

The anatomy of the

Law, Regulation and Economics of Securities and Financial Markets

in the United States

Massimiliano Caruso



AUTHOR	v
PREFACE	vi

1.

INTRODUCTION

1.1 Securities regulation and capital markets regulation	1
1.2 A fragmented market structure	2
1.3 Primary and secondary transactions	2
1.3.1 <i>Public companies, escaping the public company status, periodic reporting requirements</i>	5
1.4 Disclosure and the lemons problem	9
1.5 Efficient Capital Market Hypothesis (“ECMH”)	10
1.6 Some basic administrative law concepts	12
1.7 The Securities and Exchange Commission (“SEC”)	12
1.8 The Second Circuit	13

2.

DEFINITION OF A SECURITY

1.1 Regulatory consequences	14
1.2 Definition of a “security”	14
1.2.1 Stock	17
1.2.1.1 <i>Sale of a business</i>	18
1.2.2 Notes	19
1.2.3 <i>Evidence of Indebtedness</i>	21
1.2.4 Investment contract	22
1.2.4.1 The Howey test	24
1.2.4.1.1 <i>An investment of money (first prong)</i>	24
1.2.4.1.2 <i>A common enterprise (second prong)</i>	26
1.2.4.1.3 <i>The expectation of profits (third prong)</i>	28
1.2.4.1.4 <i>The efforts of the promoter or a third party (fourth prong)</i>	31
1.2.1.4.5 <i>The absence of already existing alternative regulatory regimes. A fifth prong?</i>	35
1.2.4.2 <i>Howey in action: offerings of crypto-assets within the definition of a security</i>	35
1.2.4.3 <i>Reves in action: lending of crypto-assets within the definition of a note</i>	57
1.2.4.3.1 <i>Crypto and the concurrent regulatory buckets of the CFTC and FinCEN</i>	60
1.3 Prosecutorial discretion, the Chevron deference and the Major Questions doctrine in the definition of a “security”	61
1.4 The economic function of the adopted definition of a “security”	64
1.5 Definition of a “security” under State law	65

1.6 A comparative analysis	66
1.6.1 <i>The definition of a security in the European Union</i>	66
1.6.2 <i>The definition of a security in the United Kingdom</i>	68

**3.
PUBLIC OFFERINGS**

1.1 Introduction and key terms	69
1.2 Public offering disclosure	74
1.3 The regulatory framework	76
1.3.1 <i>The pre-filing “quiet” period</i>	77
1.3.2 <i>The waiting period</i>	85
1.3.3 <i>The post-effective period</i>	96
1.3.3.1 <i>Shelf registration</i>	101
1.3.3.2 <i>Updating registration statement and prospectus (shelf and non-shelf registration)</i>	105
1.3.3.3 <i>Withdrawal of registration</i>	107

**4.
EXEMPT OFFERINGS**

1.1 Register or find an exemption	109
1.2 Securities exempted from registration	109
1.2.1 <i>Intrastate offerings</i>	111
1.2.1.1 <i>Rule 147</i>	112
1.2.1.2 <i>Rule 147A</i>	113
1.3 Transaction exemptions	114
1.3.1 <i>§4(a)(2) offerings exemption</i>	114
1.3.2 <i>Regulation D</i>	118
1.3.2.1 <i>Rule 504</i>	119
1.3.2.1.1 <i>Aggregation</i>	120
1.3.2.2 <i>Rule 506(b)</i>	121
1.3.2.3 <i>Rule 506(c)</i>	122
1.3.2.4 <i>Accredited and sophisticated investors</i>	123
1.3.2.5 <i>General solicitation and advertising</i>	125
1.3.3 <i>Regulation A</i>	132
1.3.4 <i>Regulation E (Rule 701)</i>	135
1.3.5 <i>Regulation Crowdfunding</i>	136
1.3.6 <i>Regulation S</i>	137
1.3.6.1 <i>Rule 903 and 904</i>	141
1.3.6.1.1 <i>Resales into the United States</i>	144
1.3.7 <i>Spin-Offs and Shell Corporations</i>	145
1.4 Integration	145
1.4.1 <i>The residual general principal of integration of Rule 152(a)</i>	146

1.4.2 Rule 152(b) four safe harbors	147
-------------------------------------	-----

5.

RESALES AND SECONDARY MARKET TRANSACTIONS

1.1 Introduction and key concepts	150
1.2 §4(a)(1), §4(a)(3), §4(a)(4) of the '33 Act and underwriters	151
1.3 Resale exemptions	153
1.3.1 Rule 144	153
1.3.2 §4(a)(1½) exemption	156
1.3.3 §4(a)(7) exemption	157
1.3.4 Rule 144A	158

6.

SECURITIES LAW LIABILITIES

1.1 Introduction and key concepts	161
1.2 Materiality	162
1.2.1 General test of material information (the total mix test)	163
1.2.2 Specific test for soft-information (probability and magnitude test)	167
1.2.3 Item 303 of Regulation S-K	168
1.2.4 Defenses	169
1.3 §11 of the '33 Act liability (fraud in the registration statement)	172
1.3.1 Defenses to a §11 cause of action	174
1.3.2 Damages	178
1.3.2.1 Evidence of damages	179
1.3.3 Contribution and Indemnification	179
1.4 §12 of the '33 Act	180
1.4.1 §12(a)(1) of the '33 Act liability (for violations of §5 of the '33 Act gun jumping rules)	180
1.4.2 §12(a)(2) of the '33 Act liability (misstatements in prospectus and oral communication)	182
1.5 Distinction and similarities between §11 and §12 of the '33 Act	183
1.6 §17 of the '33 Act liability (fraudulent interstate transactions)	184
1.7 §10(b) of the '34 Act and Rule 10b-5	185
1.7.1 Reliance and related requirements in particular	190
1.7.2 Distinction between of §11 of the '33 Act and §10(b) of the '34 Act and the cumulative remedy approach	193
1.7.3 Damages	194
1.7.4 Defenses	195
1.7.5 Contribution, proportionate liability, and related issues	195
1.7.6 Transnational securities frauds	196
1.8 Special concepts of fraud for broker-dealers	198
1.9 §14(a) of the '34 Act and Rule 14a-9	199

1.10 §29(b) of the '34 Act	201
1.11 Short swing trading	202
1.12 Insider trading	202
1.12.1 The classical theory for core insiders	206
1.12.2 Tipper-tippee liability	207
1.12.3 The misappropriation theory	208
1.12.4 Rule 14e-3	210
1.13 Regulation FD	211

7.

CAPITAL MARKETS REGULATION

1.1 Introduction and key concepts	213
1.2 Well-functioning equity markets	214
1.3 High frequency trading and controversial practices	215
1.4 Market manipulation	217
1.4.1 Manipulation under §9(a) of the '34 Act	217
1.4.2 Manipulation under §10(b) of the '34 Act and Rule 10b-5	219
1.4.3 Manipulation under §17(a) of the '33 Act	221
1.5 Short selling	221
1.6 Broker-dealers	223
1.7 Regulation NMS	225
1.8 Regulation ATS	228

Appendixes

TABLE OF STATUTES	230
RESOURCES TO DELVE INTO THE REGULATION OF SECURITIES	232