

SENATE BILL REPORT

E2SHB 1078

As of March 11, 2009

Title: An act relating to exchange facilitators.

Brief Description: Concerning exchange facilitators.

Sponsors: House Committee on General Government Appropriations (originally sponsored by Representatives Kelley, Roach, Kirby, Warnick, Bailey and Sells).

Brief History: Passed House: 3/09/09, 96-0.

Committee Activity: Financial Institutions, Housing & Insurance:

SENATE COMMITTEE ON FINANCIAL INSTITUTIONS, HOUSING & INSURANCE

Staff: Philip Brady (786-7460)

Background: A "like-kind exchange" is a transaction where one piece of property held for investment or for use in a business is exchanged for one or more other, similar pieces of property. They are also referred to as "1031 exchanges," a reference to the section of the Income Tax Regulations addressing these transactions. The property involved can be either real property or certain kinds of personal property. As long as the requirements of the Internal Revenue Code are satisfied, the taxpayer who is exchanging property can defer paying taxes on most gains made through the transaction.

The 1031 exchanges require the assistance of an exchange facilitator (facilitator) or "qualified intermediary." The facilitator holds proceeds from the sale of the original property until those funds are applied to the purchase of the replacement property. While in the possession of the facilitator, funds may be deposited in a financial institution or placed in another investment. There are typically no restrictions on the type or risk-profile of these investments, and in recent years a number of exchange facilitators have made investments that have resulted in significant losses to their clients.

There are no federal or state licensing provisions for exchange facilitators, and no state regulation specifically addressing exchange facilitators, with limited exceptions.

The Department of Financial Institutions (DFI) regulates consumer loan companies doing business in Washington. Consumer loan companies include mortgage lenders and consumer finance companies. DFI also administers the state Securities Act.

This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not a part of the legislation nor does it constitute a statement of legislative intent.

The Consumer Protection Act (CPA) prohibits unfair or deceptive practices in trade or commerce. The CPA may be enforced by private parties, the state, and all political subdivisions of the state. Persons suing under the CPA can recover actual damages, including a reasonable attorney's fee, and treble damages. Treble damages are limited to \$10,000.

Summary of Bill: Facilitators must maintain a \$1 million fidelity bond and \$250,000 of errors and omissions insurance or their equivalents and must present evidence of compliance with these requirements before entering into an exchange transaction, or whenever so requested by a client, prospective client, or the Attorney General. They must also meet the prudent investor standard as defined in trustee law. The standard is violated if a facilitator comingles client funds with its own, loans exchange funds to a related entity, or fails to preserve liquidity and principle. Facilitators must keep accounts over \$500,000 in separately identified accounts with interest going to the taxpayer, but may pool accounts under \$500,000 with the client's permission.

Each facilitator's office must be administered by an attorney, a certified public accountant, or a person who has passed an exchange facilitation test.

Facilitators must not knowingly or criminally negligently engage in certain prohibited practices, including deceptive or fraudulent acts, comingling of funds, failure to account for client funds, or failure to make required disclosures.

Facilitators violating this chapter are subject to civil lawsuits and actions under the Consumer Protection Act, and may face criminal charges for violations of certain prohibited practices. Clients may file claims against a facilitator's bonds and insurance without reducing their other legal rights. Facilitators may not sue their clients for compensation unless they can demonstrate compliance with this chapter.

Exchange facilitators must file a report with DFI on their activities by December 31, 2009. DFI must compile these reports and present them to the Legislature by January 15, 2010. The reporting requirement expires June 1, 2010.

Appropriation: None.

Fiscal Note: Available.

Committee/Commission/Task Force Created: No.

Effective Date: Ninety days after adjournment of session in which bill is passed.