

# Regulators, laws, rules

## Securities and Exchange Commission (SEC)

- Federal agency regulating securities markets and participants
- 3 prong mission:
  - Protect investors
  - Maintain fair, orderly, and efficient markets
  - Facilitate capital formation
- Enforces all federal securities legislation, including:
  - Securities Act of 1933
  - Securities Exchange Act of 1934
  - Investment Company Act of 1940
  - Insider Trading Act of 1988

## Financial Industry Regulatory Authority (FINRA)

- Self-regulatory organization
- Regulates securities firms and registered representatives
- Controls the registration process
- Requires representatives to register via Form U4
  - Form U4 disclosures
    - 10 year employment history
    - 5 year residence history
    - All criminal history
    - All financial history
    - Outside business activities
    - Regulatory punishments
  - Statutory disqualifications
    - Any felony conviction (last 10 years)
    - Securities-related misdemeanor convictions (last 10 years)
    - License suspended or revoked by another regulator
    - Proof of false statements made
  - Form U4 submitted to CRD
  - U4 disclosures made public to BrokerCheck
- Facilities code of procedure
  - May institute punishments for firms or representatives
    - Censures
    - Fines
    - Registration suspension or revocation

## Municipal securities rulemaking board (MSRB)

- Self regulatory organization governing the municipal markets
- Writes municipal regulations, does not enforce
- Enforces MSRB rules (securities firms):
  - SEC
  - FINRA
- Enforces MSRB rules (banks):
  - The Federal Reserve Board
  - Office of Comptroller of the Currency
  - Federal Deposit Insurance Corporation (FDIC)

## North American Securities Administrators Association (NASAA)

- Regulates financial industry at the state level
- Enforces provisions of the Uniform Securities Act

## Securities Act of 1933

- Primary market legislation
- Requires issuers make disclosures by prospectus
- Registration form filed, 20 day cooling off period
  - Allowed = indications of interest, tombstone, red herring
  - Prohibited = sales, recommendations, advertising
- Exempt securities
  - Regulation A+
    - Small dollar offering rule
    - Tier 1 - up to \$20 million
    - Tier 2 - up to \$75 million
      - Subject to purchaser limits (10% rule)
  - Regulation D
    - Private placement exemption
    - May offer to unlimited accredited investors
    - No more than 35 non-accredited investors
    - Accredited investors
      - \$1 million net worth (excl. residence)
      - \$200k (single) income / \$300k (joint) income
      - Financial institutions
      - Non-financial orgs w/ \$5 million+ in assets
      - Officers, directors, or partners of issuer
      - Series 7, 65, or 82 holders
  - Rule 147
    - Intrastate offering rule
    - Avoids SEC registration if offered in one state only
    - May re-sell to another state resident immediately
    - Must wait 6 months to re-sell outside of state

## Securities Exchange Act of 1934

- Secondary market legislation
- Regulates securities markets and their participants
- Created the SEC
- All forms of fraud are illegal and prohibited
- Market manipulation is prohibited
  - Spreading false rumors
  - Pump and dump schemes
  - Painting the tape / matched orders
  - Marking the open or close

## Insider Trading Act of 1988

- Trading prohibited on material, non-public information
- \$25 million max fine (firms)
- \$5 million max fine, 20 year max jail sentence (individuals)
- Treble civil penalties (3x profit made or loss avoided)

## Regulation S-P

- Firms must safeguard non-public customer information
- Must provide easy "opt out"
- Privacy notices required at account opening + annually

## FINRA RULES

- Communications
  - Correspondence
    - 25 or fewer retail investors in 30 days
    - Emails, small group letters, etc.
    - No principal pre-approval
    - No filing with FINRA, but subject to review
  - Retail communications
    - More than 25 retail investors in 30 days
    - Websites, billboards, mass mailings, etc.
    - Principal pre-approval required
    - RCs filed with FINRA 10 days before use (per-filing)
      - RCs from firms in 1st year of business
      - Investment company performance rankings
      - Securities futures communications
    - RCs filled with FINRA within 10 days of use (post-filing):
      - Investment company material without perf. ranks
      - DPP and CMO communications
      - Securities derivatives communications
  - Institutional communications
    - Only made available to institutional investors
    - No principal pre-approval or filing with FINRA
  - Public appearances
    - Unscripted seminars or interviews on media programs
    - No pre-approval or filing with FINRA
    - Subject to written supervisory procedures (firm-based)
  - Continuing education (CE)
    - Regulatory element CE
      - Conducted and facilitated by FINRA
      - Must be completed annually
    - Firm element CE
      - Conducted and facilitated by member firms
      - Must be completed annually
  - Maintaining Qualifications Program (MQP)
    - Allows former reps to retain FINRA licenses for 5 years
    - Must continue CE after leaving the industry
  - Outside business activities (OBAs)
    - Representatives must disclose earnings outside of firm
    - Written disclosure to firm required (firm may deny OBA)
  - Gifts
    - Maximum \$100 in gift value may be given
    - Business entertainment not subject to \$100 limit (not excessive)
- Performing securities transactions outside of firm
  - Considered "selling away" - may if:
    - Written disclosure firm
    - Written approval from firm if being paid
- Recordkeeping requirements
  - 3 years - employee records, trade confirms, statements
  - 4 years - complaints (FINRA)
  - 5 years - CTRs, SARs, CIP information
  - 6 years - Customer account records, complaints (MSRB)
  - Lifetime - SPAM
    - S - stock certificates
    - P - partnership agreements
    - A - articles of incorporation
    - M - meeting minutes