

HOUSE BILL REPORT

SHB 1219

As Amended by the Senate

Title: An act relating to violations connected with the offer, sale, or purchase of securities.

Brief Description: Addressing violations connected with the offer, sale, or purchase of securities.

Sponsors: By House Committee on Financial Institutions & Insurance (originally sponsored by Representatives Schual-Berke, Benson, Anderson, Upthegrove, Rockefeller and Simpson; by request of Governor Locke).

Brief History:

Committee Activity:

Financial Institutions & Insurance: 1/29/03, 2/11/03 [DPS];

Appropriations: 2/26/03, 3/3/03 [DPS(FII)].

Floor Activity:

Passed House: 3/13/03, 94-0.

Senate Amended.

Passed Senate: 4/9/03, 46-0.

Brief Summary of Substitute Bill

- Creates a Securities Prosecution Fund to be administered by the Department of Financial Institutions for the purpose of assisting law enforcement authorities in the prosecution of violations of the Securities Act.
- Increases the criminal penalties and expands the statute of limitations for violations of the Securities Act.
- Increases the fines that may be administratively imposed by the Department of Financial Institutions for violations of the Securities Act.
- Authorizes the appointment of Department of Financial Institutions' employees as special prosecuting attorneys for the purpose of prosecuting violations of the Securities Act.

HOUSE COMMITTEE ON FINANCIAL INSTITUTIONS & INSURANCE

Majority Report: The substitute bill be substituted therefor and the substitute bill do pass. Signed by 11 members: Representatives Schual-Berke, Chair; Simpson, Vice Chair;

Benson, Ranking Minority Member; Newhouse, Assistant Ranking Minority Member; Cairnes, Carrell, Cooper, Hatfield, Hunter, Roach and Santos.

Staff: Thamas Osborn (786-7129).

HOUSE COMMITTEE ON APPROPRIATIONS

Majority Report: The substitute bill by Committee on Financial Institutions & Insurance be substituted therefor and the substitute bill do pass. Signed by 27 members: Representatives Sommers, Chair; Fromhold, Vice Chair; Sehlin, Ranking Minority Member; Pearson, Assistant Ranking Minority Member; Alexander, Boldt, Buck, Clements, Cody, Conway, Cox, DeBolt, Dunshee, Grant, Hunter, Kagi, Kenney, Kessler, Linville, McDonald, McIntire, Miloscia, Pflug, Ruderman, Schual-Berke, Sump and Talcott.

Staff: Amy Skei (786-7140).

Background: Background:

In the State of Washington, the securities industry is regulated by the Department of Financial Institutions (DFI) through its Division of Securities. This division, in turn, has an Enforcement Section that investigates consumer complaints and responds to case referrals from the Attorney General's Office (AGO), law enforcement agencies, and other securities regulators. In addition to providing technical assistance to law enforcement agencies, the Enforcement Section has both a legal and investigative staff who initiate administrative, civil, and criminal proceedings against violators of the Securities Act (Act).

Willful violations of the Act, including the making of false or misleading statements to the DFI, are punishable by up to 10 years in prison or a fine of up to \$5,000, or both. A five year statute of limitations applies with respect to criminal prosecutions under the Act.

Following a formal administrative action, a person who is found by the DFI to have knowingly or recklessly violated any provision of the Act may be fined up to \$5,000 for each violation.

Where the DFI finds that it is necessary in order to protect the public interest, under certain circumstances it may sanction, discipline, or restrict the activities of any of the various securities professionals subject to its authority under the Act.

Summary of Substitute Bill:

Securities Prosecution Fund: The substitute bill creates a "Securities Prosecution Fund" (Fund), the purpose of which is to provide the AGO and local prosecutors with the

resources necessary to more effectively prosecute specified criminal violations of the Act. The Fund is derived from fines levied against violators as well as money received via restitution and disgorgement orders. No appropriation is necessary insofar as the Fund is sustained by funds obtained by the DFI through enforcement actions against violators.

The Director of the DFI (Director) must authorize any expenditure from the Fund, which must be used solely for the costs incurred in investigating and prosecuting violations of the securities code, as well as administrative costs. The AGO and prosecutors must submit an application to the DFI in order to obtain access to the Fund. The application must state the purpose of the funding request and specifically identify the criminal violations that are being prosecuted. At the conclusion of the prosecution, the AGO or prosecutor must provide the DFI with an accounting and a summary of the case.

The Fund is subject to a limit of \$1 million. If the Fund reaches this limit, excess monies are deposited in DFI's general fund until such time as the Fund again falls below the \$1 million level.

Criminal offenses: Criminal violations of the Act are made a class B felony, punishable by imprisonment of up to 10 years and a \$20,000 fine.

When done with the intent to deceive or obstruct an official proceeding, the deliberate alteration, destruction, or concealment of evidence is a criminal offense punishable by up to 10 years in prison and a fine of up to \$500,000.

The prosecution of a criminal violation of the Act is subject to a statute of limitations of either five years after the violation or three years following the discovery of the violation, whichever is later.

Prosecutorial Assistance by DFI: DFI employees may assist the AGO or prosecuting attorneys in the investigation or prosecution of violations of the Act. In addition, the AGO or a prosecuting attorney may appoint a DFI employee to serve as a special prosecuting attorney for the purpose of prosecuting violations of the Act.

Administrative actions by the DFI: The maximum fine that may be imposed by the DFI via an administrative order is increased from \$5,000 to \$10,000 for each act or omission that constitutes the basis for the order.

The Director is authorized to charge licensees for the costs and fees incurred in the pursuit of an administrative action that results in an order being issued against the licensee. The Director may also issue orders requiring an accounting, restitution, and/or disgorgement as part of such administrative action.

Cease and desist orders: The Director is authorized to charge licensees for the costs and fees incurred in the pursuit of an action that results in an injunction or cease and desist

order being issued against the licensee. The Director may also issue orders requiring an accounting, restitution, and/or disgorgement as part of such action.

Imposition of fines: In general, the maximum fine that may be imposed by the DFI in an administrative action is increased from \$5,000 to \$10,000 per violation of the Act. However, the maximum fine is increased to \$25,000 per violation with respect to knowing or reckless violations of *administrative orders* issued by the Director.

Fines collected pursuant to these provisions must be deposited in the Fund.

EFFECT OF SENATE AMENDMENT(S):

The Senate amendment reduces the securities prosecution fund from one million dollars to three hundred fifty thousand dollars. The amendment also deletes the provision authorizing the Attorney General or prosecuting attorneys from appointing DFI employees as special prosecutors and/or allowing DFI employees to assist in the prosecution of criminal violations of the Securities Act.

Appropriation: None.

Fiscal Note: Available.

Effective Date: The bill takes effect 90 days after adjournment of session in which bill is passed.

Testimony For: (Financial Institutions & Insurance) (Original bill): Given the recent scandals involving improprieties in the securities industry, this bill is needed to ensure that there is adequate funding for the prosecution of securities fraud. Because of the expense and complexity of securities fraud cases, prosecutors often lack both the training and funding necessary to pursue them. As a result, many offenses go unpunished. This bill would remedy the problem by creating the funding necessary to effectively enforce the law. Another goal of the bill is to enhance the ability of regulators and law enforcement to obtain restitution for victims. It is anticipated that the bill, if passed, would generate \$200,000 for the Fund during the first year.

Testimony For: (Appropriations) This good government bill is an attempt by the state to address the lack of confidence and trust in the securities industry. It includes penalties for knowingly mutilating documents and makes violators pay for the cost of their investigations. This bill is about deterrence and prevention. It includes heavy fines for those who try to scam the public through the securities industry. The bill is designed to complement the recently passed federal Sarbanes-Oxley Act.

Testimony Against: (Financial Institutions & Insurance) None.

Testimony Against: (Appropriations) None.

Testified: (Financial Institutions & Insurance) Representative Anderson; Carol Jolly, Office of the Governor; and Deb Bortner, Department of Financial Institutions.

Testified: (Appropriations) Representative Schual-Berke, prime sponsor; and Debra Bartner, Department of Financial Institutions.