

SENATE BILL REPORT

SB 6172

AS REPORTED BY COMMITTEE ON LABOR & COMMERCE, JANUARY 31, 1994

Brief Description: Regulating securities transactions.

SPONSORS: Senators Moore, Loveland, Quigley, Sheldon, Franklin and Fraser

SENATE COMMITTEE ON LABOR & COMMERCE

Majority Report: That Substitute Senate Bill No. 6172 be substituted therefor, and the substitute bill do pass.

Signed by Senators Moore, Chairman; Prentice, Vice Chairman; Fraser, McAuliffe, Pelz, Sutherland, Vognild and Wojahn.

Staff: Blaine Gibson (786-7375)

Hearing Dates: January 24, 1994; January 31, 1994

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. There is no requirement that this information, often contained on the new account form, be forwarded to the client for verification.

Recently many securities firms have begun charging low account activity fees when a customer's account fails to have a certain number of transactions within a certain time period. In addition, many are imposing fees on customers who transfer their accounts to another firm.

Some agreements between securities broker-dealers and clients require that disputes be resolved by arbitration. Concern has been expressed that the client has little or no say regarding the composition of these arbitration panels.

It is an unlawful activity for a broker-dealer or investment adviser to churn a client's account, or to place a client's money in unsuitable investments. Churning is generally defined 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 or investment adviser would have grounds to believe were not suitable for the client based on his or her knowledge of the client's financial and tax status and investment objectives.

The statute of limitations for a civil action for fraudulent securities practices and certain securities registration provisions is three years.

While a few courts have found that a fiduciary relationship exists between a securities broker and client, there exists no codified fiduciary duty.

SUMMARY:

Securities brokers and investment advisers must provide customers with copies of the new account form, contract signed with the customer, and many other documents describing investment objectives of the customer.

Securities brokers and investment advisers are prohibited from charging low account activity fees and transfer fees unless the customer has signed a separate document specifically authorizing the fee.

Securities clients may elect to have disputes with their brokers resolved by civil action or arbitration. The client may chose to have an arbitration panel consisting of one person selected by the customer, one by the broker dealer, and one by their mutual agreement.

A broker-dealer, salesperson, or investment adviser, or investment advisor representative who is found to have churned a client's account is liable to the customer for damages, including commissions and losses suffered, costs, and attorneys fees. The court may award up to three times damages sustained. The parties listed above who are found to have violated provisions against unsuitable investments are liable to the customer for rescision or damages, costs, and attorneys fees. Persons controlling the broker-dealer, salesperson, investment adviser or representative are liable jointly and severally if they knew or should have known of the violation, or failed to enforce compliance procedures.

The statute of limitations for civil actions for securities fraud and violations of certain securities registration provisions is extended to five years.

Broker-dealers owe a fiduciary duty to their clients if the broker has discretionary authority over the client's account, or exercises substantial control or influence over the client's decision making. Investment advisers owe a fiduciary duty to their clients if they have discretionary authority, or provide individualized investment advice for a fee. Fiduciary duty includes the duty to act with loyalty, in good faith, and with a high degree of care.

EFFECT OF PROPOSED SUBSTITUTE:

All provisions relating to the composition of arbitration panels are deleted.

Appropriation: none

Revenue: none

Fiscal Note: requested

TESTIMONY FOR:

The protections in this bill address complaints the department has received from customers of securities brokers and investment advisers.

TESTIMONY AGAINST:

Present law provides sufficient protection to customers against unfair practices. State statutes relating to arbitration panels are pre-empted by federal law. The market should be allowed to operate freely regarding fees.

TESTIFIED: Mike Stevenson, Dept. of Financial Institutions (pro); Mark Greenberg, Securities Industry Assn. (con); Kathleen Weber, Smith Barney (con)