

SENATE BILL REPORT

SB 5178

As Reported By Senate Committee On:
Financial Institutions & Housing, February 17, 1995

Title: An act relating to securities investments.

Brief Description: Regulating securities investments.

Sponsors: Senators Fraser, Hale and Prentice.

Brief History:

Committee Activity: Financial Institutions & Housing: 1/26/95, 2/17/95 [DPS].

SENATE COMMITTEE ON FINANCIAL INSTITUTIONS & HOUSING

Majority Report: That Substitute Senate Bill No. 5178 be substituted therefor, and the substitute bill do pass.

Signed by Senators Prentice, Chair; Fraser, Vice Chair; Hale, Roach, Sellar, Smith and Sutherland.

Staff: Catherine Mele (786-7470)

Background: Under the National Association of Securities Dealers (NASD) rules of fair practice, NASD members must make reasonable efforts to obtain information concerning the customer's financial and tax status and investment objectives. This information is often contained in the new account form and other forms which describe investment objectives and positions of the customer. There are currently no requirements that this information be forwarded or signed by the customer for verification.

Securities firms may charge a fee when a customer's account fails to have a certain number of transactions within a certain time period. In addition, some firms impose a fee on customers who transfer their accounts to another firm. Current law does not provide that the customer have notice of such fees before the securities firm charges the customer.

Washington law prohibits a broker-dealer or investment advisor from churning a customer's account, from placing a customer's money in unsuitable investments. Washington law defines churning as excessive purchases or sales of securities in a customer's account in light of the financial resources and character of the account. Unsuitable investments are generally defined as those which a broker dealer or investment advisor would have reasons to believe were not suitable for the customer based on his or her knowledge of the client's tax status and investment objectives. Although these activities are unlawful, there is no private right of action for the customer. It is suggested that customers should have the ability to recover in court if a broker-dealer or investment advisor engages in these activities.

Various securities firms have provisions in their contracts which predetermine where disputes between customers and broker-dealers or investment advisors are resolved. Concern has

been expressed that the location selected under such agreements may not be the one most accessible or convenient to the customer. It has been suggested that such inconvenient or inaccessible forums may deter a customer's right to bring appropriate action.

The courts have held that broker-dealers owe a fiduciary duty to their client if the broker has discretionary authority over the customer's account, or exercises substantial influence over the customer's decision making. In addition, courts hold that investment advisors owe the same duty to their customers if they have discretionary authority or provide individualized advice for a fee. Fiduciary duty includes the duty to act with loyalty, in good faith, and with a reasonable degree of care.

Summary of Substitute Bill: The customer is forwarded, within 30 days of execution, copies of the documents which set forth the customer's investment objectives, financial position, or financial needs. All other forms that are signed by the customer must be provided to the customer within 30 days of execution or amendment.

A broker-dealer or investment advisor must notify the customer of any fee charged for closing or transferring an account or for low activity over a period of time. The notification must take place when the customer opens the account or 90 days prior to a fee charge.

The customer is given a private remedy for a civil action in court when a broker-dealer or investment advisor churns the customer's account or sells an unsuitable investment to the customer.

The fiduciary duty created by the courts for brokers-dealers and investment advisors is codified.

Contracts between broker-dealers or investment advisors and their customers may not predetermine the location where the dispute is to be resolved. The place of arbitration or judicial proceedings is determined by the arbitrator or the court.

Substitute Bill Compared to Original Bill: Broker-dealers and investment advisors must provide copies within 30 days. The survival of death section is removed. The fiduciary duty is clarified.

Appropriation: None.

Fiscal Note: Available.

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

Testimony For: Customers should obtain copies of information so that they are informed about what they purchased. This is sound public policy because it protects consumers in providing notice of fees and a private action for damages. A copy of this bill was taken to the Washington State Securities Advisory Committee for comment. The comments were then incorporated into the bill.

Testimony Against: This bill provides proposals which are unique among state regulations. This bill is duplicative of some federal laws, and inconsistent with certain proposals of the

North American Securities Administrators Association currently being formulated. The proposals would impose unique and costly requirements on an international and interstate industry.

Testified: Senator Fraser; Mark Greenberg, Securities Industry Association (con); Deborah Bortner, Department of Financial Institutions (pro).