th Editions 2014-2017)
11th and 12th Editions

Click to open document in a browser

The federal securities statutes covered in this volume are administered by the SEC, a statutory body created by the Exchange Act. Its ruling body is a commission consisting of five members appointed by the President of the United States after confirmation by the U.S. Senate, one of whom is designated Chair by the President. [81] The SEC employs several thousand people across various divisions, including the Division of Enforcement, which is empowered to conduct investigations of violations, to issue cease-and-desist orders and to seek relief in the federal courts. Over the more than 80 years during which it has been in existence, the SEC has created an enormous body of precedent, through interpretive rulings, regulations, no-action letters, administrative orders and cases it has instituted in federal courts. Because of the breadth and reach of the statutes administered, the strong tradition of enforcement and the consequences of violating the statutes, most practitioners closely consult the SEC's staff, who are usually quite responsive.

Footnotes

81 § 4 of the Exchange Act.

U.S. Regulation of the International Securities and Derivatives Markets, § 1.07, KEY U.S. ANTI-MONEY LAUNDERING LAWS

U.S. Regulation of the International Securities and Derivatives Markets
1 Edward F. Greene, Alan L. Beller, Edward J. Rosen, Leslie N. Silverman, Daniel A. Braverman, Sebastian R. Sperber, Nicolas Grabar & Adam E. Fleisher, U.S. Regulation of the International Securities and Derivatives Markets § 1.07 (11th and 12th Editions 2014-2017)
11th and 12th Editions

Click to open document in a browser

p. 1-20

The Bank Secrecy Act of 1970 (the "BSA") [82] imposes a variety of recordkeeping, reporting and other anti-money laundering compliance obligations on financial institutions. The list of financial institutions that are subject to BSA regulation includes, among others: banks (including U.S. branches and agencies of non-U.S. banks), trust companies, private bankers, thrifts, brokers and dealers in securities or commodities, FCMs and registered investment companies. [83]

Apart from the regulatory requirements of the BSA, money laundering is a criminal offense under U.S. federal law. [84] The federal criminal anti-money laundering statutes provide substantial penalties for persons who conduct or attempt to conduct certain financial transactions that involve the proceeds of a broad range of enumerated "specified unlawful activities." The laws are extremely broad and are implicated not only by drug trafficking activities but also by many types of "white collar" criminal offenses. [85]

Title III of the USA PATRIOT Act (the "PATRIOT Act"), [86] known as the International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001, effected a major expansion of U.S. anti-money laundering laws. Among other things, the Patriot Act amended the BSA to impose a variety of new compliance obligations on financial institutions (particularly with regard to transactions and account relationships with non-U.S. banks and other non-U.S. financial institutions), broadened the scope of financial institutions subject to compliance requirements, expanded U.S. civil and criminal forfeiture laws and increased the penalties for criminal anti-money laundering violations.

Footnotes

82 Bank Secrecy Act of 1970, Pub. L. No. 91-508, 84 Stat. 1118 (Oct. 26, 1970), 12 U.S.C. §§ 1951–59, *as amended*, and 31 U.S.C. §§ 5311–32, *as amended*.

83 In May 2003, the Financial Crimes Enforcement Network ("FinCEN")—the bureau of the Treasury Department that is principally responsible for administering the BSA—issued a proposal to extend BSA regulation to certain investment advisers. The proposal was withdrawn in October 2008, however, and FinCEN has not issued a new proposal to require investment advisers to adopt an anti-money laundering policy. *See* § 16.15. *See also* Robert L. Tortoriello, Derek M. Bush, Hugh C. Conroy, Jr., GUIDE TO BANK UNDERWRITING, DEALING AND BROKERAGE ACTIVITIES (21st ed. Thomson, 2016) Part I.

84 *See* 18 U.S.C. §§ 1956, 1957.

85 For example, Andrew Fastow, the former Chief Financial Officer of Enron, was indicted in October 2002 by a federal grand jury for, among other things, money laundering in connection with his role in various Enron-related frauds. In 2003, executives in Enron's Internet division were also indicted by a federal grand jury for money laundering. The money laundering charges were subsequently dropped against Mr. Fastow when he pleaded guilty to conspiracy to commit securities and wire fraud in January 2004.

86 Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001, Pub. L. No. 107-56, 115 Stat. 272 (Oct. 26, 2001).