THE TAXONOMY OF GLOBAL SECURITIES: IS THE U. S. DEFINITION OF A SECURITY TOO BROAD?

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This Article compares the scope of the notoriously broad U.S. federal securities laws definitions of a “security” with its counterparts in four major global financial jurisdictions to illustrate the nature and extent of the disparate global securities definitions that profoundly shape international financial rules and potential areas of harmonizing global securities definitions. The global trade in securities developed and grew exponentially in the last three decades without a securities treaty or effective global securities rules largely because there is no global consensus on what securities are or how best to regulate them. The disparate global securities definitions are sine qua non for the dearth of effective global financial rules. They contributed significantly to the catastrophic financial regulatory failures that precipitated the recent global financial crisis. They also stoked serious disputes between countries over how to handle failed global firms and regulate financial products and institutions that caused the recent financial crisis. Furthermore, they stalled and, eventually, killed global efforts to adopt a global financial treaty or a global financial regulator. International organizations also use or define securities differently depending on the nature and mandate of the organization. Finally, they compel the CFTC and SEC to embarrassingly coordinate and enter into separate bilateral and multilateral futures and securities agreements with the same foreign regulators and global organizations. This Article found the U.S. definition starkly different from, too broad, rigid and obsolete relative to its foreign counterparts, financial market developments and global trends in securities definitions, and it offered a harmonized U.S. definition.

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I. INTRODUCTION

At the height of the global financial bubble in 2007, approximately two-thirds of United States (“U.S.”) investors owned securities of non-U.S. companies; the U.S. gross trading activity in foreign securities alone was $7.5 trillion; and foreign trading activity in U.S. securities exceeded $33 trillion.¹ The statistical comparison of the global trade in “U.S. securities” and “foreign securities” suggests that securities are homogeneous globally when, in fact, the concept, meaning, regulatory treatment and use of the term “securities” varies significantly between countries and, more ascetically, between the U.S. and other major global securities markets. Quintessential securities such as stocks and bonds still dominate the global trade in securities² but, the definition and regulatory treatment of such stocks and bonds and myriad other financial activities differ considerably globally depending on how the financial sector is structured and regulated in each country.³ The financial markets and regulations of most countries are too small to influence global finance and its regulation. Thus, this Article analyzes the disparate global concepts and definitions of a “security” by comparing the scope of the U.S. federal securities laws definition of a security (“U.S. definition”)⁴ with its counterparts in a subjective sample of four major global and regional financial centers, the United Kingdom (“UK”), Australia, India and South Africa (“Selected Countries”).

This Article does not discuss global finance or the recent global financial crisis except when necessary to demonstrate how the global variations in securities definitions affect global finance and its regulation. Although not new, the global disparities in securities definitions assumed greater significance during and immediately after the 2007-2008 global financial crisis as the world grappled with the exponential growth of global finance in the last three decades and the need to regulate it.⁵ Traditional banks and non-banking financial institutions like hedge funds and private

⁵ See, e.g., CCMR REPORT, supra note 3, at 211.
equity funds operate globally, and markets for financial activities are global. For example, the total global issuance of collateralized debt obligations (“CDOs”), i.e., re-securitizations of other forms of debt, peaked in 2007 at $179 billion. Moreover, the recent global financial crisis originated in the U.S. subprime mortgage and other securitized debt markets and it spread quickly globally because U.S. financial institutions, fueled partly by foreign capital, issued, held and sold CDOs, residential-mortgage backed securities (“RMBS”), credit default swaps (“CDS”) and other securitized debt globally.

The fact that a predominantly U.S. financial crisis spread globally was an indictment of the global financial regulatory system that has remained largely unchanged despite the exponential growth of global finance and the recent global financial crisis. Typically, the global financial regulatory scheme consists of a lattice of specialized international organizations, economic treaties and regulatory networks pertaining to financial regulation, and a mesh of national financial laws that vary significantly between countries depending on how the financial industry is structured and regulated in each country. The U.S. employs a fragmented financial scheme for banking, futures, insurance and securities. Virtually all major global securities markets utilize consolidated regulations consisting of either universal regulators for all financial activities and entities or “twin-peaks” models that divide regulatory oversight between two agencies, one responsible for prudential regulation of relevant financial firms and the other supervising business conduct and consumer protection. Among other things, the variations in global financial laws and securities definitions traditionally vitiated against effective global financial rules; they caused disputes between countries during and immediately after the recent global financial crisis; and they stalled and, eventually, killed global efforts to create legally binding global financial rules through a treaty or the harmonization of global financial laws.

The variations in global securities definitions traditionally contributed significantly to the dearth of legally binding globally coordinated financial

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6 Id.
7 Id. at 26.
8 Id. at 7-23.
11 Id.
12 See CCMR REPORT, supra note 3, at 211-217.
rules. The dearth of globally coordinated financial rules contributed immensely to the global financial regulatory failures that precipitated the recent global financial crisis. In fact, the crux of the global financial regulatory failures preceding the recent global financial crisis was the ineffective regulation of CDOs, CDS and other securitized debts in the U.S. and globally rather than the inadequate or ineffective regulation of the financial institutions that created them.  

No U.S. financial regulator supervised CDOs, CDS and other complex securitized debts because they overlapped the U.S.’s fragmented financial regulations and the U.S. Congress (“Congress”) in 2000 excluded swaps from federal financial regulation. U.S. financial institutions also exploited ineffective alternative disclosure rules for asset-backed securities under U.S. Securities and Exchange Commission (“SEC”) rules such as Regulation AB and used inaccurate credit ratings issued by unsupervised credit rating agencies, especially the big three rating agencies, Fitch, Moody’s and Standard & Poor’s. Overseas, AIG created the CDS that felled its U.S. and global operations from its London, UK offices. The UK and most countries generally employ consolidated financial laws, but their financial laws also failed spectacularly, initially, to prevent the sale of toxic securitized debts and, later, the spread of the U.S. financial crisis to their financial markets.

In fact, major U.S. and European banks that historically are most heavily regulated failed, others were acquired, bailed out, or placed in conservatorship or became bank holding companies because of their participation in lightly or unregulated asset-based securities (“ABS”). The variations in global securities definitions stocked serious disputes between countries over how to manage failed global financial firms and the

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13 See id. at 35; Jonathan C. Lipson, Enron Rerun: The Credit Crisis in Three Easy Pieces, in LESSONS FROM THE FINANCIAL CRISIS 43 (Robert W. Kolb ed., 2010).
16 See CCMR REPORT, supra note 3, at 211.
17 See MOD. REPORT, supra note 14, at 41 (Lehman Brothers misled Australian investors for municipal governments accused over the risks of CDOs).
18 See CCMR REPORT, supra note 3, at 18-27.
optimum financial regulations for the financial activities and institutions that caused the recent global financial crisis. In particular, Britain and Iceland engaged in a war of words over who should take responsibility for failed Icelandic banks doing business in the UK and the parallel bankruptcy proceedings for Lehman Brothers in the U.S. and the UK were contentious and messy. The U.S. and Europe also disagreed over the regulation of credit rating agencies, securitized debt and hedge funds leading them to pursue different regulations to similar financial activities and institutions.

A conventional international definition of a security is critical to international efforts to converge or harmonize global financial and securities laws. In fact, the lack of a universal definition of a security is, arguably, the main obstacle to the harmonization of global securities laws. After the recent global financial crisis, disputes over product classifications stalled and, ultimately, terminated global efforts to harmonize global financial rules through an international treaty like the French sponsored “Bretton Woods 3” process or global financial regulators such as the Basel Committee on Banking Supervision (“BCBS”) and the International Organization of Securities Commissions (“IOSCO”). These and other international organizations provided impetus toward global financial regulatory harmonization before the financial crisis, but they too differ significantly on how they define securities. Ultimately, leaders of the G20 countries established the Financial Stability Board (“FSB”) “to coordinate at the international level the work of national financial authorities and international standard setting bodies and to develop and promote the implementation of effective regulatory, supervisory and other financial sector policies,” without identifying and classifying the financial activities subject to such international coordination.

Lately, the global news media, and various global financial policymaking and regulatory bodies and documents such as IOSCO’s “Objectives and Principles of Securities Regulation” increasingly use the term “security” even though there is not yet universal use of the term or global consensus on its meaning. An analysis of the variations in global definitions of a security is, therefore, critical to clarifying the extent, context and meaning of the term “security” globally.

The recent global financial crisis exposed the world to the regulatory

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19 Id. at 216.
20 Id. at 216-217.
21 Id. at 213.
22 Id.
issues and grave consequences of the variations in global definitions of a security during, but for the U.S. it was déjà vu. Long before the global financial crisis, other countries often complained that the U.S. lacks a single point of contact and position at global fora such as the BCBS Accords process for developing global capital standards because of its multiple financial regulators. Actually, there is ample evidence that the Basel II agreements were less favorable to U.S. financial institutions because the discord among U.S. banking regulators weakened the U.S.’s negotiating position. Moreover, the SEC and the Commodity Futures Trading Commission (“CFTC”) have entered separately into copious bilateral and multilateral information-sharing agreements (“MOUs”) with the same foreign regulators and international organizations because a “security” in most countries and for international organizations includes futures.

The international importance of the U.S. definition pales in comparison with its significance under the U.S.’s fragmented financial laws. As a threshold matter, federal securities laws apply only to arrangements or schemes that are securities, hence a federal court finding that an instrument or scheme is not a “security” forecloses the application of the federal securities laws. Establishing security also brings the affected arrangement or scheme under the exclusive regulatory authority of the SEC and its powers, among others, to exempt any instrument or scheme and to interpret any provision of the federal securities laws, including the U.S. definition.

Finally, a security under the federal securities laws determines the classes of investments and investors that will receive the protections of the federal securities laws and the relevant securities statutes. A security under the Securities Act of 1933 ("Securities Act") means all initial offers and sales of securities must be registered with or be exempted by the SEC, but its antifraud provisions will still apply. A security under the Securities Exchange Act of 1934 ("Exchange Act") brings market intermediaries under the regulatory oversight of the SEC and self-regulatory organizations such as the Financial Industry Regulatory Authority (FINRA), including

25 See MOD. REPORT, supra note 14, at 47.
26 Id. nn 72-73.
28 See Williamson B.C. Chang, Meaning, Reference, and Reification in the Definition of a Security, 19 U.C. DAVIS L. REV. 403, 421 n.92 (1986) ("[t]he very nature of the concept of a security is that it triggers the application of the securities acts").
29 See United Housing Foundation, Inc. v. Forman 421 U.S. 837, 848 (1975) (the task of identifying securities falls on the SEC and, ultimately, the federal courts).
registering with both regulators. A security under the Investment Company Act of 1940 (“Investment Company Act”) denotes that, unless exempted, a pool of securities issuing interests in the pool would be an investment company subject to its comprehensive federal regulations and investor protections.

The U.S. definition is notorious for its over-inclusiveness. Its statutory language includes traditional capital-raising instruments such as stocks and bonds, terms not customary to the financial markets and the law such as “investment contracts” and extremely broad terms such as “any interest or instrument commonly known as a ‘security.’” Except for security-based futures, federal securities laws do not define these disparate terms or articulate the relevant economic or legal criteria for distinguishing “securities” from “non-securities.” The task of identifying and defining securities falls on the SEC and, ultimately, the federal courts. Whether a financial instrument is a security under the federal securities laws, therefore, is a matter determined by the federal courts.

The federal courts, especially the U.S. Supreme Court (“Supreme Court”), have interpreted the U.S. definition more broadly than the statutory language provides to include a wide range of disparate instruments such as a franchise, an orange grove, a condominium, real estate lots, gold and silver bullion, diamonds, beavers, chinchillas, minks and myriad other instruments and schemes mainly as “investment contracts.” Federal courts have also found securities in futures and insurance contracts, if they, in fact, involve securities even though federal securities laws do not apply to futures and securities.

31 Id.
34 See infra Part II.B; Marine Bank v. Weaver, 455 U.S. 551, 556 (1975); Forman 421 U.S. at 847-848.
36 See Forman, 421 U.S. at 848.
38 See Chicago Mercantile Exchange v. SEC, 883 F.2d 537, 544 (7th Cir. 1989) (index participations are both futures and securities); Roth v. Am. Family Mut. Ins. Co., 567 F.3d 884, 886 (7th Cir. 2009) (variable universal life insurance policies both securities and insurance contracts).
The scope of the U.S. definition has been debated *ad nauseam*, but its scope relative to its counterparts in other countries is largely unknown, partly, because of the variations in global definitions of a security, the limited, but growing use of the term “security” globally and the dearth of comparative literature on the subject. This Article identifies and highlights the differences in global securities definitions and possible areas of global securities definitional convergence. It conducts a parallel analysis of the scope of the U.S. definition and its counterparts in the Selected Countries to determine whether the former is too broad relative to the latter. This Article finds that the U.S. definition is, indeed, too broad relative to its Selected Countries counterparts in terms of the sheer number and diversity of instruments it reaches and its coverage of futures and insurance products that are expressly excluded or exempted from the federal securities laws. Yet, it also established that the U.S. definition is obsolete relative to financial market developments and global trends in securities definitions and it suggested and provided a harmonized U.S. definition.

After this introduction, Part II discusses the U.S. definition from statutory and judicial perspectives starting with the changes made to it by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (“DFA”). Part III replicates the exercise in Part II in respect of each of the Selected Countries’ definitions of a security. Part IV highlights and discusses the key differences between the U.S. definition and its Selected Countries counterparts. Part V compares the scope of the U.S. definition with the Selected Countries’ definitions to determine whether the former is broader in scope than the latter. Finally, Part VI draws on trends in global and the Selected Countries’ securities definitions to propose a modernized or harmonized U.S. definition before Part VII concludes this Article.

II: THE U.S. DEFINITION OF SECURITY

A. DFA Reforms of U.S. definition

Congress recognized the convergence of U.S. and global banking, futures, insurance and securities markets and the catastrophic regulatory failures behind the recent financial crisis that involved overlapping financial activities they offered that created and exploited coverage and regulatory

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gaps among the U.S.’s multiple financial agencies. Nonetheless, Congress ignored proposals by the U.S. financial industry, its regulators and even the U.S. Department of the Treasury (“Treasury Department”) and enacted the DFA that left the number of U.S. financial regulatory agencies, their objectives, responsibilities and the laws they administer largely untouched. Congress added security-based swaps only to the U.S. definition. That was remarkable given that lightly or unregulated ABS, swaps and private pools of capital at the center of the recent financial crisis are predominantly unclassified “securities” or security-related financial activities. Moreover, the U.S. financial sector is an engine for constant financial innovation that, undoubtedly, will create more new and exotic financial activities, but Congress did not amend the U.S. definition to make it flexible and forward-looking enough to respond to future market changes.

i. U.S. Definition and U.S. Functional System

Perhaps, the most fundamental flaw of the DFA in the area of securities regulatory reforms was its failure to consolidate the regulation of futures and securities and their respective regulatory agencies, the CFTC and the SEC into one federal regulatory agency. Traditionally, the U.S. employs a “functional” financial regulatory system that “maintains separate regulatory agencies across segregated functional lines of financial services such as banking, insurance, securities and futures.” That has translated into a fragmented financial regulatory system consisting of a complex network of federal and state financial laws developed since the Civil War overseen by multiple federal and state agencies with exclusive jurisdictions over specific sectors of the financial industry. The functional model served the U.S. well and there are still many of its features worth retaining, but the consolidation and globalization of financial firms and services and the convergence of financial products resulting in complex instruments that defy the jurisdiction of regulatory agencies created coverage and regulatory gaps that contributed to the recent financial crisis.

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41 See, e.g., Arthur E. Wilmarth, Jr., The Dodd-Frank Act: A Flawed and Inadequate Response to the Too-Big-to-Fail Problem, 89 OR. L. REV. 951, 663-667 (2011) (detailing how large, complex financial institutions caused the financial crisis).
43 DFA §§ 761(a)(2), 768 (a)(1).
44 See BLUEPRINT, supra note 42, at 11-13.
45 Id. at 4, 27.
46 See, e.g., MOD. REPORT, supra note 14, at 5-15.
47 See id. at 48.
of the recent financial crisis, for example, are debt insurance policies ordinarily regulated by the states as bond insurance contracts, but labeling them as CDS gave them features of futures, insurance and securities that allowed them to avoid both state and federal regulations.48

The perpetual product and jurisdictional conflicts between the CFTC and the SEC contributed immensely to the U.S.'s failure to predict or effectively respond to the recent financial crisis. In 1974, Congress amended the Commodity Exchange Act of 1936 ("CEA") and allocated exclusive jurisdiction over derivatives to the CFTC and security-based derivatives to the SEC, but even then a plethora of financial activities with features of both futures and securities proved extremely difficult to split into securities and futures spawning numerous product and jurisdictional disputes between the two agencies.49 The two agencies litigated and entered into several mutual agreements to resolve these product and jurisdictional conflicts long before the DFA, including the famous Shad-Johnson Accord codified across the federal futures and securities laws.50

The DFA converted these flawed dispute resolution mechanisms between the CFTC and the SEC into statutory requirements. It directs them to consult and coordinate with each other before initiating rulemakings or issuing orders on matters within their respective jurisdiction and to refer lingering disputes between them to the U.S. Court of Appeals.51 The CFTC and SEC consulted each other extensively and issued numerous comprehensive joint rules and orders before to no avail.52 Furthermore, the judicial review option follows legal precedents and federal futures and securities laws that historically defer to the federal courts to adjudicate all questions concerning the legal definitions of futures and securities.53 The CFTC and SEC, federal futures and securities laws, and the federal courts have all failed thus far to illuminate the differences between futures and securities even before the emergence of hybrid products in the last thirty years that overlap and blur the historical distinction between futures and

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50 See id. at 7-9.
51 See DFA §§ 712(a)(1)-(2), 718, 719.
securities.\textsuperscript{54} As the Shad-Johnson Accord, federal court opinions and the DFA show, Congress is yet to address definitively the fundamental issues of whether and when hybrid instruments such as options, index participations and swaps are futures, securities or both. The Shad-Johnson Accord gave the SEC jurisdiction over options on securities (including exempt securities), certificates of deposit, foreign currencies traded on a national securities exchange, and groups or indices of securities.\textsuperscript{55} It also gave the CFTC authority over futures contracts and options on futures contracts on exempt securities (other than municipal securities), certificates of deposit, and indices of securities that satisfy the statute’s criteria.\textsuperscript{56} Practically and functionally, there is no difference between options on futures and securities options and other securities derivatives and their markets because they all serve the same purpose of facilitating the management and transfer of risk.\textsuperscript{57} The DFA distinguished between swaps and security-based swaps regulated by the CFTC and the SEC respectively, but the agencies jointly found the statutory definitions and scopes of the two swaps identical.\textsuperscript{58}

Overall, the Dodd-Frank Act goes a long way in addressing the conflicting and overlapping jurisdiction over products between federal financial regulators, but it does not go far enough. Its failure to consolidate the fragmented U.S. financial system that now regulates similar securities, futures and insurance products that serve similar purposes under different rules remains its principal flaw. That creates real and potential for inconsistent regulatory treatment of similar products, gaps in consumer and investor protection, or duplication among regulators. Consequently, after DFA, the U.S. definition still excludes futures and insurance products.

\textit{ii. Swaps}

Swaps developed and operated in the U.S., until the DFA, “unseen and unregulated.”\textsuperscript{59} Title VII of the DFA aptly entitled the “Wall Street Transparency and Accountability Act of 2010,” regulates U.S. swaps and their markets for the first time ever. It places swaps into three broad categories: “swaps” regulated by the CFTC; “security-based swaps” regulated by the SEC; and “mixed swaps” regulated jointly by the CFTC

\begin{itemize}
  \item \textsuperscript{54} See, e.g., Chicago Mercantile Exchange, 883 F.2d at 544.
  \item See OTC REPORT, supra note 49, at 8.
  \item See id.
  \item See id.
  \item See SEC. HARM, supra note 53, at 7.
  \item See Swap Release, supra note 35.
\end{itemize}
and SEC depending on the nature of the underlying financial instrument.\textsuperscript{60}

The DFA divides jurisdiction over swaps between the CFTC and the SEC along the traditional futures and securities structure. It also defines “swaps” “security-based swaps” and “mixed swaps” and it mandated the CFTC, the SEC and the Board of Governors of the Federal Reserve System to jointly further define these terms.\textsuperscript{61} These financial regulators determined that no further definitions of the terms are warranted because a “swap” as defined in section 1a(47) of the CEA includes a “security-based swap” if certain statutory exceptions and characteristics are excepted, and also because the same CEA definition of a “swap” establishes the scope of agreements, contracts, and transactions that could be “security-based swaps.”\textsuperscript{62} Put differently, these regulators found no daylight between swaps and security-based swaps as artificially distinguished under the DFA. Thus, the DFA and its rules and regulations have failed to provide a bright-light standard to differentiate between the different forms of swaps, which perpetuate and raise the potential for new coverage gaps and product and jurisdictional conflicts between the CFTC and the SEC.

\textit{iii. Private Funds}

Consistent with the U.S. definition that traditionally excludes mutual funds and other pooled investments or managed funds such as hedge funds, venture capital funds (“VCFs”) and private equity funds (“private funds”), the DFA also excluded them from the U.S. definition.\textsuperscript{63} It, however, repealed section 203(b)(3) of the Investment Advisers Act of 1940 (“Advisers Act”) to require advisers to private funds that are excluded from the definition of “investment company” under the Investment Company Act by reason of section 3(c)(1) or 3(c)(7) of Investment Company Act to register under the Advisers Act.\textsuperscript{64} Section 3(c)(1) exempts a private fund

\textsuperscript{60} DFA § 721(a)(21) added CEA § 1a(47) defining a swap; DFA § 761(a)(6) added Exchange Act § 3(a)(68) defining a security-based swap; DFA § 721(a) added mixed swap to CEA § 1a(47)(D); DFA § 761(a) added mixed swap to Exchange Act § 3(a)(68)(D).

\textsuperscript{61} See DFA § 712(d)(1).

\textsuperscript{62} See Swap Release, supra note 35.


with 100 or less beneficial owners of its outstanding securities that does not publicly offer its securities. Section 3(c)(7) exempts a private fund that offers its securities to “qualified purchasers” only.65 Additionally, the DFA provides limited Advisers Act exemptions for private fund advisers of less than $150 million, VCFs and foreign private advisers.66

The DFA’s definition of a private fund as an “investment company” instead of a security creates at least two potential coverage and regulatory gaps of private funds. First is the Investment Company Act’s definition of an “investment company” as an issuer of and investor in securities because the meaning of an “issuer” varies with the context in which it is applied and that of a “security” is unsettled.67 Whether or not an entity is issuing securities under the Investment Company Act is determined under the Howey test.68 The problem is that private funds pursue diverse investment strategies, including investing in non-securities such as currencies, commodities, insurance and gold.69 For example, hedge funds, particularly offshore funds, routinely bought pools of non-variable life settlements.70 Life settlements are not securities in the U.S. and private funds that invest in such instruments will avoid regulation by showing that they are not issuing or investing in securities.71

The second is the exemption of VCFs. This is potentially problematic primarily because there is no practical or noticeable difference in the organization and operation of VCFs and other private funds. Even the same private fund often defies strict classification.72 Generally, U.S. private funds organize as limited partnerships with the private funds’ advisers serving as the general partners and the investors as limited partners.73 In many cases,

65 See VCFs Release, supra note 64.
66 DFA § 407 added Advisers Act § 203(l) exempting VCFs; DFA § 408 added Advisers Act § 203(m) exempting private fund advisers; DFA § 403 added Advisers Act § 203(b)(3) exempting foreign private advisers.
68 See TAMAR FRANKEL & CLIFFORD E. KIRSCH, INVESTMENT MANAGEMENT REGULATION, 93 (3d. ed. 2005); SEC v. W. J. Howey Co., 328 U.S. 293 (1946) (citrus groves and contracts to service are a security as investment contracts).
70 See, e.g., LIFE REP., supra note 30, at 5.
71 Id.
72 See, e.g., HF REPORT, supra note 69.
private funds are managed by the same advisers who may structure them so that they fall outside the federal securities laws as happened in 2004 when some advisers to hedge funds lengthened the lock up period beyond the two years the SEC had imposed on investors in order to avoid registration. Furthermore, in this area of law, form matters because it determines whether a private fund must be registered or exempted from registration. Advisers who intend to defraud investors or to evade the federal securities laws will restructure parts or all their private funds into VCFs.

The DFA could have closed these old and potential coverage and regulatory gaps rather simply by making units or participatory interests in an investment company a security under U.S. definition consistent with other major global financial jurisdictions. That would require a new definition of an investment company based on its structure rather than the securities private funds issue, own or trade. The model for and parameters of the new “investment company” is the “investment contracts” analysis that other countries already employ as collective investment schemes, managed funds, mutual funds or funds. The main advantage of such a reclassification of an investment company are that it removes the need to define a “security”, “issuer” and individual private funds under section 3 of the Investment Company Act because units or participatory interests in a private fund and not the private fund itself are securities. It also removes the need to determine the structure, ownership, investment strategies or the instruments pooled investments invest in or issue.

iv. Asset-Backed Securities


The Exchange Act-ABS is neither the first nor the only definition of ABS under the federal securities laws. In 1992 and, again, in 2004, the
Securities Act, Regulation AB ("Reg. AB-ABS") defined ABS for the purposes of securities registrations under the Securities Act. The Exchange Act-ABS is, however, broader than the Reg. AB-ABS because it applies to securities normally sold in transactions exempt from registration under the Securities Act and Reg. AB-ABS such as CDOs, securities issued or guaranteed by a government sponsored entity such as Fannie Mae and Freddie Mac and municipal securities. In fact, the SEC interprets the Exchange Act-ABS to include all ABS whether or not sold in Securities Act registered transactions if the original transaction has a covenant to repurchase or replace an asset.

The main issue with the DFA definition and regulation of ABS is that both the Exchange Act-ABS and the Reg. AB-ABS focus on narrow aspects of ABS regulation rather than the entire asset securitization markets. The Exchange Act-ABS applies to disclosure and other regulations for ABS transactions containing covenants to repurchase or replace an asset only pursuant section 943 of the DFA. Reg. AB-ABS determines the types of securities offers appropriate for the alternate disclosure and regulatory regime provided in Regulation AB and it excludes public offerings of securities outside its scope such as synthetic securitizations. Some argue that the regulatory failures of ABS emanated predominantly from Regulation AB that made it optional for dealers issuing mortgage-backed securities to provide granular loan-level data regarding the original mortgages. Evaluations of the availability of data on the loan types and surveys on analysts from money managers, hedge funds, insurers, GSEs, Wall Street banks, and mortgage insurers who specialized in RMBS revealed that numerous data fields considered essential by investors were simply not available to them. Those data fields would be available to the analysts under the disclosure requirements of the Securities Act. Thus, the DFA weakened its otherwise significant ABS rules by restricting them to ABS covenants to repurchase or replace an asset instead of appending them to the U.S. definition.

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81 Rule 15Ga1 Release, supra note 78.
82 Id.
83 Id., Section III.A.2 & Item 1101(c) of Reg. AB [17 CFR 1101(c)].
84 Id.
85 See CCMR REPORT, supra note 3, at 145-153.
86 Id.
B. DFA Effects on U.S. definition

As with all other significant U.S. federal financial laws enacted in response to financial crises or corporate accounting scandals such as the financial crisis of the 1920s and the corporate scandals of 2001-2002, the DFA is Congress’ regulatory response to the 2007-2008 financial crisis. Not surprisingly, federal securities laws are generally ad hoc regulations designed primarily to regain investor confidence through investor protections against fraud, preventing the recurrence of the abuses that caused the financial crises and punishing future wrongdoers.

Although the causes and effects of the recent financial crisis are substantially similar to the financial crisis of the 1920s, Congress treated the U.S. definition manifestly differently in the DFA than it did under the Securities Act, conceivably, because it established or perceived the causes of the two financial crises to be different. In 1933, Congress blamed “speculative schemes which have no more basis than so many feet of ‘blue sky’” or the “sale of stock in fly-by-night concerns, visionary oil wells, distant gold mines and other like fraudulent exploitations” for causing the financial crisis. It, therefore, included virtually every instrument or scheme it identified or perceived to have caused or had potential to cause another financial crisis in the U.S. definition regardless of its financial or legal meaning or ordinary use in the financial industry. Other instruments, notably, the inclusive term “investment contracts” came from the state blue-sky laws, ostensibly for clarity and continuity, although none of the blue-sky laws defined it and state courts had yet to settle its meaning.

In 2010, Congress blamed “frauds and mistakes” committed by corporate and private fund managers for causing the financial crisis, but it did not add ABS, swaps (other than security-based swaps) and private funds that caused it to the U.S. definition. Instead, the DFA deferred to the SEC and other federal financial regulators by adopting their existing definitions.

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90 See, e.g., McGinty, supra note 33.
91 See 1 L. LOSS, SECURITIES REGULATIONS, 455, 483-517 (1961).
and regulatory frameworks for such instruments, while tightening corporate governance rules.\textsuperscript{93}

Ultimately, after almost eight decades of experience with the U.S. definition, Congress found its foundation still sound and left it largely untouched. In fact, the DFA reinforces the U.S. definition by ascribing to it the same meaning as in section 3 of the Exchange Act.\textsuperscript{94} The Exchange Act definition of a security tracks the same language in all other federal securities laws and federal courts have held them to be virtually identical.\textsuperscript{95}

C. U.S. Definition of Security

As a threshold condition, the federal securities laws apply only to financial transactions that constitute securities.\textsuperscript{96} Four federal securities laws, the Securities Act, the Exchange Act, the Investment Company Act and the Advisers Act, define a “security” in substantially similar language.\textsuperscript{97} A court finding of a security under one of the statutes, therefore, resolves the same issue under other federal securities laws.\textsuperscript{98}

The Securities Act provides the first and principal definition of security under the federal securities laws. Its section 2(a)(1), as amended, states that “unless the context otherwise requires” (“context clause”):

\begin{quote}
The term “security” means any note, stock, treasury stock, security future, security-based swap, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a “security”, or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.
\end{quote}

Essentially, this and other federal securities laws’ definitions of a security consist of several discrete elements. First, it incorporates traditional

\begin{footnotes}
\footnote{93}{See text accompanying notes 60, 64-66, 78-83.}
\footnote{94}{DFA § 2(15)(A).}
\footnote{95}{See, e.g., Tcherepnin v. Knight 389 U.S. 332, 338-339 (1969) (absent special circumstances, Securities Act and Securities Exchange Act definitions of security are identical).}
\footnote{96}{See, e.g., McGinty, supra note 33, at 1035.}
\footnote{98}{Weaver, 455 U. S. at 555, n.3; Forman, 421 U.S. at 847, n.12.}
\end{footnotes}
is the U. S. Definition of a Security Too Broad?  [15-Dec-15]

20  Security securities such as stocks and bonds. Second, it includes relatively new and complex instruments like security-based swaps. Third, it covers instruments popular with dubious promoters who circumvented state blue-sky laws prior to the federal securities laws such as interests in oil, gas or mineral rights. Fourth, it engrosses disparate terms without established meaning or common usage in the financial industry or the law such as “investment contract.” Fifth, it provides extremely broad terms such as “any interest or instrument commonly known as a ‘security.’” Sixth, it is contradictory insofar as the context clause that precedes it effectively qualifies it and exempts some instruments, but the inclusive term “any note, stock …” that immediately follows the context clause, plainly means all the enumerated instruments are automatically securities. Seven, except for security-based futures, the U.S. definition and the federal securities laws do not define its important terms. Finally, neither the U.S. definition nor the federal securities laws provide a statutory mechanism for the SEC to append new instruments to the U.S. definition. The cumulative effect of all these factors is that federal courts enjoy almost unfettered discretion to determine what is and is not a security under the federal securities laws.

i. Proof of Security

Since the U.S. definition does not dispose of the question of what is a security under the federal securities laws, whether an instrument is a security is a matter of fact to be determined by the federal courts. The federal courts, particularly the Supreme Court, have profoundly shaped the scope of the U.S. Definition. The Supreme Court’s definitional case law has also evolved over the last eight decades. Overall, the Supreme Court has created three tests to establish a security under the federal securities laws. Since Joiner in 1943, “novel, uncommon, or irregular devices, whatever they appear to be, are also reached if it be proved as a matter of fact that they were widely offered or dealt under terms or courses of dealing which established their character in commerce as ‘investment contracts.’” The second test applies to stocks. In Landreth, the Supreme Court created a rebuttable presumption that stock is a security. Finally, in Reves, the

99 See SEC v. C.M. Joiner Leasing Corp., 320 U.S. 344, 351 (1943) (found oil and gas lease assignments tied to promises to drill oil wells securities as investment contracts).
100 See, e.g., Carney, supra note 39, at 319.
101 15 U.S.C § 77a-(16)-(17).
102 See, e.g., McGinty, supra note 33, at 1039.
103 Id.
104 Joiner, 320 U.S. at 351.
105 Landreth Timber Co. v. Landreth, 471 U.S. 681 (1985) (100% ownership interest in company sold through common stock).
Supreme Court adopted the “family resemblance test” to evaluate promissory notes. The discussion of each of these tests follows.

ii. Investment Contract Analysis

The term “investment contract” is not defined anywhere in the federal securities laws. It, nonetheless, preoccupied the Supreme Court in the first forty years of the Securities Act, partly because of the rise in “veiled and devious” schemes involving the unbundling of elements of investments and repackaging them as a combination of real or personal property and some other economic arrangement such as oil drilling or service contracts on real property. The first of such cases, Joiner, held that the term “investment contract” was broad enough to cover such “veiled and devious” and “novel, uncommon or irregular” devices, but the Howey court defined the term and created the famous “Howey test.” The “Howey test” is rather symbol. It defines an “investment contract” as “a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party.” It, therefore, consists of four factors that must be proved on a case-by-case basis before an instrument is found a security as an investment contract.

The first factor of the Howey test is the “investment of money” requirement. It requires the investor to commit assets in a manner that exposes her to financial loss or to give up specific consideration in return for a separable financial interest with characteristics of a security, and the investor to make the investment. The second factor is the “expectation of profits.” It requires profits to derive from capital appreciation of the initial investment or from participation in earnings resulting from the use of the investors’ funds. The third factor is that “profits arise solely from the efforts of others.” This entails that profits must derive from the entrepreneurial or managerial efforts of others although the profits no longer need to come solely from the efforts of others.

107 Joiner, 320 U.S. at 345-347.
108 Id. at 352.
109 Howey, 328 U.S. at 298-299.
110 Id.
111 S.E.C. v. Rubera, 350 F.3d 1084 (9th Cir. 2003); S.E.C. v. SG Ltd., 265 F.3d 42 (1st Cir. 2001); Salazar v. Sandia Corp., 656 F.2d 578 (10th Cir. 1981).
The final factor of the Howey test is the common enterprise rung. Common enterprise means investments in which the fortunes of the investor interweave with and depend on the efforts and success of those seeking the investment of third parties.\textsuperscript{114} Three tests of what constitutes a common enterprise have emerged from federal court opinions: horizontal commonality; broad vertical commonality; and narrow (strict) vertical commonality.\textsuperscript{115} Horizontal commonality involves the pooling of assets from multiple investors in a way that all the investors share in the profits and risks of the project.\textsuperscript{116} Broad vertical commonality denotes that the success or failure of the pooled investments depends primarily on the expertise or efforts of the investment promoter.\textsuperscript{117} Under the narrow vertical commonality approach, there must be some interdependence or mutuality of interest in the success of the investor and the investment promoter.\textsuperscript{118} What constitutes a common enterprise depends entirely on the federal circuit. In some jurisdictions, a showing of either vertical commonality or horizontal commonality may satisfy the common enterprise element.\textsuperscript{119} Other jurisdictions require a showing of either horizontal commonality or vertical commonality only.\textsuperscript{120}

\textit{iii. Stocks}

“Stock” is quintessentially a security to forestall further analysis hence it is included in all federal securities laws definitions of security.\textsuperscript{121}

\begin{itemize}
  \item \textsuperscript{114} S.E.C. v. Koscot Interplanetary, Inc., 497 F.2d 473 (5th Cir. 1974).
  \item \textsuperscript{115} See Westchester Corp. v. Peat, Marwick, Mitchell & Co., 626 F.2d 1212 (5th Cir. 1980); S.E.C. v. Kirkland, 521 F. Supp. 2d 1281 (M.D. Fla. 2007) (applied the horizontal test); S.E.C. v. R.G. Reynolds Enterprises, Inc., 952 F.2d 1125 (9th Cir. 1991) (accepted vertical commonality test); Brodt v. Bache & Co. Inc., 595 F.2d 459 (9th Cir. 1979) (narrow vertical commonality test accepted).
  \item \textsuperscript{116} See \textit{SG Ltd.}, 265 F.3d 42; \textit{Infinity}, 212 F.3d 180.
  \item \textsuperscript{117} \textit{Reynolds Enterprises}, 952 F.2d 1125 (scheme sharing profits 30\% to investors and 70\% promoter, vertical commonality met).
  \item \textsuperscript{118} See Hocking v. Dubois, 885 F.2d 1449 (9th Cir. 1989).
  \item \textsuperscript{120} SEC v. Banner Fund Intern., 211 F.3d 602 (D.C. Cir. 2000) (horizontal commonality only); Long v. Shultz Cattle Co., Inc., 881 F.2d 129 (5th Cir. 1989); SEC v. Unique Financial Concepts, Inc., 196 F.3d 1195 (11th Cir. 1999) (vertical commonality only).
  \item \textsuperscript{121} L. \textit{LOSS}, \textit{FUNDAMENTALS OF SECURITIES REGULATION} 212-212 (1983) (stock is so quintessentially a security as to foreclose further analysis); \textit{Landreth}, 471 U.S. at, at 693-694; \textit{Forman}, 421 U.S. at 850.
\end{itemize}
Nonetheless, that has not foreclosed judicial interpretation of the term. The leading case of *Landreth* noted that traditional stocks “represents to many people, both trained and untrained in business matters, the paradigm of security” and created a presumption that common stock is a security.\(^{122}\) Instruments labeled as “stock” must possess the usual characteristics of stock, i.e., the right to receive dividends contingent upon an apportionment of profits, negotiability, the ability to be pledged or hypothecated, the granting of voting rights to the number of shares owned and the capacity to appreciate in value, in order to qualify as stock under the federal securities laws.\(^{123}\) If an instrument labeled “stock” is without the traditional features of stock, courts must look to the economic substance of the transaction to determine whether the stock is a “security” within the meaning of the federal securities laws.\(^{124}\)

**iv. Notes and Evidence of Indebtedness**

A “note” and “evidence of indebtedness” are two substantially similar debt instruments included in the U.S. definition.\(^{125}\) The Supreme Court in *Reves* adopted the “family resemblance test” to determine whether an instrument labeled “note” or “promissory note” constitutes a security.\(^{126}\) The “family resemblance test” provides that “a note is presumed to be a “security,” and that presumption may be rebutted only by a showing that the note bears a strong resemblance (in terms of the four factors we have identified) to one of the seven enumerated categories of instrument.”\(^{127}\) The seven enumerated notes are: notes delivered in consumer financing; notes secured by a mortgage on a home; short-term notes secured by a lien on a small business or some of its assets; a notice evidencing a “character” loan to a bank customer; short term notes secured by an assignment of accounts receivable; notes that formalizes an open-account debt incurred in the ordinary course of business; and notes evidencing loans issued by commercial bank for current operation.\(^{128}\) The *Reves* court also adopted a four-pronged formula for adding

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\(^{122}\) *Landreth*, 471 U.S. at 688-693.

\(^{123}\) *Id.*; *Tcherepnin*, 389 U.S. at 339; *Forman*, 421 U.S. at 851.

\(^{124}\) *Id.*

\(^{125}\) Llanos v. U.S., 206 F.2d 852 (9th Cir. 1953), *cert. denied* 346 U.S. 923 (1953) (promissory notes were “evidence of indebtedness”).

\(^{126}\) *Reves*, 494 U.S. at 60-67.

\(^{127}\) *Id.* at 67.

instruments to the seven excluded notes.\textsuperscript{129} First is the motivation of the parties in entering the agreement.\textsuperscript{130} Notes sold for business purposes are securities and notes issued to finance minor assets or consumer goods are not securities.\textsuperscript{131} Second is the “plan of distribution” to determine if the instrument is for “common trading for speculation or investment.”\textsuperscript{132} Selling notes to a broad segment of the public suffices. Third is the reasonable expectation of the parties.\textsuperscript{133} Fourth is whether there is another regulatory regime that renders the application of the Securities Act moot.\textsuperscript{134} All the four factors must be satisfied in order for a note to constitute a security.\textsuperscript{135} In general, federal courts find securities in notes that are widely distributed to the public.\textsuperscript{136}

**D. Exempt and Excluded Securities**

Sections 3 and 4 of the Securities Act provide the primary, albeit, limited exemptions from the registration and prospectus requirements of the Securities Act, but its sections 12(a)(2) and 17 antifraud provisions will still apply. Section 3 provides for exempted securities and section 4 provides for exempted transactions. Additionally, the SEC may exempt any security under sections 3(b) and 28 of the Securities Act if the exemption is necessary or appropriate in the public interest and is consistent with the protection of investors.

Regardless of whose hands they fall into and the frequency of sale, exempted securities never have to be registered under section 5 of the Securities Act. Major exempted securities in section 3(a) of the Securities Act include securities issued by government and banks; short-term commercial paper; securities issued by religious, educational, charitable, and other such organizations; interests in a railroad equipment trust; and certain certificates issued by a receiver or trustee.

Unlike exempted securities in section 3, exempted transactions in section 4 of the Securities Act are exempt from registering under section 5 for only one specific transaction. Accordingly, if a buyer of an exempted transaction wishes to resell, she must find another transaction exemption or the securities have to be registered. Securities exchanged with existing security holders or issued under a plan of exchange approved by a court of

\textsuperscript{129} Reves, 494 U.S. at 66-67.

\textsuperscript{130} Id. at 66.

\textsuperscript{131} Id.

\textsuperscript{132} Id.

\textsuperscript{133} Id. at 67.

\textsuperscript{134} Id.


law or other governmental authority or issued in private placement or issued in an intrastate transaction constitute the four main securities transactions exempted under the Securities Act.\textsuperscript{137} Transactions involving accredited investors, California issuers with over 50\% of their property, payroll and sales in the state, qualified institutional buyers and limited offerings of not more than $5 million issued within 12 months complete the list of other exempted transactions under the Securities Act.\textsuperscript{138}

The Supreme Court carved out limited exclusions to investment contracts, stocks and promissory notes designed primarily to curtail securities class action litigation that flourished in the 1960s and 1970s prompted substantively by its expansion of the U.S. definition under \textit{Howey} and procedurally by the federal courts’ willingness to find implied rights of action in securities claims.\textsuperscript{139} Federal courts have invoked the context clause to exclude numerous securities that do not require registration or regulation under the federal securities laws.\textsuperscript{140} \textit{Forman} and \textit{Landreth} exclude stock without the usual characteristics of common stock.\textsuperscript{141} \textit{Daniel} and \textit{Weaver} provide a general exclusion for securities regulated by other federal laws or federal, state or foreign authorities.\textsuperscript{142} \textit{Reves’} “family resemblance test” excludes seven types of notes and any additional notes with strong resemblance to the seven excluded noted.\textsuperscript{143}

III: SELECTED COUNTRIES’ SECURITIES DEFINITIONS

1. THE UNITED KINGDOM

A. Securities as Investments in FSMA

The securities markets in the UK are regulated mainly by European Union (“EU”) laws in form of EU Directives and domestically by the

\textsuperscript{137} 15 U.S.C. §§ 77ca(11), 77d(2).
\textsuperscript{138} See generally LARRY D. SODERQUIST & THERESA A. GABALDON, SECURITIES REGULATIONS 177-205 (6\textsuperscript{th} ed. 2006).
\textsuperscript{139} See McGinty, \textit{supra} note 33, at 1054 n.92.
\textsuperscript{140} See generally, THOMAS L. HAZEN, LAW OF SECURITIES REGULATIONS §§ 4.20 \textit{et seq} (4th ed. 2002); HAROLD S. BLOOMENTHAL & SAMUEL WOLFF, SECURITIES AND FEDERAL CORPORATE LAW §§ 3:18 \textit{et seq} (2d ed. 2002); \textit{Weaver}, 455 U.S. 551 (excluded unique profit-sharing agreement because not tradable publicly although \textit{Howey} test satisfied).
\textsuperscript{141} \textit{Forman}, 421 U.S. at 851 (stock conveyed only right to rent unit in building);
\textit{Landreth}, 471 U.S. at 686-687.
\textsuperscript{142} \textit{Weaver}, 455 U.S. at 557-559 n.7; Teamsters v. Daniel 439 U.S. 551, 569-570 (1979) (compulsory, non-contributory employee pension plan under ERISA excluded).
\textsuperscript{143} \textit{Reves}, 494 U.S. at 66-67.
Financial Services and Markets Act, 2000 (“FSMA”). The Financial Services Authority (“FSA”), the universal regulator of the UK’s financial services industry until 2013 when it will split into two regulators—the Financial Conduct Authority and the Prudential Regulation Authority—estimates that 70% of the UK’s financial services regulatory policy is driven by EU initiatives. The effect of EU Directives on UK securities laws is to create a parallel securities regulatory scheme in which the FSA must recognize financial schemes approved in and provided by other European Economic Area (“EEA”) Member States, whilst the full array of domestic UK securities laws still applies to such schemes if promoted in the UK.

The FSMA and its subordinate legislation define “securities” in diverse contexts, but for all intents and purposes, the myriad of instruments it regulates as “investments” are synonymous with the U.S.’s “security.” Defining “investment” and hence a “security” in the UK is a two-part process that requires a thorough examination of section 22 of the FSMA and its secondary legislation. The general rule and first part of such an analysis is to determine whether an activity is a “regulated activity” under section 22(2) of the FSMA and Part II of its Schedule 2. Section 22(1) of the FSMA sets out two conditions required for an activity to be a regulated activity. First, the activity must be conducted only by way of business (the “business test”). Second, the activity must relate to an investment of a specified kind (section 22(1)(a)) or in the case of an activity of a kind which is also specified for the purposes of the FSMA, is carried on in relation to property of any kind (section 22(1)(b)).

Establishing a regulated activity under the FSMA determines what is and is not regulated by the FSA and the specific activities covered by the “General Prohibition” in section 19. The General Prohibition provides that no person may carry on a regulated activity in the UK or purport to do so unless he is an authorized or an exempt person. Thus, an entity or individual must obtain prior FSA authorization or exemption called Part IV Permission before conducting a regulated activity.

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146 Alistair Alcock, United Kingdom, in INTERNATIONAL SECURITIES REGULATION 3 (Robert C. Rosen et al. eds., 2003).

147 FSMA, 2000, c. 8, section 22(2), Sch. 2 art. 2-9 (U.K.) (hereinafter Sch. 2).

148 FSMA §§ 40-55.
managing investments; investment advice; establishing collective investment schemes (“CIS”); using computer-based systems for giving investment instructions; and activities of reclaim funds.\textsuperscript{149}

If an activity is a regulated activity under Part I of Schedule 2, the second and final step under section 22(1) is to determine whether the activity is included in the categories of “investments” specified in Part II of Schedule 2. Section 22(4) defines “investment” in a general and uninformative way to include any asset, right or interest. Part II of Schedule 2 specifies regulated activities that are “investments” as:

- Securities
- Instruments creating or acknowledging indebtedness
- Government and public securities
- Instruments giving entitlement to investments
- Certificates representing securities
- Units in collective investment schemes
- Options
- Futures
- Contracts for differences
- Contracts of insurance
- Participation in Lloyd’s syndicates
- Deposits
- Loans secured on land
- Rights in investments

Section 22(5) of the FSMA read with article 25 of Schedule 2 permits the Treasury, by order, to append or exempt any regulated activities and/or investment. Thus, an “investment” and hence a “security” in the UK includes the activities specified in Part II of Schedule 2 and any activity the Treasury may append under section 22(5) of the FSMA read with article 25 of Schedule 2.

\textbf{B. Pooled Investments as Units in CIS}

\textit{i. EU Regulation of UK CIS}

The regulation of CIS in the UK consist of three broad levels that can be abridged, in descending order, as EU regulation, UK legislation and regulation by the FSA.\textsuperscript{151} EU regulation in form of the Undertaking for Collective Investment in Transferable Securities (“UCITS”) (or EEA’s harmonized funds directive), as amended, became part of UK corporate and securities laws in 1985.\textsuperscript{152} The UCITS covers “transferable securities” which it defines as shares in companies and other securities equivalent to shares in companies, bonds and other forms of securitized debt and any other negotiable securities which carry the right to acquire any such transferable securities by subscription or exchange.\textsuperscript{153} The purpose of the UCITS Directive was to facilitate the cross-border movement of investment

\textsuperscript{149} Sch. 2 arts 2-9A.
\textsuperscript{150} Id. arts 11-24.
\textsuperscript{151} See, e.g., 1985 O.J. (L 375) 611, arts. 3-18 as amended by 1988 O.J. (L 100) 2203, arts. 1-32 & 1995 O.J. (L 168) 26, arts. 7-13; FSMA §§ 235-238.
\textsuperscript{152} 1985 O.J. (L 375) 611.
\textsuperscript{153} Id.
funds to retail investors across the EEA. EU “passporting” laws permit schemes established under the UCITS to apply to any open-ended collective investment vehicle that is established, authorized and promoted to the public in any EEA Member State.\(^{154}\) Conversely, non-UCITS funds do not enjoy passport rights because they are established and operated pursuant to national laws, hence they have different investment and borrowing powers from UCITS. For instance, the UCITS does not apply to CIS in real property, commodities, private equity funds, hedge funds and structured funds constituted in any EEA Member State primarily because these schemes borrow for investment purposes, which the UCITS strictly prohibits.\(^{155}\)

In 2004, the EU introduced a non-UCITS to regulate schemes falling outside the UCITS.\(^{156}\) Non-UCITS schemes are authorized and regulated at national level by Member States and can be promoted throughout the EEA.\(^{157}\) Thus, at EU level, the UCITS and non-UCITS mandate the UK to recognize and regulate UCITS retail schemes and non-UCITS retail schemes constituted domestically and in other EEA Member States and other countries.

\textit{ii. UK Regulation of CIS}

The FSMA classifies and regulates most forms of pooled investments as CIS. Establishing, operating or winding up a CIS is a regulated activity under article 8 of Schedule 2 and, hence subject to the General Prohibition.\(^{158}\) Units in a CIS are investments under article 16 of Schedule 2. Such units can be either shares in or securities of an Open-Ended Investment Companies and/or any right to participate in a CIS.\(^{159}\)

FSMA, section 235(1), defines a “CIS” as any arrangement with respect to property of any description, including money, the purpose or effect of which is to enable persons taking part in the arrangements (whether by becoming owners of the property or any part of it or otherwise) to participate in or receive profits or income arising from the acquisition, holding, management or disposal of the property or sums paid out of such profits or income. Section 235(2) requires the arrangements in section 235(1) to be such that the persons who are to participate (“participants”) do

\(^{154}\) See 2004 O.J. (L 145) 39, art. 1.
\(^{156}\) 2004 O.J. (L 145) 39
\(^{157}\) Id.
\(^{158}\) FSA v. Fradley & Ano. [2005] EWCA (Civ) 1183 (Eng.).
\(^{159}\) Sch. 2, arts 16(1)-(2).
not have day-to-day control over the management of the property whether or not they have the right to be consulted or to give directions. Finally, section 235(3) requires the arrangements to also possess either or both of the following characteristics: (a) the contributions of the participants and the profits or income out of which payments are to be made to them are pooled; and/or (b) the property is managed as a whole by or on behalf of the operator of the scheme.\textsuperscript{160}

The England and Wales Court of Appeals, the UK’s second highest court, determined the scope of section 235 as a case of first instance in \textit{Fradley}.\textsuperscript{161} \textit{Fradley} found section 235 drafted in an open-textured way using highly general words with wide meanings such as “arrangements” and “property of any description”, which it interpreted together with “profits” and “operator.”\textsuperscript{162} No formality is required to constitute “arrangements” and in some contexts, communications may amount to arrangements even if they are not legally binding.\textsuperscript{163} The term “property of any description” could include amounts of money paid by persons joining the scheme and there is no requirement for those monies to be invested in some investment.\textsuperscript{164} Betting winnings in \textit{Fradley}, for example, were “profits” under section 235(1) although the betting schemes were illegal under section 18 of the Gaming Act 1845.\textsuperscript{165} An “operator” means two or more operators acting as operators of a single scheme. Consequently, the singular in the statute includes the plural so that it is proper to refer to a single set of arrangements as a single scheme. Finally, a scheme is a CIS even if some (not all) the participants in it have transferred day-to-day control of the management of their monies to the operators of the scheme because the fact that some of them have relinquished day-to-day control to the operators of the scheme means section 235(2) is satisfied as regards them.\textsuperscript{166}

\textbf{C. Exempt Securities and Public Offerings}

The FSMA does not exempt or exclude any investment in Schedule 2. Instead, its section 22(5) read with article 25 of Schedule 2 empower the Treasury, by order, to exempt any regulated activity or investment. The FSMA, however, provides and permits the Treasury or the FSA to exempt individual types of investments from specific statutory or regulatory

\begin{itemize}
\item \textsuperscript{160} \textit{Fradley}, [2005] EWCA (Civ) 1183, at [31].
\item \textsuperscript{161} Id. at [32].
\item \textsuperscript{162} Id. at [31].
\item \textsuperscript{163} Id. at [31]. \textit{See also}, e.g., Re Duckwari plc [1999] Ch 253, at 260.
\item \textsuperscript{164} Id. at [33].
\item \textsuperscript{165} Id. at [46]; Russell-Cooke Trust Co v. Elliott [2002] All E.R. (D) 197.
\end{itemize}
requirements. The Treasury may exempt or exclude any CIS under section 235(5). Section 239 exempts CIS organized and operating as single property schemes (as defined in this section) from the restrictions on promotion in section 238(1).

Part VI of the FSMA that regulates public offers of securities and listing requirements in the UK defines “securities” in section 102A(3) differently from the general definition in article 11 of Schedule 2 as “transferable securities” and exempts money market instruments with a maturity of less than twelve months. Section 102A(3) also exempts limited transferable securities issues and issuers from the prospectus rules in section 85(1) and the disclosure rules of sections 80, 81 and 87A respectively. Section 85(5)(a) and Schedule 11A exempts units in an open-ended CIS and non-equity transferable securities issued or guaranteed by governments, local or regional authorities of EEA States, public international bodies of which an EEA State is a member, the European Central Bank or the central bank of an EEA State from the prospectus rules. Section 86(1) provides similar exemptions for securities offers: to qualified investors; to fewer than 100 persons, other than qualified investors, per EEA State; for the minimum individual acquisition of at least €50,000; denominated in amounts of at least €50,000; and offers not exceeding €100,000. Sections 82 and 87 exempt disclosures: contrary to public interest; or seriously detrimental to the issuer or unnecessary for intended purchasers; or so trivial not to influence the appraisal of the financial position and prospects of the issuer from disclosure; or prohibited from disclosure by a certificate issued by the Secretary of State or the Treasury.

2. THE COMMONWEALTH OF AUSTRALIA

A. ACA Definitions of Securities

The two principal federal statutes governing securities in Australia are the Corporations Act, 2001 (“ACA”) and the Australian Securities and Investments Commission Act, 2001 (“ASIC Act”). ACA is a comprehensive and voluminous statute that regulates all aspects of corporations and most of Australia’s non-banking financial markets. It contains several definitions of a “security” or “securities” spread across its ten chapters in varying forms depending on the corporate or financial activity the respective chapter is designed to regulate. Nonetheless, sections 9 and 92 of ACA provide four major definitions of “securities” consisting of the “general” definition in section 92(1) and subject-specific definitions applicable to: a “body”; acquisitions and takeovers; and sales of listed securities and the regulation of financial markets in sections 92(2), 92(3)
and 92(4) respectively.

i. General Securities

Chapter 1, Parts 1.2 and 1.2A of ACA, the Interpretation segments of the statute, define a wide array of corporate and financial terms, including “securities,” either expressly or by referring them to other, and often, subject-specific areas of the statute, for further and more detailed definitions. The term “securities” falls into the latter category and section 9, the “dictionary,” defines the term by ascribing to it the meaning of “securities” in section 92.

Section 92 provides four definitions of “securities.” The first is the section 92(1) definition describable as ACA’s “general definition” of “securities” because it applies to all corporate and financial activities except the activities covered in sections 92(2)-92(4). Section 92(1) defines “securities” to mean: (a) debentures, stocks or bonds issued or proposed to be issued by a government; or (b) shares in, or debentures of, a body; or (c) interests in a managed investment scheme (“MIS”); or (d) units of such shares. Sections 92(1)(f) and 92(1)(g) excludes derivatives other than an option to acquire by way of transfer a security covered by sections 92(1)(a), (b), (c) or (d) and an “excluded security.” Section 9 of ACA defines an “excluded security” as shares, debentures or an interest in a MIS composed by a right to participate in a retirement village scheme.

ii. Securities of Bodies

The second ACA definition of securities is section 92(2) applies exclusively to a “body.” Section 9 defines a “body” as body corporate or an unincorporated body and includes, for example, a corporation, society or association, but does not include governments. The term “body corporate” is also defined in section 9 as a body corporate that is being wound up or has been dissolved and a registrable (unincorporated entity or foreign company) body. The section 92(2) definition tracks the same language and form of the section 92(1) definition. It states that “securities” when used in relation to a body, means: (a) shares in the body; or (b) debentures of the body; or (c) interests in a MIS made available by the body; or (d) units of such shares. Sections 92(2)(e) and (f) and sections 92(1)(e) and (f) provide identical exclusions involving derivatives and an excluded security.

iii. Securities in Acquisitions and Takeovers

The third definition of securities in section 92(3) applies specifically to
Chapter 6 to 6CA of ACA that regulates the acquisition of control and
takeover of interests in listed companies, unlisted companies with more than
50 members, listed bodies that are not companies and listed MIS.\textsuperscript{167} It
defines “securities” as: (a) shares in a body; or (b) debentures of a body; or
(c) interests in a registered MIS; or (d) legal or equitable rights or interests
in: (i) shares; or (ii) debentures; or (iii) interests in a registered MIS; (e)
options to acquire (whether by way of issue or transfer) a security covered
by paragraph (a), (b), (c) or (d), but excludes: (f) a derivative (as defined in
Chapter 7) other than an option to acquire by way of transfer a security
covered by paragraph (a), (b), (c) or (d); or (g) a market traded option.

The section 92(3) definition differs from the sections 92(1) and 92(2)
definitions in five respects. First, unlike sections 92(1)(c) and 92(2)(c) that
include interests in an MIS and interests in an MIS made available by the
body respectively, section 92(3)(c) applies only to a registered MIS.
Second, section 92(3)(d) introduces legal or equitable rights or interests in
shares, debentures and interests in a registered MIS as securities. Third,
section 92(3)(e) also introduces options to acquire (whether by way of issue
or transfer) shares, debentures, interests in a registered MIS and legal or
equitable rights in such instruments as securities. Fourth, a market traded
option replaces an excluded security from the list of excluded securities in
sections 92(1)(g) and 92(2)(g). Finally, sections 92(2) and 92(3) omit
government securities that are included in the section 92(1) definition.

\textit{iv. Security as Financial Product}

Section 92(4), the fourth and final section 92 definition of securities,
provides two definitions of securities that, through a complex series of
interlocking sections, apply to fundraising rules in Chapter 6D\textsuperscript{168} and
defines a “security” as a “financial product” in Chapter 7 regulating
Australia’s financial markets. Section 92(4) does not define a security. It
provides, instead, that in Chapter 6D “securities” has the meaning given by
section 700 and in Chapter 7 “security” has the meaning given by section
761A. Section 700 does not define a security either. It provides that in
Chapter 6D, securities has the same meaning as it has in Chapter 7, but does
not include a security referred to in paragraph (e) of the definition of
security in section 761A. Section 761A defines a “security” as:

(a) a share in a body; or (b) a debenture of a body; or (c) a legal or
equitable right or interest in a security covered by paragraph (a) or (b); or

\textsuperscript{167} See ACA §§ 111AC, 602(a)(i), 603-4, 671A; Attorney-General (Austral.) v.
Alinta (2008) 242 A.L.R. 1 at [51], [55]; ASIC v. Pegasus Leveraged Options Group

\textsuperscript{168} Thompson v. ASIC (2002) 117 F.C.R. 159 at [15]-[16].
(d) an option to acquire, by way of issue, a security covered by paragraph (a), (b) or (c); or (e) a right (whether existing or future and whether contingent or not) to acquire, by way of issue, the following under a rights issue: (i) a security covered by paragraph (a), (b), (c) or (d); (ii) an interest or right covered by paragraph 764A(1)(b) or (ba); but does not include an excluded security. In Part 7.11, it also includes a managed investment product.

The section 761A definition of a “security” is, ultimately, the section 92(4) definitions of a “security” and “securities.”

When applied to the regulation of the financial markets in Chapter 7, a “security” as defined in section 92(4) (section 761A), is a “financial product” under section 764A(1)(a). Sections 9, 761A and 763A of ACA define “financial product.” In section 9, a financial product has the meaning given to it in Chapter 7. Section 761A in Chapter 7 defines “financial product” to have the meaning given in its Division 3. Sections 763A and 764A are the relevant sections in Division 3. Section 763A defines “financial product” as a facility through which or through the acquisition of which a person does one or more of the following: makes a financial investment; or manages financial risk; or makes non-cash payments. Section 764A (“Australian definition”) enumerates the “specific things that are financial products” to include a security; MIS; derivatives; non-life or sinking fund policy contracts of insurance; foreign exchange contracts; eligible international emissions unit; and anything declared by the regulations to be a financial product. Section 765A(1) provides an equally long list of excluded financial products, including an excluded security, health insurance policies and anything the Australian Securities and Investment Commission (“ASIC”) declares not a financial product in section 765A(2). A financial product is also the statutory mechanism the ASIC Act and ACA regulate new instruments since the Financial Services Reform Act, 2001 broadened the range of products that are securities and futures in Australia and covered them as financial products.

**B. Pooled Investments as Interest in MIS**

Chapter 5C of ACA regulates non-superannuation funds (non-retirement pension and other pooled investment schemes) as MIS. Interests in MIS

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173 See id. at [85].

174 See, e.g., Brookfield Multiplex Ltd v International Litigation Funding Partners
are securities under sections 92(1)(c), 92(2)(c), 92(3)(c) and 92(4) by reference to 761A(e)(ii), and as a financial product in section 764A(1)(b) and (ba) of the CA. The expression “interest in an MIS” is defined in section 9 to mean a right to benefits produced by the scheme (whether the right is actual, prospective or contingent and whether it is enforceable or not). An “MIS” in section 9(a) is a scheme with the following features:

(i) people contribute money or money’s worth as consideration to acquire rights (interests) to benefits produced by the scheme (whether the rights are actual, prospective or contingent and whether they are enforceable or not); (ii) any of the contributions are to be pooled, or used in a common enterprise, to produce financial benefits, or benefits consisting of rights or interests in property, for the people (the members) who hold interests in the scheme (whether as contributors to the scheme or as people who have acquired interests from holders); (iii) the members do not have day-to-day control over the operation of the scheme (whether or not they have the right to be consulted or to give directions).

The first requirement in section 9(a)(i) is that: people contribute money or money’s worth; as consideration to acquire rights to benefits; and such benefits being produced by the scheme. To “contribute,” according to the courts, involves giving, paying, supplying money’s worth, or generally giving for a common purpose. The benefits produced by the scheme need not be just some gain or profit. Rather, a “benefit” broadly includes schemes that produce outcomes that benefit its members such as recreational or lifestyle schemes. Opportunities to prosecute a claim with virtually no exposure to any costs or outgoings in the event of failure, for instance, constituted a benefit in Brookfield Multiplex.

The second requirement in paragraph 9(a)(ii) has three facets: that any of the contributions are pooled, or used in a common enterprise; to produce financial benefits or benefits consisting of rights or interests in property; and for the scheme members. The pooling of contributions is not limited to funds or physical pooling of assets. Knowing where resources are located and that the resources are available to the members fulfills the pooling condition. A scheme is a common enterprise if shared or belongs to

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175 See, e.g., ASIC v Enterprise Solutions 2000 (2000) 35 A.C.S.R. 620 at [6] (“interest” is a right to have a scheme operate in accordance with the agreements they have made and to be paid moneys due).
176 Id., at [50].
179 Id. at [81].
180 Id. at [83].
181 Id. at [90]-[93].
“more than one as a result of joint action or agreement.”\textsuperscript{182} Finally, the “day-to-day control” requirement in paragraph 9(a)(iii) means control in fact rather than the legal right to control. Control in fact entails that members as a whole must participate in making the routine, ordinary, everyday business decisions relating to its management and the members as a whole are bound by the decisions that are made.\textsuperscript{183}

The scope of this MIS definition is clearly broad. It would cover many schemes that do not require registration or regulation under the ACA. Accordingly, sections 9(c) to (n) provide thirteen categories of exclusions to MIS and authorizes ASIC to exclude any scheme.\textsuperscript{184} They include certain partnerships; a body corporate; a superannuation fund; a franchise; a statutory fund; a barter scheme; a retirement village; a co-operative company; or a scheme declared by the regulations not to be a MIS.\textsuperscript{185}

A scheme that fulfills all three elements of the definition of an MIS is a statutory MIS that must be constituted, registered and conducted as prescribed in Chapter 5C otherwise it is predisposed to be wound up.\textsuperscript{186} Conversely, a scheme that falls short of any of the three requirements of an MIS is not a statutory scheme within the meaning of section 9 and cannot be subject to a winding up order in terms of section 601EE of the ACA.\textsuperscript{187}

\section*{C. Exempt Securities and Public Offerings}

ACA exempts three securities from its section 92 definitions of securities: a derivative;\textsuperscript{188} an excluded security;\textsuperscript{189} and a market traded option in section 92(3)(g), but a derivative is enumerated as a financial product in section 764A(1)(c). Moreover, ACA, which does not refer to public offerings as generally understood, regulates all public offerings of securities unless a clear exemption exists. Section 708 exempts small scale or personal offerings, sophisticated investors and professional investors, among many other exempted securities offerings.\textsuperscript{190} The public offerings

\textsuperscript{182} Id. at [98].
\textsuperscript{183} See, e.g., Burton, (2006) 32 W.A.R. at [81]-[83].
\textsuperscript{184} Brookfield Multiplex, (2009) 180 F.C.R. at [26].
\textsuperscript{185} Id., at [18].
\textsuperscript{186} Id., at [84]; ASIC v Fuelbanc Austr. Ltd [2007] FCA 960, at [26] [30].
\textsuperscript{187} See, e.g., National Australia Bank Ltd v. Norman 6 (2009) 74 A.C.S.R. 561, [181]–[183] (a scheme to misappropriate investors’ funds is not statutory MIS).
\textsuperscript{188} See ACA §§ 92(1)(f); 92(2)(f); 92(3)(f).
\textsuperscript{189} Id., §§ 92(1)(g); 92(2)(g); 92(3)(g); 761A.
exemptions are subject to restrictions, including the restrictions on advertising in section 734 and securities hawking provisions in Part 6D.3. Finally, section 9(c) to (n) exclude thirteen MIS, including franchises, partnerships with less than twenty members and any scheme declared by the regulations not to be a MIS. Section 765A provides a comprehensive list of specific things that are not financial products, including an excluded security, health insurance, foreign currency exchange contracts and any facility, interest or other thing ASIC specifies as not a financial product.

3. THE REPUBLIC OF INDIA

A. SCR Act Securities Definition

Between 1992 and 2004, India completely overhauled its securities regulations as part of its New Industrial Policy by repealing and replacing the capital control laws in force since independence from Britain in 1947.191 For historical and other reasons, India modeled its new securities laws along or copied them outright from the securities laws of the UK.192 India modernized the Securities Contracts (Regulation) Act, 1956 (“SCR Act”) and the Companies Act, 1956 (“Companies Act”) and introduced the Securities and Exchange Board of India Act, 1992 (“SEBI Act”) and the Depositories Act, 1996 (“DA”).193 The SCR Act regulates the Indian secondary securities markets and contracts in securities and the Companies Act regulates corporations and the primary securities markets.194 The SEBI Act created the Securities and Exchange Board of India (“SEBI”), its securities regulator, and it regulates pooled investments.195 The DA established securities depositories and regulates the transfer of securities.196

Section 2(h) of the SCR Act (“Indian definition”) is India’s sole definition of “securities.” It states that “securities” include:

(i) shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company

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191 See BLOOMENTHAL, supra note 37, § 58A-3; Dara P. Mehta, Securities Regulations in India, in INTERNATIONAL SECURITIES REGULATION 9 (Robert C. Rosen et al. eds., 2003).
194 See SCR Act; Companies Act §§ 55-81.
195 See BLOOMENTHAL, supra note 37, § 58A:5-7; 28 THE INDIAN LAW INSTITUTE, ANNUAL SURVEY OF INDIAN LAW 560 (Alice Jacob ed. 1992) (explaining the creation of the SEBI).
196 DA §§ 2, 9.
or other body corporate; (ia) derivative; (ib) units or any other instrument issued by any collective investment scheme to the investors in such schemes; (ic) security receipt as defined in clause (zg) of section 2 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002; (id) units or any other such instrument issued to the investors under any mutual fund scheme; (ie) any certificate or instrument (by whatever name called), issued to an investor by any issuer being a special purpose distinct entity which possesses any debt or receivable, including mortgage debt, assigned to such entity, and acknowledging beneficial interest of such investor in such debt or receivable, including mortgage debt, as the case may be; (ii) Government securities; (iia) such other instruments as may be declared by the Central Government to be securities; (iii) rights or interest in securities.

India added derivatives, units in CIS or mutual fund scheme, security receipts, certificates, Government securities and instruments declared by Central Government of India to this definition in the last twenty years. These amendments and the exhaustive definitions of the material terms in the SCR Act and its regulations shaped the Indian definition.

B. Pooled Investments Units in CIS

Consistent with most jurisdictions around the world, India regulates pooled investments as CIS. The Indian definition includes two forms of CIS: units or any other instrument issued by any CIS to the investors in such schemes; and units or any other such instrument issued to the investors under any mutual fund scheme. The SEBI Act defines a “unit” as any instrument issued under a scheme, by whatever name called, denoting the value of the subscription of a unit holder.

The SEBI Act defines a “CIS” as any scheme or arrangement made or offered by any company under which: (i) the contributions, or payments made by the investors, by whatever name called, are pooled and utilized solely for the purposes of the scheme or arrangement; (ii) the contributions or payments are made to such scheme or arrangement by the investors with a view to receive profits, income, produce or property, whether movable or immovable from such scheme or arrangement; (iii) the property, contribution or investment forming part of scheme or arrangement, whether identifiable or not, is managed on behalf of the investors; (iv) the investors

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199 See, e.g., id. at 55.
200 SCR Act § 2(h)(ib)-(ic); M/s. PCS Industries Ltd v. SEBI, Appeal No. 31/2001 (SAT) (Mumbai), http://www.sebi.gov.in (units in mutual funds security under SRC Act).
do not have day to day control over the management and operation of the scheme or arrangement.\(^{202}\) This definition of a CIS is so broad that it covered CIS like time-shares and club memberships that the government did not intent to regulate. Thus, the SEBI Act excludes seven such schemes, including registered co-operative societies, contracts of insurance governed by insurance statutes, and pension schemes.\(^{203}\)

The SEBI Act currently authorizes and regulates three broad categories of CIS: CIS; Mutual Funds (MFs); and VCFs.\(^{204}\) Regardless of the similarity between CIS and MFs vis-à-vis the pooling of savings and issuing of securities, the SEBI Act historically differentiated them based on their investment objectives. MFs invest exclusively in securities and CIS invest only in plantations, real estate and art funds.\(^{205}\) Commencing in January 2006, however, the SEBI has permitted gold Exchange Traded Fund schemes to invest in gold and gold related instruments. From May 2008, the SEBI has also authorized MFs to invest in real estate as part of the SEBI’s continuous review of regulations in response to market changes.\(^{206}\)

Under section 12(1B) of the SEBI Act, no person shall sponsor or cause to be sponsored or carry on or cause to be carried on any VCFs or CIS, including MFs, unless he obtains a certificate of registration from the SEBI in accordance with the Regulations. The SEBI Act prescribes civil and criminal sanctions for violations of its section 12 read with sections 11, 11AA, and the Regulations.

### C. Exempt Securities and Public Offerings

The SCR Act does not provide for exclusions or exemptions from the securities laws. Instead, exemptions are available to certain issuers and securities offerings pursuant to the Guidelines issued by the SEBI. The Guidelines apply to initial public offers by new companies and existing private or closely held companies and in further issues of capital by existing companies by way of shares, debentures and bonds with limited exemptions.\(^{207}\) The limited exemptions from securities issues include exempt private placements i.e., issues of securities to a select group of persons not exceeding 49, and which is neither a rights issue nor a public

\(^{202}\) See, e.g., SEBI Act § 11AA(2); Varindhaban Forests Ltd. v. SEBI, Appeal No. 55/2001 (SAT), [http://www.sebi.gov.in/](http://www.sebi.gov.in/).

\(^{203}\) SEBI Act § 11AA(3).

\(^{204}\) See, e.g., ISMR 2008, supra note 197, at 55.

\(^{205}\) Art Funds are essentially unauthorized CIS, see, id. at 57; SEBI (Mutual Funds) Regulations, 1996, Gen. S. R. & O. 856 (E), Reg. 2(q).

\(^{206}\) See ISMR 2008, supra note 197, at 57.

\(^{207}\) See Mehta, supra note 191, at 22.
issue. Finally, the SEBI Act provides seven broad exclusions to CIS.

4. THE REPUBLIC OF SOUTH AFRICA

A. SSA Securities Definitions

In 2005, South Africa (“SA”) consolidated its network of capital market legislation into the Securities Services Act 36 of 2004 (“SSA”). Six years later in August 2011, it, again, proposed to repeal the relatively new SSA and replace it with the Financial Markets Bill, 2011 (“FMB”). The SSA is SA’s principal securities law for its secondary securities markets while the new Companies Act 71 of 2008 (“SACA”) and the Collective Investment Schemes Control Act 45 of 2002 (“CISCA”) regulate the primary securities markets and pooled investments respectively. The SSA provides two definitions of securities and the CISCA provides the third one, but the SSA primary and SA’s definition of securities in section 1(a).

Sections 1(a)-(b) of the SSA (“SA definition”) define “securities” as:

(i) shares, stocks and depository receipts in public companies and other equivalent equities, other than shares in a share block company as defined in the Share Blocks Control Act, 1980 (Act No. 59 of 1980); (ii) notes; (iii) derivative instruments; (iv) bonds; (v) debentures; (vi) participatory interests in a collective investment scheme as defined in the Collective Investment Schemes Control Act, No. 45 of 2002, and units or any other form of participation in a foreign collective investment scheme approved by the Registrar of Collective Investment Schemes in terms of section 65 of that Act; (vii) units or any other form of participation in a collective investment scheme licensed or registered in a foreign country; (viii) instruments based on an index; (ix) the securities contemplated in subparagraphs (i) to (viii) that are listed on an external exchange; and (x) an instrument similar to one or more of the securities contemplated in subparagraphs (i) to (ix) declared by the registrar by notice in the Gazette to be a security for the purposes of this Act; (xi) rights in the securities referred to in subparagraphs (i) to (x); (b) excludes- (i) money market instruments except for the purposes of Chapter IV; and (ii) any security contemplated in paragraph (a) specified by the registrar by notice in the Gazette.

The FMB proposes two changes to this definition by preceding it with “securities means listed and unlisted…” in order to clarify that it also captures unlisted securities and by correcting the reference to money market

\[\text{Id.}\]

\[\text{See SEBI Act § 33(1).}\]

\[\text{See SSA § 117.}\]

instruments in section 1(b)(i) to money market “securities”.\textsuperscript{212} Other than that, the FMB retains the SSA exemptions of a Share Block Company (a company owning and operating a retirement village) in section 1(a)(i), money market instruments (securities) in section 1(b) and any security in section 1(a) specified by the Registrar. Section 1(b)(x) remains dormant because so far the Registrar has not excluded any security.

When applied to the custody and administration of securities in Chapter IV of the SSA, “securities” in section 29 include the enumerated instruments in section 1(a), certificated and uncertificated securities, and money market instruments. “Certificated securities” are securities evidenced by a certificate or written instrument and “uncertificated securities” are securities not evidenced by a certificate or written instrument and are transferable by entry without a written instrument under section 29. The FMB will remove certificated securities and replace money market instruments with money market securities consistent with its changes to section 1(b)(i) of the SSA.

C. Pooled Investments as Interests in CIS

CISCA regulates the CIS industry in SA. Its section 1 defines “CIS” as a scheme, in whatever form, including an open-ended investment company, in pursuance of which members of the public are invited or permitted to invest money or other assets in a portfolio, and in terms of which: (a) two or more investors contribute money or other assets to and hold a participatory interest in a portfolio of the scheme through shares, units or any other form of participatory interest; and (b) the investors share the risk and the benefit of investment in proportion to their participatory interest in a portfolio of a scheme or on any other basis determined in the deed, but not a CIS authorized by any other Act. A “participatory interest” means any interest, undivided share or share whether called a participatory interest, unit or by any other name, and whether the value of such interest, unit, undivided share or share remains constant or varies from time to time, which may be acquired by an investor in a portfolio.\textsuperscript{213}

CISCA authorizes and regulates five types of CIS based on their investment objectives: CIS in Securities; CIS in Property; CIS in Participation Bonds; Declared CIS; and Foreign CIS.\textsuperscript{214} Managers of any of these CIS may convert them into another type of CIS subject to the


\textsuperscript{213} Id.

\textsuperscript{214} CISCA §§ 39, 47, 52, 62, 65.
Conversion of CIS regulations in section 77 of CISCA. All CIS must satisfy a plethora of similar statutory requirements, including that no person may operate a CIS without registration as a manager, authorized agent, or is exempted by the Registrar. Additionally, the constitution of all CIS must contain prescribed information.215 Failure to comply with the Registrar’s directions or contravening any CISCA provision attracts the cancellation or suspension of the offending CIS’s licence, civil and/or criminal sanctions.216

D. Exempt Securities and Public Offerings

The SSA definition of securities excludes money market instruments and any instrument specified by the Registrar of Securities Services in section 1(b). CISCA allows the Registrar to exempt any CIS. Section 96 of SACA exempts several securities offerings, including: small offers not exceeding ZAR100,000; offers to existing shareholders or debenture holders of a company; rights offers; single offers of shares to company directors, officers and their close relatives; and limited one-time offers to 50 persons or less aggregating up to ZAR100,000.

IV: COMPARATIVE ANALYSIS OF SECURITIES DEFINITIONS

A. Issues in Comparing Global Definitions of Securities

Securities are unique in that they developed and operate globally without global securities treaties, legally binding global securities rules, even global consensus on what they are or how best to regulate them globally. The global financial and securities regulatory framework consists of dizzying numbers of national laws and a similarly bewildering web of “international bodies that have their own mandates.”217 National securities laws are generally fragmented or consolidated; rule-based or principles-based.218 Fragmented and rules-based securities regulations are increasingly vanishing globally, except in the U.S. and a few holdout countries that

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215 See id. §§ 5, 32, 97; Yarram Trading v. ABSA 2007 (2) SA 570 (CIS in property requirements).
typically prescribe detailed rules for banking, futures, securities and insurance goods and services they regulate separately despite the interconnectedness of these markets today.219 The converse and trends in national securities regulations globally involve semi or fully consolidated principled-based financial laws.220

The current global financial regime consists of at least five different types of global organizations with different mandates over the same or different financial activities.221 At international treaty level are formal international organizations such as the World Bank.222 At international political level are periodic state-to-state contact groups like the G20.223 At national regulator level are trans-governmental networks such as IOSCO.224 The fourth and fifth types are informal bilateral and regional arrangements between national regulators often reduced to MOUs and private standards setting bodies such as the International Accounting Standards Board respectively.225 Global financial regulatory collaboration occurs predominantly through the non-binding rules and standards set by trans-governmental networks that also traditionally led efforts to converge global regulations, but their main contribution to global financial regulation “is to pool together technical expertise, ensure the sharing of information and provide a framework for regulatory cooperation when the political will appears.”226 IOSCO and other trans-governmental networks do not regulate global finance and even countries that adopt IOSCO standards still regulate critical aspects of financial activity, including the definition of a security.

The typically heterogeneous national and global financial regulations raise three broad issues for comparing global definitions of a security. First, the national definitions of a security are as varied as the national securities regulations themselves even between countries that share the same financial regulatory system such as Australia and the UK. Second, the dearth of harmonized or legally binding global securities rules means identical financial activities offered globally are defined and regulated differently in each jurisdiction, hence there is no model global definition of a security. Finally, the use of the term “security” is not global. For example, the U.S.

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219 See Brown, supra note 218, at 372, 378.
220 See id.; Walsh, supra note 218.
222 Id.
223 Id.
224 Id.
225 Id.
226 Id. at 263-264.
definition of a “security” is synonymous with “securities” in India and SA, “investments” in the UK and “financial product” in Australia.

Generally, the U.S. and the Selected Countries’ definitions have two key similarities. The first is that they all provide non-exhaustive lists of instruments consisting of a security and leave it to their courts, legislatures or regulators to enumerate additional instruments. The second is they all include, in different fashions, traditional debt and equity products like stocks and bonds and new and exotic ones such as security-based swaps.

B. Sources of Securities Definitions Variations

At least three factors account for the variations in global financial and securities laws. First is whether the country’s financial laws are consolidated or fragmented and principles-based or rule-based. The U.S. employs a “functional” financial regulatory system that generally regulates financial activities according to their function irrespective of who offers what financial products or services. Theoretically, functional regulatory schemes provide consistency in regulation, they focus regulations and regulators on their respective function area, and they generally prevent the need for functional regulators to develop expertise in all aspects of financial regulation. The U.S. relies entirely on the definition of financial activities to allocate federal financial agency jurisdiction and the U.S. definition covers and the SEC regulates securities and security-based products only. In contrast, Australia and the UK, two of the Selected Countries with the most consolidated financial laws, include insurance, futures and securities in their definitions of investments and financial products respectively. India and SA whose securities laws regulate the non-banking financial industry include futures and securities in their definitions of a security.

Second is whether the financial laws are rules-based led by the U.S. or principles-based for which the UK is the torchbearer. Rules-based regulations are often rigid because they prescribe detailed rules that should or should not be observed. The U.S. definition is rules-based. It, therefore, enumerates several financial activities that constitute securities. It is also so rigid that only Congress can append additional securities to it.

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227 See generally Cristie L. Ford, Principles-Based Securities Regulation, 55 MCGILL L.J. 1, 6 (2010).
230 See ACA § 764; FSMA § 22(1).
231 See SCR Act § 2(h)(ia); SSA § 1(a)(iii).
233 See, id.
Conversely, principles-based regulations are generally flexible and more sensitive to context, but potentially less certain. The Selected Countries’ definitions are generally principles-based. Typically, they are drafted in general terms to afford the regulators or the governments maximum flexibility to rapidly capture product and regulatory changes.

Third, the origins and purposes of the financial laws provide a less obvious, but significant source of and an explanation for the variations in U.S. and the Selected Countries’ definitions. Major U.S. financial laws are generally remedial and punitive laws enacted in response to financial crises. That helps to explain, first, why the U.S. definition is rules-based. The U.S. definition prescribes the instruments that are securities so that financial market participants can tailor their conduct accordingly because of the stiff civil and criminal penalties of the federal securities laws.

Second, the successive financial crises influence the language and scope of the U.S. definition. Actually, Congress deliberately designed the U.S. definition broadly initially to include fraudulent schemes of the 1920s and 1930s. Subsequent amendments to the U.S. definition and the only instruments exhaustively defined in the federal financial laws are security-based futures and ABS because they created and exploited regulatory gaps that caused the recent global financial crisis.

Conversely, the need to modernize or harmonize national financial laws to create competitive investment climates for domestic and foreign capital motivated the Selected Countries’ financial laws. Thus, their definitions generally include modern instruments traded on their domestic and global financial markets like an Australian carbon credit unit and an eligible international emissions unit. For example, the Indian added security receipts and certificates issued in securitization transactions in 2002 and 2007 respectively to capture the growth of global securitization

234 See, e.g., Ford, supra note 227, at 6-10.
235 See ACA § 764A(1)(m); FSMA § 22(2); SCR Act § 2(h)(iia); SSA § 1(b)(ii).
237 See Fordham Symp., supra note 73.
240 See ACA § 764A(ka)-(kb).
transactions.\textsuperscript{241} Furthermore, their principles-based statutory language balances between specificity for typical securities like stocks and bonds and generalization and flexibility regarding securities that take multiple forms like ABS by making receipts, certificates and similar instruments issued in such transactions securities, rather than the underlying financial transactions.\textsuperscript{242}

\textbf{C. Key Variations in Securities Definitions}

Although it is tempting and largely correct to lump together the Selected Countries’ definitions, the reality is that no two countries have identical definitions. The U.S. and the Selected Countries’ definitions fall into three distinct categories based on their form and substance. The first is the U.S. definition that is not replicated in form or substance in any foreign jurisdiction, including the Selected Countries. The second is the Australian and the UK definitions that are identical in almost every respect. They both cover futures, securities, pooled investments and insurance. In fact, the term “financial products” as defined in section 763A of ACA is identical to “regulated activities” in Section 22(2) of the FSMA and the “specific things that are financial products” in section 764A of ACA is identical to “the classes of activity and categories of ‘investments’” in section 22 (1) of the FSMA. The Indian and SA definitions constitute the third and final group. They both employ the term “securities” in substantially the same way as the U.S. definition, but they differ from the U.S. definition in statutory language and scope insofar as they cover futures, securities and pooled investments using modern language.

Overall, the pattern that emerges is of the U.S. definition that covers securities and security-based financial activities only, the Australian and UK definitions that cover futures, insurance, pooled investments and securities and the Indian and SA definitions that cover futures, pooled investments and securities. What constitutes futures, insurance, pooled investments and securities differs significantly between countries and more starkly, between the U.S. and the Selected Countries.

\textit{i. Debt and Equity Securities}

The definitions of securities in each jurisdiction include debt and equity instruments, but what constitutes such instruments marks the first major divergence in the U.S. and the Selected Countries’ definitions. In the Selected Countries, “securities” usually mean shares or stock, debentures,

\textsuperscript{241} See supra text accompanying notes 197-8.
\textsuperscript{242} See id.

debenture stock and bonds of an incorporated or unincorporated body or company.243 The U.S. and SA definitions are the only ones that include “notes” as debt securities without defining the term.244 The leading U.S. case of Reves conceded that a “note” is a relatively broad term that encompasses instruments with widely varying characteristics depending on whether the instruments are issued in a consumer context as commercial paper or in some other investment context and found securities in notes that fulfill the “family resemblance test” without defining the term.245 Section 1 of SA’s Bills of Exchange Act 34 of 1964 is the only SA law that defines a “note” as a “promissory note” in its section 87(1). Section 87(1) defines a “promissory note” as an unconditional promise in writing made by one person to another, signed by the maker, and engaging to pay on demand or at a fixed or determinable future time, a sum certain in money, to a specified person or his order, or to bearer. This definition of a promissory note is probably not what the SA definition had in mind because SA securities laws do not apply to banking laws and vice versa.

Finally, the U.S. and UK definitions contain “evidence of indebtedness” and “instruments creating or acknowledging indebtedness” respectively as debt securities.246 The FSMA defines the later as: debentures; debenture stock; loan stock; bonds; certificates of deposit; and any other instruments creating or acknowledging a present or future indebtedness, while Reves developed the “family resemblance test” for notes and evidence of indebtedness without defining the term.247

ii. Complex Instruments

The U.S. definition covers and federal courts evaluate “novel, uncommon, or irregular devices” and “veiled and devious” financial schemes as “investment contracts” and “any interest or instrument commonly known as a “security.”248 The Supreme Court suggested in Howey that the investment contract analysis provides a full measure of protection to the investing public, but its ability to do so is disputed both in the U.S and abroad.249 The Selected Countries studied and adopted many

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243 See ACA §§ 9, 92; Sch. 2, art. 11; SCR Act § 2(h)(i); SSA § 1(a)(i), (iii)-(v).
244 See 15 U.S.C. § 77b (a)(1); SSA § 1(a)(ii).
246 See 15 U.S.C. § 77b(1); Sch. 2 art. 12.
247 See Sch. 2 art. 12; Reves, 494 U.S. at 60-67.
248 Joiner, 320 U.S. at 351.
249 Howey, 328 U.S. at 298; Carney & Fraser, Defining a Security: Georgia’s Struggle With the “Risk Capital” Test, 30 EMORY L.J. 73 (1981) (arguing that the Howey test is irrelevant to investor protection).
aspects of the U.S. federal securities laws, except the U.S. definition, but they discounted the investment contract analysis as a regulatory tool for evaluating new or hybrid instruments and preventing “veiled and devious” schemes, and hence they universally do not include it in their definitions. The Selected Countries’ definitions do not distinguish between new or complex financial activities and traditional securities largely because it is superfluous. By their statutory definitions, the Selected Countries permit their governments or regulators to identify and add any financial activities to them as a security. By their consolidated financial regulations, the Selected Countries’ definitions include hybrid instruments by virtue of covering futures, insurance and securities. Furthermore, the Selected Countries’ definitions universally require securities sponsors and/or their schemes to be registered or exempted subject to conditions such as fit and proper person tests and credit ratings of schemes before offered to the public. Approval for or exemption from registration is available to a sponsor or scheme that meets the definition of a security or convinces the government or regulators to declare a new instrument as securities.

iii. Pooled Investments

The U.S. definition traditionally excludes mutual funds and other pooled investments and the DFA left that longstanding regulatory set-up intact. U.S. pooled investments constitute securities indirectly as an investment company under section 3 of the Investment Company Act if the pool of investments issues, owns, invests or trades in securities. All the Selected Countries treat pooled investments differently. First, their definitions include interests or units in CIS as securities. Second, while issuing, owning, investing and trading in securities is a prerequisite to establishing an investment company under the Investment Company Act, the opposite is true regarding establishing a CIS. The Selected Countries determine a CIS for the sole purpose of registering or exempting it if it satisfies the statutory definition of a CIS because any interests or units issued by any CIS

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251 See ACA § 92(1)(c), 764A; Sch. 2 art. 16; SCR Act § 2(h)(ib), (id); SSA § 1(a)(vi)-(vii).
252 See FSMA §§ 19-22, 31, 40; ACA §§ 601EB, 601EE; SEBI Act § 12(1B); CISCA §§ 5, 32, 97.
253 See Thompson, supra note 63.
254 See LIFE REP., supra note 30, at viii.
255 ACA §§ 764A(1)(b)-(ba); Sch. 2 art. 16; SCR Act § 2(h)(ib); SSA § 1(a)(vi).
automatically constitute securities. Finally, both the U.S. and the Selected Countries use the Howey test or variations of it to establish an investment company and a CIS. Whether or not a pooled fund or entity is issuing securities under the Investment Company Act is determined under the Howey test. Whether a scheme is a statutory CIS in the Selected Countries is also determined using variations of the Howey test. Thus, the Howey test establishes a U.S. security and a CIS in the Selected Countries.

iv. Futures, Insurance and Other Instruments

Futures, insurance and other instruments are treated and classified differently in all the countries depending on the degree of consolidation of each country’s financial laws. The U.S. definition excludes futures and insurance financial activities unless they have securities features such as security future and security-based swaps added to the U.S. definition in the last thirty years. All the Selected Countries’ definitions include all forms of futures as derivatives, futures or options. The Australian and UK definitions include insurance as contracts of insurance, participation in Lloyd’s syndicates and life insurance policies. The Indian Definition explicitly includes security receipts and certificates issued in securitization transactions or by securities depositaries. Government securities are included in the statutory definitions of securities in all other countries except SA and the U.S.

v. Definitional Terminology

The language and depiction of similar instruments in the U.S. definition differs significantly from the Selected Countries’ definitions. First, the U.S. definition is notorious for using terms not ordinary to the financial markets or with established financial or legal meaning outside judicial interpretations such as “investment contracts.” Its counterparts in the Selected Countries’ generally track modern financial and legal terminology. Second, the U.S. definition includes numerous certificates for securities such as “collateral-trust certificate” and “any certificate of interest or

[256] See FSMA §§ 19-22, 31, 40; ACA §§ 601EB, 601EE; SEBI Act § 12(1B); CISCA §§ 5, 32, 97.
[257] See FRANKEL & KIRSCH, supra note 68.
[258] See ACA § 9; CISCA § 1; FSMA § 235(1); SEBI Act § 11AA.
[259] See ACA § 764A(1)(c); Sch. 2 arts 16-17; SCR Act § 2(h)(ia); SSA § 1(a)(iii).
[260] See ACA § 764A(1)(d)-(f); Sch. 2 arts 19-20.
[262] See ACA § 92(1); Sch. 2 art.13; SCR Act § 2(h)(ii).
participation in, temporary or interim certificate” which the Selected Countries universally collate under the generic terms akin to “certificates representing securities.”264 Third, the U.S. definition includes instruments such as “interest or participation in any profit-sharing agreement” and “fractional undivided interest in oil, gas, or other mineral” which typically are forms of pooled investments. The Selected Countries bundle together such instruments with investment contracts, mutual funds and other pooled investments under the rubric participatory interests or units in CIS or MIS.265 The final notable difference in the terminology of the U.S. and the Selected Countries’ definitions is the extent to which the U.S. definition slices securities options into “any put, call, straddle, option, or privilege on any security” in order to distinguish them from options on futures outside its jurisdiction.266 The Selected Countries’ definitions need not make such distinction because they already include options on futures and securities.

vi. The Judiciary and Securities Definitions

The broad language of the U.S. definition and its use of unfamiliar terms in finance or the law that neither it nor the federal securities laws define hand the task to the SEC, and ultimately to the federal courts to decide which of the myriad financial transactions in our society come within the coverage of the federal securities laws.267 In fact, only security-based futures in the U.S. definition, “security future”, “narrow-based security index”, and “security futures product” and “security-based swap”, are extensively defined in section 3(a)(55) of the Exchange Act and section 1a of the CEA respectively.268 Historically, Congress has included security-based futures in the U.S. definition either after court battles over whether they are futures, securities or both, or in order to provide greater legal certainty to foreclose product and jurisdictional disputes between the CFTC and SEC over such products.269 Consequently, the U.S. definition does not dispose of the threshold issue of whether or not an instrument or scheme is a security. That is determined, almost exclusively, by the federal courts, which shaped the scope of the U.S. definition.270

The Selected Countries’ definitions and their securities laws curtail the

264 See Sch. 2 art. 15; SCR Act §§ 2(h)(ic), 2(h)(ie); SSA § 1(a)(x).
265 See supra text accompanying note 255.
267 See Forman, 421 U.S. at 848.
269 See Chicago Mercantile Exchange, 883 F.2d at 544 (index participations both futures and securities to be regulated by the CFTC); MOD. REPORT, supra note 14.
270 See generally Lowenfels & Bromberg, supra note 238, at 488 (discussing the meaning of security under the federal securities laws).
courts’ jurisdiction over them in three significant ways. First, they all use modern and straightforward terms with established financial and legal meanings. Second, they or their securities laws, rules and regulations extensively define or explain the material terms in the definitions, complete with real life examples and question and answers in some cases.271 Finally, the Selected Countries’ definitions authorize their governments or regulators to add to or remove any financial instrument from the securities definitions.272 Consequently, major court battles over the Selected Countries’ definitions are very rare, and largely unnecessary. The securities definitional issue that arise occasionally in enforcement matters in the Selected Countries overwhelmingly involve pooled investments and the specific issue of whether a scheme is a statutory CIS or MIS that must be organized and operated in accordance with the statute rather than whether the units or participatory interests a CIS or MIS offers are securities.273

V. COMPARISONS OF THE SCOPES OF SECURITIES DEFINITIONS

A. Scope of the U.S. Definition

The U.S. definition is drafted broadly using terms like “any note, stock, bond…” which plainly means federal securities laws apply to every enumerated instrument, including mundane arrangements like I.O.U.s given between friends.274 It also includes broad terms such as “in general, any interest or instrument known as a ‘security’” and instruments that are not readily recognized as securities such as “investment contracts” and “profit-sharing agreements” which neither it nor the federal securities laws define. Moreover, it uses words like “any note, stock, bond…” which create confusion as to its exact meaning and scope because such words suggest that all the enumerated instruments are automatically securities, but the context clause that precedes it qualifies them and even excludes instruments that bear the enumerated names, but are, in fact, not securities.275 Actually, the overly broad statutory language of the U.S. definition, its use of unusual terms that are largely undefined and the context clause that causes inherent confusion as to its true meaning and scope denotes that the U.S. definition does not dispose of the question of what is a security under the federal

271 See ACA § 9, 92, 761A; Sch. 2, Pts I & II; SCR Act § 2; SSA § 1.
272 See ACA § 764A(1)(m); FSMA § 22(2); SCR Act § 2(h)(iiia); SSA § 1(b)(ii).
274 See, e.g., McGinty, supra note 33, at 1038 n.17.
275 Id. at 1039.
securities laws. Whether an instrument is a security under the U.S. definition is a matter of fact to be determined initially by the SEC and, eventually, by the federal courts.

The federal courts shaped, almost exclusively, the scope of the U.S. definition by interpreting its somewhat conflicting statutory language overly inclusively. When interpreting the U.S. Definition, federal courts have mostly tried to balance its broad and conflicting statutory language and the statutory purposes of the federal securities laws. Thus far, the federal courts have tried and failed to determine an unequivocal meaning of the U.S. definition or to produce a clear legal test to evaluate it that is consistent with the purposes of the federal securities laws. Actually, the Supreme Court has interpreted the U.S. definition almost twelve times since 1943 and it developed disparate tests for investment contracts, notes and stocks that failed to clarify its exact meaning or scope. Even the Supreme Court conceded in Landreth that “its cases ha[d] not been entirely clear on the proper method of analysis for determining when an instrument is a ‘security.’”

One method the Supreme Court frequently invokes, but has not been entirely clear on its proper use, is the investment contract analysis or the Howey test. In Joiner, its first definitional case, the Supreme Court equated “investment contracts” to “instrument commonly known as a security” and applied the two to cover potentially infinite numbers of “novel, uncommon or irregular” instruments as securities. When applied in Howey, “investment contracts” embodied a flexible rather than a static principle, one that was capable of adaptation to meet “the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits.” Howey also said the term “in general, any interest or instrument known as a ‘security’” does not limit the scope of the U.S. definition to those securities that precede it such as stocks and bonds because an instrument or transaction need not be of the type commonly known as a security to constitute a security under the federal securities laws. In Edwards, its most recent definitional case, the Supreme Court said courts must construe “investment contracts” broadly to “encompass virtually any instrument that might be sold as an investment.”

276 Id.
277 Id. at 1036 n.2.
278 Id.
279 Landreth, 471 U.S. at 688.
280 Joiner, 320 U.S. at 352-353.
281 Id. at 352.
282 Howey, 328 U.S. at 299.
283 Id.
284 Edwards, 540 U.S. at 389.
Despite the foregoing, the Supreme Court insists that the Howey test provides a mechanism for determining whether an instrument is an “investment contract” only.\textsuperscript{285} For example, in Landreth, it declined to apply the Howey test to notes because applying the Howey test to traditional stock and all other types of instruments listed in the statutory definition would make the federal securities laws’ enumeration of many types of instruments superfluous, and would be inconsistent with Congress’ intent in enacting the securities laws.\textsuperscript{286}

Yet, the Supreme Court and its lower courts have rendered the U.S. definition largely superfluous in two significant ways. First, while the Landreth court reiterated that the Howey test does not apply to any case in which an instrument is alleged to be a security, once the “stock” label did not hold true, it perceived no reason to analyze the case differently whether it viewed the instrument as “investment contracts” or “instrument commonly known as a 'security.'”\textsuperscript{287} The problem with this method of determining a security is threefold. First, it disregards the U.S. definition’s enumeration of instruments such as stock. Second, Landreth created a rebuttable presumption that “stock” is a security. It follows that the “stock” label cannot hold true only if successfully rebutted under the Landreth test for stock. Third, federal courts regularly apply the Howey test in many cases involving exempted or excluded futures and insurance instruments alleged to be a security.\textsuperscript{288} The trend that emerges is that federal courts will apply the “investment contracts” analysis to other enumerated instruments when other judicial tests for enumerated instruments like stock fail, and to excluded and exempted instruments alleged to be a security. That does not only render the U.S. definition superfluous, but it also confirms the general observation that the U.S. definition does not dispose of the question of what is a security under the federal securities laws. Whether an instrument is a security is a matter of fact determined by the federal courts.

Second, and more fundamentally, the Supreme Court has disregarded the statutory language and appealed to the purposes of the federal securities laws to expand the scope of the U.S. definition beyond recognition.\textsuperscript{289} The Howey court said federal courts look behind the name of the instrument because when searching for the meaning and scope of “security” under the federal securities laws, form should be disregarded for substance and the

\textsuperscript{285} \textit{Reves}, 494 U.S. at 63.
\textsuperscript{286} \textit{Id.} at 64; \textit{Landreth}, 471 U. S. at 692.
\textsuperscript{287} \textit{Landreth}, 471 U. S. at 692 n.5.
\textsuperscript{288} \textit{See, e.g.}, LIFE REP., supra note 30, at 23-4; SEC v. Mutual Benefits Corp., 408 F.3d 737, 742 (11th Cir. 2005) (non-variable life settlement contracts are securities as investment contracts).
\textsuperscript{289} \textit{See, e.g.}, \textit{Edwards}, 540 U.S. at 389.
emphasis should be on economic reality. In \textit{Weaver}, the Supreme Court said the U.S. definition is “quite broad” and designed to include “the many types of instruments that in our commercial world fall within the ordinary concept of a security.” Finally, \textit{Reves} said that Congress’ purpose in enacting the securities laws was to “regulate investments, in whatever form they are made and by whatever name they are called” and hence, it enacted a broad definition of a security sufficient to “encompass virtually any instrument that might be sold as an investment.”

All told, federal courts have expanded the already broad scope of the U.S. definition to include instruments that uninitiated readers of the statute would recognize. Federal courts have found securities in a franchise, an orange grove, a condominium, real estate lots, gold and silver bullion, diamonds, beavers, chinchillas, minks and myriad other financial activities mainly as investment contracts. The scope of the U.S. definition is, therefore, virtually infinite consisting of the enumerated instruments and any investments, in whatever form and by whatever name they are called, the federal courts determine to be securities, mostly as investment contracts.

**B. Scope of Selected Countries’ Definitions**

The scopes of the Selected Countries’ definitions divide perfectly into two distinct groups depending on the degree of consolidation of the country’s financial laws and, hence, the structure of their definition of security. The first group comprises the Australian and UK definitions that share at least three common elements that affect their scope. First is that they cover futures, securities, insurance, pooled investments, money market instruments and other financial activities consistent with their consolidated financial laws. The second is they provide comprehensive lists of specific things that are financial products and investments respectively. Third, they include financial services such as making or dealing in investments through the definition and regulation of investments as “regulated activities” and “financial products.” The second group consists of the Indian and SA definitions that exclude insurance activities and financial services completely. They typically cover futures and securities.

In general, the Selected Countries’ definitions collectively limit their

\footnotesize{\begin{itemize}
  \item \textsuperscript{290} \textit{Howey}, 328 U. S. at 298; \textit{Weaver}, 455 U.S. at 552 n.1, 560.
  \item \textsuperscript{291} \textit{Weaver}, 455 U.S. at 555-56; \textit{Forman}, 421 U.S. at 849.
  \item \textsuperscript{292} \textit{Reves}, 494 U.S. at 61.
  \item \textsuperscript{293} See supra text accompanying note 37.
  \item \textsuperscript{294} See ACA §§ 763A, 764A; FSMA § 22(2); Sch. 2, Pts. I & II.
  \item \textsuperscript{295} Id.
  \item \textsuperscript{296} Id.
\end{itemize}}
scopes to the enumerated instruments and any additional instruments specified by their governments or regulators, principally, because they use modern and unequivocal language with established meanings in the financial industry and in law. The Selected Countries’ definitions, securities laws, rules and regulations also define exhaustively the already unequivocal terms in their definitions. Finally, the Selected Countries’ definitions are flexible enough to respond to market and regulatory using the authority given to their governments or regulators to add to, exempt or exclude any financial activity from the statutory definitions.

C. Scopes of U.S. versus Selected Countries definitions

On paper, the scope of the U.S. definition is narrower than all the Selected Countries’ definitions because it and the federal securities laws apply to securities only while the Selected Countries’ definitions generally cover futures, insurance, pooled investments and securities. In reality, the opposite is true measured, first, by the unprecedented range of “securities” the U.S. definition covers and, second, and more importantly, because federal courts have expanded it to cover futures, insurance and numerous other investments if they, in fact, involve securities. In addition to its broad statutory language that potentially covers any investment activity as “any interest or instrument commonly known as a ‘security’” and others, the U.S. definition covers pooled investments through the definition of an investment company as an issuer and investor in securities and ordinary business activities such as distributorship and franchise agreements.

Federal securities laws do not apply to both futures and insurance, but Congress and the federal courts crafted technical legal standards to include them anyways under the U.S. definition. The U.S. definition expressly covers security futures and security-based swaps, and federal courts have found securities in financial instruments with features of both futures and securities. Section 3(a)(8) of the Securities Act exempts insurance from the federal securities laws, but the U.S. definition still covers insurance products in two ways. First, stocks and bonds of insurance corporations are traditional securities under the U.S. definition. Second, the section 3(a)(8) insurance exemption is not available to variable life insurance contracts.

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297 Id.
298 See ACA § 764A(1)(m); FSMA § 22(2); SCR Act § 2(h)(iia); SSA § 1(b)(ii).
299 See supra text accompanying note 37.
300 See Chicago Mercantile Exchange, 883 F.2d at 544.
301 See 15 U.S.C. § 77c(a)(8); LOSS, supra note 91, at 496-501 (an insurance contract is not a security); American Equity Inv. Life Ins. Co. v. SEC, 613 F. 3d 166 (D.C. Cir. 2010) (fixed indexed annuities are not annuity contracts and therefore a security).
policies and variable annuities that pass through to the purchaser the investment performance of a pool of assets, which the SEC and the federal courts hold as securities.302

None of the Selected Countries’ definitions is drafted so broadly to cover potentially countless financial activities as “financial products,” “investments” or “securities”. Moreover, the statutory language, the extensive definitions of the enumerated instruments and the authority given to the governments or regulators to add to or remove any financial activity from the definitions make it virtually impossible to apply the Selected Countries’ definitions to other areas of the financial industry, especially through judicial construction, as does the U.S. Definition. Besides, the Selected Countries limit the exclusive powers they grant to the governments or regulators to specify or declare new instruments as securities. For example, section 1(a)(x) of the SSA requires the Registrar to add new instruments that are “similar to one or more” of the enumerated instruments.

Thus, despite and because of the differences in securities laws and the definitions of securities between the U.S. and the Selected Countries, the broad statutory language of the U.S. definition and the overly-inclusive meaning given to it by the federal courts make its scope practically immeasurable and, hence, generally broad and too broad relative to the Selected Countries’ definitions.

VI: HARMONIZING U.S. DEFINITION

A. Impetus for Harmonizing U.S. Definition

The U.S. definition is remarkably resilient. It has outlived all the financial crises and emerged from the ensuing financial regulatory reforms largely the same as it has been since 1933.303 Many factors account for its resilience, but the most obvious one is that the federal securities laws have also remained largely unchanged over the same period. Furthermore, the SEC prefers the status quo in which courts historically adjudicate all questions concerning the legal definition of a security. Without changing the fragmented U.S. financial regulatory scheme or the support or leadership of the SEC that administers it, the overhaul of the U.S. definition has never gained traction over the years. Even though Congress did not converge or modernize the U.S definition during its recent financial reforms, it did not remove the need for such reforms that may still occur in the future in response to at least four possible financial regulatory and

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303 See, e.g., Lybecker, supra note 87.
market developments.

First is if Congress revisits the Treasury Department’s 2008 proposal to merge and consolidate the fragmented financial regulatory system, especially the merger of the SEC and CFTC that escaped the recent financial overhaul mainly because it never gained political traction in Congress. The U.S. currently employs a “functional” regulatory system although some argue that it actually uses a hybrid system that combines “functional” and “institutional” regulatory schemes. The U.S. Treasury Department proposed a consolidated “three-peak” model consisting of three regulators: a market stability regulator; a prudential regulator; and a business conduct regulator that is consistent with trends in most major financial markets. Securities regulations would fall under the business conduct regulator comprising, among others, the merged CFTC and SEC.

A consolidated U.S. financial regulatory regime would put the U.S. at par with other major global centers such as the UK and Australia. A semi-consolidation of the SEC and the CFTC only means the new U.S. definition will include futures and securities similar to India and SA. A full consolidation similar to that of the UK will require regulation of insurance at federal level for the first ever and the ensuing U.S. definition will include futures, securities and insurance. A full or partial consolidation of U.S federal financial laws will also pooled investments as units or participatory interests in an IC, CIS or MIS.

The second is if Congress adopts the principles-based rules instead of the rules-based approach it employs pursuant to the federal securities laws. The adoption of principles-based securities regulations in the U.S. started in earnest with the Sarbanes-Oxley Act and the DFA. The DFA contains numerous principled-based rules such as section 619 that permits federal banking agencies, the SEC and the CFTC, by rule, to add new private funds similar to hedge funds and private funds. A principles-based U.S. definition would enable the SEC to alter significantly its language to conform it to U.S. and global financial and regulatory practices as it has

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305 See, e.g., BLUEPRINT, supra note 42, at 138-41; Schooner & Tayler, supra note 239, at 328 (argued the U.S. is a hybrid system).
306 See BLUEPRINT, supra note 42, at 143-183.
307 Id.
308 See, e.g., SEC, HARM., supra note 53, at 7.
already done to its definitions of ABS and VCFs under the DFA.\textsuperscript{310}

Third is the possible establishment of a legally binding international financial regulatory scheme through a treaty, international organizations, or the harmonization of global financial laws.\textsuperscript{311} Although global efforts to harmonize global financial regulations have stalled for now, the contemporary patchwork of national financial regulations is simply unsustainable in today’s globalized financial markets. The most fundamental lesson from the recent financial crisis is the folly of relying on national laws to regulate the globalized financial markets characterized by high capital mobility and its willingness to create and exploit regulatory gaps wherever they exist. Most of these national financial regulations, including the U.S., are comparable to, consistent with or higher than international standards such as IOSCO’s principles for securities regulations, but differences in legal systems and the discretion countries have to choose what to include in their national regulations often negate a more consistent alignment of global financial regulations based on global standards. Because of the variations in global securities laws, SEC staff, for example, now strongly recommend negotiating MOUs only with foreign regulators empowered to provide assistance beyond that required by the IOSCO standards.\textsuperscript{312} The SEC requires the foreign regulator’s authority to have powers to gather Internet service provider, phone and other records other than bank, broker, and beneficial owner information on behalf of the SEC or to compel testimony.\textsuperscript{313} A binding global financial regulatory regime will include a harmonized “security” definition the U.S. will be obligated to adopt.

Finally, the technology that facilitated the recent rapid growth of global finance and the creation of complex instruments that traverse traditional regulatory boundaries will continue to develop faster than financial laws can adjust.\textsuperscript{314} The main issue with technologically advanced new and complex financial products is always how to identify them sufficiently in legal terms to enable specific regulation. Already, the U.S. struggled to define and regulate complex instruments driven partly by technology such as CDS.\textsuperscript{315} Technology is also linking global financial markets changing the

\begin{footnotesize}
\footnote{310}{See supra text accompanying note 93.}
\footnote{311}{See David Sanger & Mark Landler, In Europe, Obama Faces Calls for Rules on Finances, N.Y. TIMES, Apr. 2, 2009, at A1.}
\footnote{313}{Id.}
\footnote{314}{See, e.g., Kathleen C. Engel & Patricia A. McCoy, A Tale of Three Markets: The Law and Economics of Predatory Lending, 80 TEX. L. REV. 1255, 1273–79 (2002) (detailing some of these technological changes).}
\footnote{315}{See, e.g., McCoy, Pavlov & Wachter, supra note 14, at 501-509.}
\end{footnotesize}
financial intermediation system as we know it and putting pressure on national regulators.\textsuperscript{316} For example, in 2008, investors for municipal governments in Australia accused Lehman Brothers of misleading them regarding the risks of CDOs.\textsuperscript{317} Eventually, technology will develop to the extent that the national securities regulations, including the U.S. definition of security, will become superfluous.

**B. Harmonized U.S. definition**

No two countries in the world, including the Selected Countries, have the same securities laws or definitions of a security, but the instruments and language of their definitions of securities is practically homogeneous. Collectively, the Selected Countries’ definitions provide a representative sample of global trends in the definitions of security and are instructive of a conventional global definition of security because of the influence of EU laws on the securities laws of the UK and other former colonial powers like France, Spain and Portugal and international organizations such as IOSCO. Most Commonwealth countries have adopted UK securities laws, with the necessary changes, including Australia, India and SA, especially, as evidenced by the striking similarities in form and substance between the UK and Australian definitions.

Nonetheless, a harmonized U.S. definition must acknowledge the fundamental variations in securities regulations between the U.S. and the Selected Countries, particularly the degree of consolidation of financial regulations. Short of another catastrophic financial crisis caused by financial regulatory failures, the U.S. will not regulate insurance at federal level or consolidate its financial regulations any time soon. Thus, the proposed harmonized U.S. definition excludes futures and insurance products except security-based futures and insurance that the U.S. definition already covers expressly or pursuant to federal court opinions as follows:

In this Act, “security” means: (a) shares, scrips, stocks, bonds, debentures, or other marketable securities of a like nature in or of a body corporate or an unincorporated body; (b) security-based futures instruments; (c) security-based insurance instruments; (d) instruments based on an index; (e) a certificate or receipt or instrument (by whatever name called) representing securities; (f) such other instruments similar to one or more instruments covered by subparagraphs (a) to (f) the SEC, may, by rule, determine to be a security; (g) units or any other form of instruments covered by subparagraphs (a) to (f) issued by any investment company to the in such company; (h) a legal or equitable right or interest in a security covered by subparagraphs (a) to (g); (i) a right (whether

\textsuperscript{316} See, e.g., MOD. REPORT, supra note 14.

\textsuperscript{317} Id. at 41.
existing or future and whether contingent or not) to acquire a security covered by subparagraphs (a) to (h).

The proposed harmonized U.S. definition addresses the major criticisms of the appropriate language, meaning and scope of the U.S. definition. First, it replaces the context clause that precedes it with “[I]n this Act, ‘security’ means…” Federal courts have invoked the context clause to provide unprecedented elasticity to the U.S. definition. Its proper language, meaning and scope has also been contentious with prominent academics and judges like Professor Loss and Justice Jackson arguing that the context clause viewed in light of legislative history suggests that the context should be that of the surrounding factual circumstances instead of the surrounding statutory language that the federal courts usually apply. Second, it excludes the catch-all phrase “any notes, stock …” which would include, for example, I.O.U.s issued between friends, but for the limits under the “family resemblance test.” Additionally, the harmonized U.S. definition makes it clear that only the stock, bonds and other instruments of entities or bodies constitute securities. Third, it purges inclusive and unusual instruments such as “investment contract” and replaces them with contemporary terminology such as marketable instruments. Fourth, it excludes a “note” because most countries, except SA, exclude it. Besides, debentures and other debt instruments adequately cover investment notes.

Fifth, the harmonized U.S. definition consolidates similar instruments in the U.S. definition under generic terms. It consolidates all certificate and receipt-based instruments under the generic term “certificates, receipts or instruments representing securities.” It also covers other certificate and receipt-based instruments such as a “right to subscribe to or purchase any of the foregoing” as “rights or interests in securities.” It, additionally, consolidates security future, security-based swaps and other security-based future instruments under the general category of “security-based futures.” Similarly, it grouped together the various instruments based on some index or stock exchange and covered them simply as “instruments based on an index.” It, further, introduces security-based insurance instruments as securities to cover insurance products with securities features. The federal courts already exclude such insurance products from the insurance exemption in section 3(a)(8) of the Securities Act, which they evaluate and hold securities as investment contracts. Thus, security-based insurance instruments would also compensate for the loss of investment contracts.

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318 See LOSS, supra note 121.
319 Id. at 261 n.13.
320 See supra text accompanying note 274; Reves, 494 U.S. at 65.
under which insurance contracts are currently evaluated.

Sixth, the proposed harmonized U.S. definition modernizes the coverage of U.S. pooled investments by introducing units or interests issued by an IC as a security. Finally and most fundamentally, it turns the rules-based U.S. definition into a principles-based one by defining instruments in general terms and allowing the SEC to declare any instrument as a security. Both instruments will significantly curtail the jurisdiction of the federal courts to determine securities under the federal securities laws and eliminate the inclusive and controversial term “investment contracts” currently used to evaluate new and unique instruments.

Authorizing the SEC to add new products to the U.S. definition has implications that go beyond the scope of the U.S. Definition. As the securities market regulator, the SEC has intimate knowledge of and unparalleled expertise in the financial markets and can easily summon the financial industry to help determine whether an instrument is a security, when to add it to the U.S. definition, introduce it to the financial markets and the name of the new instrument. That will provide legal certainty over whether or not some new or complex instruments are covered by the U.S. definition. It will also ensure speedy and timely introduction to the securities markets and regulation of new instruments as opposed to the current laborious process in which the SEC has to ask Congress or the federal courts to include instruments to the U.S. definition. For example, SEC staff identified life settlements as a security in 2007 and recommended that Congress adds them to the U.S. definition in July 2010 and that request is still pending. The harmonized U.S. definition hastens the process by equipping the SEC with statutory authority to add new products without first obtaining Congressional or judicial approval.

The true meaning and scope of the harmonized U.S. definition will be determined by exhaustive definitions of the material terms in the statute and/or the rules similar to the U.S. federal financial laws’ treatment of security-based futures and as is the norm in all the Selected Countries’ definitions. Similar definitions of the material terms in the harmonized U.S. definition based on U.S. and global financial industry usage and federal court precedents will be necessary to compliment this principles-based definition.

C. Investment Contracts as Investment Company

The harmonized U.S. definition breaks with the long U.S. tradition of excluding pooled investments and regulating some of them as investment

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322 See LIFE REP., supra note 3, at 39-43.
contracts and others as an IC. It follows international trends by regulating all pooled investments as units or interests in an investment company. Yet, it is carefully designed to exclude pooled investments in futures, insurance, pension or retirement schemes outside the jurisdiction of the federal securities laws by insisting that the units or interests concerned must involve securities or similar instruments. It also retains the term “IC” instead of adopting “CIS,” “MIS” Managed Funds or Mutual Funds used interchangeably globally.

A CIS is, actually, one of the few securities expressly defined by IOSCO as “an open-ended CIS that issues redeemable units and invests primarily in transferable securities or money market instruments,” excluding schemes investing in property/real estate, mortgages or venture capital.323 Most countries, including the Selected Countries, refined and expanded on the IOSCO definition to include CIS in stocks, bonds and instruments IOSCO expressly excluded such as property/real estate, mortgages and VCFs.

Remarkably, the Selected Countries’ statutory definitions of CIS are based on the Howey test.324 If the U.S. were to follow the rest of the world and regulate all forms of pooled investments as CIS and making units in such CIS securities, the Howey test or any of the Selected Countries’ definitions of a CIS would suffice as the new definition of an IC.325 The regulation of IC would require significant changes to the Investment Company Act that are outside the scope of this Article, suffice to say schemes similar to those in Joiner and Howey will be subject to similar regulatory treatment as mutual funds and other private funds.

VII: CONCLUSION

The differences in global securities laws and the lack of a model global definition of security made the comparison of the definitions and scope of the U.S. definition with the Selected Countries’ asymmetrical. This Article, nonetheless, showed that the scope of the U.S. definition is indeed too broad relative to Selected Countries’ definitions in two ways. First, consistent with the broad statutory language and the overly inclusive construction given it by the federal courts, the scope of the U.S. definition is virtually limitless regarding the range of “securities” it reaches. Second, by judicial construction, it covers security-based futures and insurance products that

324 [See ACA § 9; CISCA § 1; FSMA § 235(1); SEBI Act § 11AA.]
325 [See id.]

are exempted or excluded from the federal securities laws and numerous non-traditional instruments that are not enumerated in the U.S. definition, if, in fact, they involve securities such as franchise agreements. None of the Selected Countries’ definitions is drafted so broadly, and they certainly do not cover financial activities outside futures and securities in India and SA’s case, and futures, insurance and securities in Australia and the UK’s case. Yet, the U.S. definition is remarkably too rigid and obsolete relative to market developments and global trends in securities definitions. Thus, this Article suggested and provided a harmonized U.S. definition that addresses the longstanding criticisms over the proper language, meaning and scope of the U.S. definition and aligns it with global financial market developments and trends in global securities definitions without altering its fragmented financial regulatory scheme.