MINUTES

MONTANA SENATE
52nd LEGISLATURE - REGULAR SESSION

COMMITTEE ON BUSINESS & INDUSTRY

Call to Order: By Chairman J.D. Lynch, on January 25, 1991, at 10:00 a.m.

ROLL CALL

Members Present:

J.D. Lynch, Chairman (D)
John Jr. Kennedy, Vice Chairman (D)
Betty Bruski (D)
Eve Franklin (D)
Delwyn Gage (R)
Thomas Hager (R)
Jerry Noble (R)
Gene Thayer (R)
Bob Williams (D)

Members Excused: None

Staff Present: Bart Campbell (Legislative Council).

Please Note: These are summary minutes. Testimony and discussion are paraphrased and condensed.

Announcements/Discussion: None

HEARING ON SENATE BILL 137

Presentation and Opening Statement by Sponsor:

Senator Chet Blaylock, sponsor of the bill, stated that senate bill 137 deals with the area of securities which is monitored and enforced by the state auditor's department, the insurance department, and the securities department. One of the great problems that has arisen in Montana and all the way across the United States is that there is all kinds of people that are now calling themselves financial consultants. If they do not register; and at this time we cannot make them register, some of the people are not entirely honest and some citizens have been taken in a cruel fashion. This legislation is designed to clear

up some of those problems.

Proponents' Testimony:

Robyn Young, deputy commissioner of securities representing the state auditor's department and Montana securities department, spoke in favor of the bill (See Exhibit 1).

Tom Altmeyer, certified financial planner and the chairman of the Montana association of certified financial planners, spoke in favor of the bill. The state of Montana would be best served to follow the guidelines of the international board of standards and practices for certified financial planners, and to use that institution as a self regulatory organization to best handle issues relevant to financial planning, however in the absence of legislation to propose this. As a financial planning practitioner, he is continuously held in a position of trust and confidence from his clients. As a certified financial planner, he is donned by a code of ethical conduct that includes full disclosure in holding his clients best interest as his best interest. This bill goes a long way for others that are held in a similar position of trust and confidence will be bound to follow similar codes of conduct. He is very sensitive to the very few that do fraudulent activities which casts a shadow over all of those who practice. This bill will be an aid to eliminate these fraudulent acts.

Jim Howeth, president of the anna corporation, spoke in favor of the bill. The anna corporation is a registered investment adviser, and in the past year they have worked with Robyn Young in drafting this bill.

Allen Chronister, representing the state bar of Montana, spoke in favor of the bill (See Exhibit 2, 2A, 2B).

Opponents' Testimony:

Tom Harrison, representing the Montana society of certified accountants, spoke in opposition of the bill. Some people are advertising themselves as investment advisors and ought to be registered. Why aren't there complaints, why aren't these people pressured to register if in fact it is required by law. They are not only in violation of their own ethics, but they are in violation of the law itself. How many layers of bureaucracy and regulation do we put on the few people that remain in Montana trying to scratch a business living from a rather sterile soil. The anti-fraud application applies to everyone that would propose to be brought under this bill. In addition to the securities violation laws, superimposed over that is the ability in Montana to sue anyone if they misrepresented any of these transactions to you as a consumer. To say that this is unavailable is simply untrue. That remedy is there. Any consumer who feels they have been frauded or misrepresented either intentionally or negligently has cause of action under the present law. It would be interesting to see the list, and to see how many banks, lawyers, CPA's, etc. are on it. That would at least provide some justification for this additional layer of bureaucracy. The present law allows fraud to be brought. He is on the board of directors for valley bank, and stated that if you can get all the regulators out of your bank so that you can actually sit down and do some business, that's a red letter day. The thing that is not

needed is another group of auditors, investigators, etc. plowing through the books and costing the business community great money in order to do something that is already well done, and with no documented cases justifying it. If this bill is to be advocated, it should be put into a subcommittee some arrangement has to be made for people that do this on an incidental basis no intentions of being professionals in it, and ought not to be regulated in by another chair of bureaucracy when they are already over regulated as we stand.

Bruce MacKenzie, representing securities industries association, spoke in opposition of the bill. It is important to note that in the initial policy statement of the securities act for Montana, it states "that is shall be the policy and it shall be construed to, number two promote uniformity among the states". This bill was intended to providing an elimination of confusion. This bill will do nothing but create more confusion. Montana would be the first among any states to eliminate the definition of investment advisors. Banks, trust companies, savings institutions, attorneys, and CPA's solely incidental to their business and also registered broker/dealers. Registered broker/dealers as a regular part of their practice provide advise concerning securities. They are not subject to registration as investment advisors, it is part of their job. They are registered as broker dealers. This legislation, by eliminating the exemption from the definition for registered broker/dealer would then bring them under the regulation for an investment advisor. So they have all the regulations for broker/dealers and now they are subject to regulations for investment advisors. They are exempting the registration requirements, but they are not exempt from all of the rules and regulations. They are now subject to the entire regulatory burden placed on them by the commissioner's office. There has been no effort done by the commissioner's office to define solely incidental. Not one state has removed this exemption from definition, there is no need to impose this regulatory burden on industries and individuals who are already well regulated in this area. The sole purpose is to pick up those people who are not being registered. Section four of the bill talks in terms of civil liability provisions under the act. There is a liability 307-1 that creates liability to any person that offers or sells securities in violation of 30-10-302. That is a requirement which requires the securities to be registered. Montana is unique in which it does not require any liability or create any liabilities on a civil liabilities basis for those broker/dealers or investment advisors who fail to register. There is a regulatory burden on one hand, but no penalty on the other. There must be a purchase or sale in order to there to be liability under the securities act, this is not only for investment advisors, but also for broker/dealers. If they want to have liability for those who are not registering, they can easily do it in section one by saying if you don't register you have liability. Pure and simple, don't mess around with these other provisions that impose more liability on those who are already playing by the rules. This bill is anything but a disclosure bill, it imposes significantly new liabilities that

are not present under any other state law, nor federal law to investment advisors, banks, savings and loans, trust companies, brokers, attorneys, CPA's, engineers, who never had the responsibility before under any other law. He urges the committee to submit this bill to a subcommittee for study.

Questions From Committee Members:

Senator Williams asked how many FTD's.

Robyn Young replied none. They don't want any additional FTD's. They don't want any additional budget.

Senator Williams how many cases were brought to Robyn Young's attention of people being swindled out of funds.

Robyn Young replied that there has been about three cases in Montana. There has never been a case where it specifically included an investment advisor section, however there has been criminal cases where the person was acting as a financial planner.

Senator Williams asked if Robyn Young feels that they can prosecute under the current laws.

Robyn Young replied that they had a difficult time taking on a criminal case under the existing law.

Senator Thayer stated that in Young's testimony she said they found at about seventy unregistered dealers in the yellow pages, why weren't these people turned over to the appropriate agency to prosecute.

Young stated that the survey was done approximately a year ago, and they decided to target certain areas. One of the more common type of person that would have been unregistered were the CPA's. They took the approach to try to inform the CPA's in their monthly newsletters what their registration requirements were. First, informing them of what the law was, and asking them to comply with the law. They have had many register as a result of that kind of correspondence. They are trying to get the compliance voluntarily and then take course.

Senator Thayer asked the bulk of these people were then in fact professional CPA's. Were there any lawyers, banks, or trust companies.

Young replied that basically makes up the remainders. There were no lawyers that can be recalled, but there were insurance agents, and people that have securities licenses that were using the wrong name for investment advisory. They were doing it through their broker/dealers.

Senator Thayer commented that CPA's under the current laws would have been excluded.

Young replied no. As soon as they hold themselves out to the public as financial planners, they would be considered to be no longer solely incidental. And that is based on the interpretation of solely incidental.

Senator Thayer commented stated that in the past they have had several bills that come from the auditor's office with the idea that we want to talk to the committee. This is so called mono legislation. From the testimony that he has heard today,

this bill is from that.

Young replied that it is not entirely non uniform. The section in 30-10-307 is from uniform act language on the civil liability. Other states have decided to more actively enforce that registration requirement.

Senator Noble commented that if you were trying to find people that were non registered financial planners, and you referred to the yellow pages you could just go through and refer to names that are not on Young's list, you could send them a registered letter that they have six days to register or else. Is it harder than that.

Young replied that her testimony about the seventy people that they found in the yellow pages and the hundred and twenty registered was merely testimony to state how much confusion there is out there in the industry as to who is required to register and who is not required to register. They want to get involuntary compliance rather than spending a lot of time on hearings saying that the people are in violation of the law. Eventually they would like to enforce this, but the law is not as clear as they would like it to be.

Senator Noble commented that he thought maybe that just sounded to simple to him, and asked who did the commissioner's office contact did they talk to anybody in the industry first.

Young replied that yes they did. One of the groups that they worked very closely with over the past few months and actually helped instigate looking at this was Mr. Howeth who represents a true investment money manager, but they also worked with Dave Johnson of the Montana society of CPA's.

Senator Noble commented that Mr. Harrison said that this regulatory statute would put a unnecessary burden on those who are already over burdened. He asked how Robyn Young felt about that.

Young replied that there were two purposes of this. One of those purposes was to exactly address that dual registration burden. They have already been covered by the fraudulent practices, and they should be covered. The anti fraud does not cover all of their professional activity only those cases where they are giving advise without a security.

Senator Hager asked would this bill have anything for someone who calls from out of state.

Young replied yes. The person must be licensed in Montana so it gives more authority from out of state practitioners than in state practitioners. Attorneys who aren't licensed in Montana, couldn't call into Montana.

Senator Hager asked how about out of country.

Young replied that the same would apply to that.

Senator Hager asked if there was a penalty.

Young replied yes. The situation of international fraud is a concern that the securities industries is facing right now, because you do run into burdens trying to enforce securities laws internationally. It takes care of out of state calls, and it takes care of foreign calls as well as they can conceivably do under current international law.

Senator Gage commented that when listening to Bruce

Chronister's testimony he gathered that probably there are some things that we should do in some of these areas. He then asked if he would characterize the bill as killing a fly with a sledge hammer.

Bruce Chronister replied yes.

Senator Thayer asked how they would police the people calling in from other states solicitating.

Robyn Young replied that specifically pertaining to investment advisory activities, it would be policed by the same kind of administrative powers that they have. Generally when it is out of state they start with the cease and desist order which is an administrative action. If they continue to violate our laws, it is a criminal act and a county prosecutor or the attorney general will have to handle that case.

Senator Thayer stated that Mr. Harrison indicated under the present law, consumers have the right to sue. The new language dealing with that certain area is probably not necessary, but even lessens the language that Robyn Young is proposing.

Young replied that the section 30-10-305 gives them the power when they have a final cease and desist order to become evidence for use in a civil action in 30-10-307. Actions under 30-10-307 are generally easier to prove than acts of general fraud.

Senator Thayer commented that Tom Altmeyer testified as a proponent to this bill, but thought he had concurred that it would have been like some other type of legislation. He then asked if Altmeyer was referring to the uniform securities act.

Altmeyer replied no. The board of practices the rules and regulations that foresee a group of certified financial planners. They are a body that is a policing organization for certified financial planners. There have been some efforts by the institute for certified financial planners on a nation wide level to have this board the self regulating organization for financial planners. They haven't proposed this in the state of Montana, but possibly in a few years this could be done.

Senator Lynch commented that all of us want to get the bad guys, but none of us want to harass the good guys. He went on to ask Tom Harrison what his suggestions are to help this.

Harrison replied that all people are covered by this act in that respect. Is there a need for banks to be swept into this, the answer is obviously no. The remedy that Mr. MacKenzie suggested is the only thing that is necessary. They haven't opted any regulations that define what is met by the present law. They haven't followed up on these "baddies" that they say are out there. They are out there unregistered now, and they don't do anything about it. The answer to get the few people registered that aren't registered now is to sweep in a few thousand people that are not only not causing any problems but there is no reason for them to be subjected.

Senator Williams commented that Tom Harrison is an attorney, apparently a banker, and asked if he represents the CPA's also.

Harrison replied yes.

Senator Williams stated that Robyn Young responded to a question that she had a lot of input from the CPA's.

Harrison stated that he can just represent to him that the board of directors is meeting as they speak. He came to this meeting with one short stop at his office where he left the car running direct from that board of director's meeting with these words.

Senator Noble commented if somebody gets five, ten, or fifteen calls a week from out of state investors. He is tired of this. He went on to ask Mr. Harrison that in his opinion is this even worth studying.

Harrison replied that in a subcommittee that sure it is. Mr. MacKenzie's outline stated what ought to be done. Make it a requirement that the everybody registers. If they can't enforce that with their scarce resources, then come back and try it again.

Senator Thayer asked if it was true that the department has not yet put the rules to use in this act.

Robyn Young replied under the current act it does not say that the insurance commissioner has the authority to adopt rules. They have adopted rules of unethical practice relating to registered investment advisors and they have made their positions clear that they have adopted 1092 applying to investment advisors that hold themselves out to the public as financial planners.

Senator Gage asked if they need statement of intent where there is a rule making authority that permits this opposed to mandatory.

Bart Campbell stated that a statement of intent is necessary regardless of whether the rule making authority is in the form of "may" or "shall". The reason that this does not have a statement of intent is not on this bill, which he drafted, is that in looking at other sections of existing law he made the decision that those sections were broad enough branches of authority that the commissioner already had the authority to make rules so we weren't really extending that branch of authority.

Senator Lynch asked if possibly the opponents could put their objections specifically by section if possible, in writing.

Closing by Sponsor:

Senator Blaylock closed by saying that as he listened to the opponents to this bill and the objections that the bill was too broad, and we shouldn't give this branch of authority to the auditor's office. There were lawyers speaking, lawyers are very jealous that they want anybody entering that profession to meet all of the standards. There were CPA's testifying, they want the CPA's to go through all of the riggers. There is nothing bad about people that are calling themselves financial advisors and fooling with the life savings of our citizens of Montana to have a few regulations. If we're not going to give the auditor's office the authority to handle this, then their dealing with mush. Before the committee just hammers this bill into nothing, the auditor's office has a real story and a real reason for having this bill before the committee.

Senator Lynch asked if Robyn Young could write up something to show himself and the committee where she would like to change

the law. The present remedy, and what her new remedy is going to be. If a person has been defrauded, what he could do now as a consumer as opposed to what he could do under this bill as a consumer.

Robyn Young replied yes.

Senator Lynch asked the committee what they would like to do about this bill.

Senator Noble asked if they could see some of the changes that the testifying people want to make.

Senator Lynch replied that they would decide what to do on Tuesday, January 29, with the documented proposed changes in hand. He went on to say that if it does go to a subcommittee then all interested parties would be invited.

ADJOURNMENT

Adjournment At: 11:30 a.m.

J.D. LYNCH, Chairman

DARA ANDERSON, Secretary

JDL/dia

ROLL CALL

Business&Industry COMMITTEE

DATE 1/25/91

____ LEGISLATIVE SESSION ____

NAME	PRESENT	ABSENT	EXCUSED
Senator Bruski	X		
Senator Franklin	X		
Senator Gage	X		
Senator Hager	X		
Senator Noble	X		
Senator Thayer	X		
Senator Williams	X		
Senator Kennedy	X		
Senator Lynch	X		

Each day attach to minutes.

Amendments to Senate Bill No. 137
First Reading Copy

Requested by Senator Blaylock
For the Committee on Business and Industry

Prepared by Bart Campbell
January 23, 1991

1. Page 7, line 1.
Following: "(12)"
Strike: "(a)"

2. Page 7, line 6.
Strike: "(i)"
Insert: "(a)"
Renumber: subsequent subsections

3. Page 7, lines 13 through 15.
Strike: subsection (b) in its entirety

4. Page 11, line 6.
Following: "registered"
Insert: "as an investment adviser or as an investment adviser representative"

5. Page 11, line 10.
Following: "broker-dealers"
Insert: "and salesmen"

6. Page 11, line 11.
Following: "chapter"
Insert: ", provided that the investment advisory activities of salesmen are conducted under the supervision of a broker-dealer"

7. Page 11, line 12.
Following: "companies"
Strike: "or"

8. Page 11, line 13.
Following: "companies"
Insert: ", or the agents or employees of the entities conducting investment advisory activities under the supervision of the entities"

TESTIMONY

January 25, 1991
Senate Bill 137
Robyn J. Young
Montana Securities Department

SENATE BUSINESS & INDUSTRY
EXHIBIT NO. 1
DATE 1/25/91
BILL NO. SB 137

For the record, my name is Robyn Young. I am the Deputy Commissioner of Securities. I am here representing the State Auditor and Montana Securities Department in support of Senate Bill 137, entitled: "An Act to Revise the Provisions of the Securities Act of Montana Relating to Investment Advisers."

A decade ago, most financial service companies and professionals -- banks, brokerage houses, insurance companies, and tax accountants -- stuck to their area of expertise. Brokers sold stock, insurance agents sold insurance, and banks accepted deposits and made loans. Investment advisers were simply the firms that managed large investment portfolios for the wealthy.

Today the traditional distinctions are blurred. Today, the trend is for banks, insurance agents, and stockbrokers to market their financial service products as "financial planning." Anyone can simply hang out a shingle and call themselves a "financial planner." There is no single professional organization, such as the American Medical Association, the American Institute of Certified Public Accountants, or the American Bar Association that regulates the financial planning industry. There is no uniformity of the educational background, experience, or examination required to become a financial planner.

Financial planning is promoted as a basic service of use to middle income Montanans. While there are many honest and skilled people doing excellent work today as financial planners,

it is also apparent that the largely unregulated financial planning industry provides fertile ground for a substantial number of swindlers, con artists, and thieves. The victims of financial planning fraud are not only the wealthy, but often they are retirees, and middle-class families.

Even within the legitimate industry, planners often have numerous conflicts of interest which present a threat to the financial well-being of the consumer. Financial planning itself may be a service, but it almost always leads to the purchase of financial products. Most planners' incomes are dependent upon commissions from the sale of products, which tends to cloud their objectivity in making recommendations to their clients.

The relationship between a financial planner and a client involves a much greater degree of trust than the relationship between a salesmen and customer. Financial planners have a fiduciary obligation to their clients and should be required to disclose a variety of information including their source of compensation, conflicts of interest, educational or professional background, and prior history of disciplinary actions or criminal violations.

Financial planning is one of the leading growth industries. The Consumer Federation of America has estimated that there are over 400,000 financial planners in the United States. Under current law, anyone who advertises that they provide financial planning services is required to register as an investment adviser. However, the regulatory agencies, namely the United States Securities and Exchange Commission and state securities departments, are grossly underfunded and understaffed to enforce this registration requirement.

In Montana, we have required investment adviser firms to register for the past 10 years. We currently have approximately 120 investment advisers registered. An informal survey of the telephone yellow pages, taken by securities department personnel, disclosed over 70 advertisements for financial planners or investment consultants whom we believe should be registered and are not. Failure to register is a violation of the law. Many financial planners are confused about the registration requirements, and have no understanding of the investment adviser laws and regulations.

In other states, and on a national level, there has been a great deal of controversy over the issue of "dual registration" as it applies to financial planners. Banks, insurance companies, attorneys, and accountants all claim that they are already adequately regulated. However, current law requires accountants and attorneys to register as investment advisers if they hold themselves out to the public as financial planners.

We believe that Senate Bill 137 achieves a balance between the issues of consumer protection and the bureaucracy of dual registration. Everyone who provides investment advisory services will be covered under the fraudulent and prohibited practices sections of the Montana Securities Act. Everyone who advertises their services as financial planning in Montana will be regulated, registered, or licensed by some state agency or board. Every consumer of financial planning or investment advisory services in Montana will have access to all of the important information about their investment adviser. The banks, insurance companies, brokerage firms, and accountants will all have to play by the same rules when they offer financial planning services.

At the same time, we must be practical about the regulatory burden we are placing on legitimate businesses. Careful study

of the existing Securities Act reveals the fact that registered investment advisers are subject to our unethical practices rules, while unregistered advisers are not. This results in a disincentive to registration. Without additional staff to actively enforce our registration requirements, we have a situation where the honest and ethical registered investment adviser has a competitive disadvantage with those who simply ignore the laws.

Senate Bill 137 provides exemptions from registration as an investment adviser for certified public accountants, attorneys, banks, trust companies, insurance companies, and registered broker-dealers. This will allow the Montana Securities Department the ability to concentrate its registration enforcement efforts on financial planners who are not regulated or licensed by any other agency.

In summary, the changes to the regulation of investment advisers and financial planners that would result from the passage of Senate Bill 137 are:

1) The definition of investment adviser is amended to more clearly cover firms and individuals who advertise themselves as financial planners. The public assumes that a financial planner's services will include investment recommendations.

2) Additional exemptions from the registration requirements for investment advisers have been provided to alleviate the burden of "dual registration" for professionals and others who provide financial planning as part of their other business or professional activities.

3) The amendments to the fraudulent and prohibited practices section allow the commissioner of securities the authority to enforce rules defining unethical activities for all

investment advisers, not only those who are required to register. These rules require that investment advisers: disclose conflicts of interest; disclose their method of compensation; and make only suitable investment recommendations. The rules prohibit investment advisers from: executing unauthorized transactions in clients accounts; charging excessive fees; or misrepresenting to clients their qualifications and other material facts.

4) The civil liabilities section of the Securities Act has been amended to create a private right of action to enable victims of fraudulent investment advisers to sue the violators for damages. Our current law limits civil liability to instances involving the actual purchase of an investment, and would not enable victims to recover fees, and other losses incurred as a result of investment adviser violations. At least 20 other states currently provide this right.

With the passage of Senate Bill 137, the playing field for financial planners and investment advisers will be leveled. All financial planners or investment advisers will have the same responsibilities to put their clients interests first, and to disclose all material facts. Senate Bill 137 gives the Montana Securities Department improved laws to enforce to safeguard Montana consumers from financial planning fraud.

The Montana Securities Department urge the committee to vote "do pass" on Senate Bill 137. Thank you for your time and consideration. I would be very happy to answer any questions you may have.

SECTION BY SECTION ANALYSIS

SECTION 1. Definitions

Page 5, lines 15-22.

Amends 30-10-103(11), MCA, Definition of Investment Advisor, to more specifically include firms and individuals that hold themselves out as providers of financial planning and related services by eliminating most exclusions from the definition. The current language causes a great deal of confusion relating to which advisers and what advisory activities come under the jurisdiction of the securities department and the Securities Act. By excluding various categories of advisers from the definition of an investment adviser, it results in a false belief that these individuals are not governed by any of the antifraud sections pertaining to investment advice.

SECTION 2. Registration of Investment Advisers and Investment Adviser Representatives

Page 11 and 12.

Amends 30-10-201(3), MCA, Registration of Investment advisers, to add exemptions for individuals and firms previously excluded from the definition. Professionals who are already subject to other state licensing requirements and supervised by other regulatory agencies or boards could be investment advisers by definition, if they engage in investment advisory activities. The intent of most of the exemptions is to decrease the regulatory burden of registration for individuals and firms that are already subject to regulation by another state agency or regulatory board; as in the case of professionals that are licensed to do business in Montana, banks and insurance companies, or broker-dealers that are currently registered as such with the department.

Amendments to Section 2.

The amendments submitted to the committee today are necessary to provide an exemption for the salesmen, agents, and employees that are investment adviser representatives of entities that are exempt. We inadvertently neglected to specify that these individuals would also be exempt from registration, provided their activities were directly supervised by the exempt firm.

Page 16, lines 5-9.

Amends 30-10-201(11), MCA, to allow the commissioner to adopt rules that would require that registered investment advisers disclose information as necessary to protect advisory

clients. This requirement is similar to the Federal Securities and Exchange Commissions rule that registered investment advisers provide prospective clients with a disclosure brochure.

SECTION 3. Fraudulent and other prohibited practices

Page 21, lines 20 and 21.

Amends 30-10-301(2), to grant the commissioner the authority to adopt rules specifying dishonest or unethical practices by persons engaging in investment advisory activities. The current Administrative Rules (6.10.127 ARM) defining "unethical practices" of investment advisers apply only for purposes of denial, revocation, or suspension of the registration of a "registered" investment adviser. This creates a unfair burden upon those advisers who register because they are required to abide by these rules, while we cannot enforce compliance with the rules upon non-registered advisers and representatives. The rules on unethical practices would apply across the board to all individuals and firms that advertise their investment consulting or financial planning services to the public and/or provide investment advice or financial planning services as part of a regular business.

Page 24, lines 3-6.

Amends 30-10-301(6), MCA, to eliminate the requirement to notify the commissioner when an investment adviser has custody of client securities or funds. In the process of expanding the definition of investment adviser, it is necessary to amend 30-10-301(6) so that the commissioner must specify through rules when an investment adviser may take or have custody of securities or funds of clients. It is more practical to define which investment advisers should be prohibited from having custody through rules.

SECTION 4. Civil Liabilities--limitations on actions

Page 24, lines 24 and 25, and Page 25 lines 1-10.

Amends 30-10-307, MCA, by adding a new Subsection (2) that permits private remedies for violations of 30-10-301(2)-(6), MCA, pertaining to fraudulent or prohibited practices involving advisory activities in cases not involving the sale of a security. Since the purpose of 30-10-307 is to deter a wrongdoer, the amendment creates a private right of action to enable consumers to sue for damages when they sustain losses due to violations involving investment advice.

HEAN CHRONICLER
1/25/91

SENATE BUSINESS & INDUSTRY
EXHIBIT NO. 2
DATE 1/25/91
BILL NO. SB 137

Testimony on SB 137 on behalf of the State Bar of Montana
Senate Business and Industry Committee

The State Bar of Montana opposes SB 137 only to the extent that it would repeal the current language in Section 30-10-103 which exempts from regulation as an "investment adviser" a lawyer providing investment advice "solely incidental to the practice of his profession." See page 5 of the bill. The bill specifically repeals that exemption, but then provides that lawyers are exempt from registration as investment advisers. (§2, page 11 of the bill.)

If the current law had never exempted lawyers we would probably have no position on SB 137. However, the State Bar is concerned with the repeal of an established exemption from regulation. Courts commonly hold that the Legislature is presumed to intend to make a change when it amends a statute, and this change could easily be construed to indicate a Legislative intent that lawyers who provide investment advice only incidental to their practice are in fact "investment advisers" for purposes of regulation, but not registration, under the act. The act contains broad broad regulatory powers (see §2, page 16; §3, page 21) which would presumably lead to regulations applicable to the activities of lawyers who provide investment advice as an incidental part of their practice.

Many lawyers from time to time find themselves giving advice to clients about sums of money. For example, lawyers who regularly represent plaintiffs in personal injury cases may find their clients asking for advice on what to do with settlements or judgments. Should the money be taken in a lump sum or in periodic payments, and then should it be put in the bank or a CD? Should they buy stock with it? These lawyers are trial lawyers representing injured people, they are not investment advisers. Any investment advice they may give is wholly incidental to their primary and overriding profession. Lawyers routinely representing commercial and business clients may find themselves in similar situations.

Nevertheless, if the lawyer responds and tries to give his client advice, these situations could be construed as giving advice on securities or as providing financial planning services or advice. If so, then the lawyer is an "investment

adviser" under the act. (See §1, page 5 of the bill.) If this should be true, we suggest that a great deal of confusion and uncertainty will arise between the Auditor and attorneys over who is covered by the regs and who is not. The present situation, which we understand has presented no known problems with attorneys acting primarily as "financial advisers," is much more easily understood and applied and is preferred.

Further, to the extent that there is a perceived need to provide consumer protection, that goal is adequately covered by existing provisions governing attorneys. Attorneys are subjected to detailed and rigorous rules of professional conduct, a substantial number of which are designed to protect the lawyer's clients. Additional, the Bar has a Client Security Fund which is available to reimburse clients harmed by dishonest conduct, rules on arbitration of fee disputes, and an active commission on practice which investigates and acts upon complaints about attorneys. The public is therefore already adequately protected with regard to anything lawyers may do.

Lastly, regulation of lawyers' activities by the Auditor under this act may conflict with the exclusive jurisdiction of the Montana Supreme Court to regulate the practice of law. The Court has closely guarded this power over the years and is likely to continue doing so.

Therefore the State Bar proposes that the current bill be amended as follows:

AMEND on page 6, line 25, by inserting the following: "(iii) a lawyer whose performance of these services is solely incidental to the practice of his profession."

AMEND on page 11, line14, by deleting "lawyers,".

Client Security Fund Rules

RULE 1 - DEFINITIONS

For the purpose of these Rules, the following definitions apply:

A. The "Board" means the Client Security Board of the State Bar of Montana;

B. The "Fund" means the Client Security Fund of the State Bar of Montana;

C. A "lawyer" means one who, at the time of the act complained of, was an active member of the State Bar of Montana;

D. A "claim" is a written application to the Board for the reimbursement of a loss sustained as a result of the dishonest conduct of a lawyer;

E. The "claimant" is the person filing the claim.

RULE 2 - FUNDS

The Board of Trustees of the State Bar of Montana shall, after consultation with the Board, provide funding necessary for the proper payment of claims and establish a budget for the payment of the costs of administration. All monies or other assets allocated to the fund shall be held in a separate account in the name of the fund. All expenses of the Board shall be paid from the client security fund accounts.

RULE 3 - BOARD

The Board shall consist of nine (9) lawyers who are active members of the State Bar of Montana, appointed pursuant to State Bar By-Laws. The Chairperson shall serve for one (1) year, or until a successor is elected or his or her term expires.

RULE 4 - MEETINGS OF THE BOARD

A. The Board shall meet from time to time upon the call of the Chairperson or the Chairperson shall call a meeting upon the written request of at least two (2) members of the Board. A meeting may be held by long distance telephone conference call.

B. Except for a meeting by conference call, the Chairperson shall give the members not less than fifteen (15) days' notice of the time and place of each meeting. Notice of any meeting may be waived by a member either before or after the meeting.

C. A quorum of any meeting of the Board shall be five (5) members.

D. When a hearing on a claim is scheduled, a panel consisting of not less than three (3) members shall hear the evidence as hearing examiners and if a quorum is not present, shall report to the next meeting of the Board.

E. Written minutes of each meeting shall be prepared and properly maintained.

RULE 5 - DUTIES AND RESPONSIBILITIES OF THE BOARD

The Board shall have the following duties and responsibilities:

A. To receive, evaluate, determine and pay claims;

B. To promulgate rules of procedure not inconsistent with these Rules;

C. To recommend to the Secretary-Treasurer and the Board of Trustees of the State Bar of Montana the amounts and terms of sums which may be needed to currently pay reimbursable claims;

D. To purchase insurance to cover extraordinary claims in excess of the assets of the Fund, provided that the purchase of such insurance is approved by the Board of Trustees of the State Bar of Montana.

E. To provide a report to the Board of Trustees of the State Bar of Montana at the Annual Meeting of the State Bar of Montana and to make other reports and publicize its activities as the Board may deem advisable or as directed by the Board of Trustees of the State Bar of Montana;

F. To employ and compensate from the Fund's account, investigators, consultants, accountants, legal counsel, and other persons as necessary; and

G. To prosecute claims for restitution to which the Fund is entitled.

RULE 6 - APPLICATIONS FOR REIMBURSEMENT

The Board shall prepare and adopt a form of application for reimbursement upon which all claims shall be made. The application may be obtained without charge from the office of the State Bar of Montana, P.O. Box 577, Helena, Montana 59624 (406)442-7660. The application shall contain the statement that, by establishing the Client Security Fund, the State Bar of Montana does not acknowledge any legal responsibility for the acts of individual lawyers in connection with the claims made.

RULE 7 - PROCESSING APPLICATIONS

A. If the Chairperson of the Board determines that the conduct of an attorney, as alleged in an application for relief, would constitute dishonest conduct in accordance with Rule 9 of these rules, the Chairperson shall send a copy of each application to each member of the Board and to the Chairman of the Commission on Practice. A copy shall be sent by certified mail, return receipt requested, to the lawyer, at his last known address. The Chairperson may cause an investigation of the claim to be made by a member of the Board, any other active member of the State Bar of Montana, or retained investigator who shall be reimbursed for actual and necessary expenses.

B. A report with respect to a claim shall be submitted to the Chairperson of the Board by the person to whom it has been referred for investigation, as soon as practicable. The Chairperson shall, after reviewing the report, send a copy of the full report or a summary thereof to each member of the Board.

C. The Board shall review each claim to determine whether the claim is a reimbursable loss and to determine the extent, if any, to which the claim shall be reimbursed. In all cases, the alleged defalcating attorney or his personal representatives shall be given an opportunity to be heard by the Board if he or she so requests, or if the Board deems a hearing necessary.

D. The Board, in its sole discretion, shall determine the amount of loss, if any, for which a claimant shall be reimbursed from the Fund. In making such determination, the Board shall consider:

(1) The negligence, if any of the client which contributed to the loss;

(2) The comparative hardship of the client suffered by the loss;

(3) The total amount of reimbursable losses of the clients of one lawyer or association of lawyers;

(4) The assets of the Fund available for reimbursement;

(5) The total amount of reimbursable losses in previous years for which reimbursement has not been made due to lack of assets;

(6) No reimbursement shall be made to any client unless the reimbursement is approved by a majority vote of the members of the Board at a meeting where at least a quorum of the members is present.

RULE 8 - ASSIGNMENT FOR REIMBURSEMENT

In the event reimbursement is made to a client, the Board shall require an assignment in the same amount and may bring such action as is deemed advisable against the lawyer or his or her estate. Such action shall be brought in the name of the State Bar of Montana.

RULE 9 - FINDING OF DISHONEST CONDUCT

The Board shall require proof by a preponderance of credible evidence that the claimant's loss was a result of the lawyer's dishonest conduct. "Dishonest conduct" means a willful act committed by a lawyer against a client in the manner of defalcation or embezzlement of money or the wrongful taking or conversion of money, property, or other things of value resulting in a loss to the client, provided:

(1) That as a result of such dishonest conduct, the lawyer shall have been disbarred or indefinitely suspended from the practice of law or shall have voluntarily been permitted to surrender his or her Certificate of Admission to practice law; or

(2) That the lawyer shall have died or shall have been adjudged mentally incompetent; or

(3) That the lawyer shall have been found guilty of a crime arising out of the claimed dishonest conduct which caused the loss; or

(4) That a judgment or decree was entered against the lawyer in any proceeding arising out of the claimed dishonest conduct which caused the loss, and, if a judgment for money was entered against the lawyer in favor of the claimant, that the lawyer has failed to pay the judgment and execution issued on the judgment has been returned uncollected.

RULE 10 - CLAIMS

A. The claim shall be filed no later than two (2) years after the claiment knew, or should have known, of the dishonest conduct of the lawyer.

B. The loss shall have arisen out of and during the course of a lawyer-client relationship between the lawyer and the claimant, or a fiduciary relationship between the lawyer and the claimant in which the Board finds that the claimant reasonably believed that the lawyer was acting in his capacity as a lawyer. In determining the relationship between the lawyer and the claimant, the Board shall consider the following factors:

(1) The disparity in bargaining power between the lawyer and the claimant;

(2) The extent to which the lawyer's status overcame the normal prudence of the claimant;

(3) The extent to which the lawyer received information about the financial affairs of the claimant; and

(4) Whether the principal part of the transaction was an activity which required a license to practice law.

C. The following losses shall not be reimbursable:

(1) The loss of a spouse, child, parent, grandparent, sibling, partner, associate, or employee of the lawyer causing the loss;

(2) A loss covered by a bond, surety agreement, or insurance contract to the extent covered thereby, including any loss to which any bonding agent, surety, or insurer is subrogated, to the extent of that subrogated interest;

(3) The loss of any financial institution which is recoverable from a "banker's blanket bond" or similar commonly available insurance or surety contract.

RULE 11 - RECONSIDERATION

The claimant may request reconsideration within thirty (30) days of the denial or determination of the amount of a claim. If the claimant fails to make a request or the request is denied, the Board shall make its recommendation to the Board of Trustees of the State Bar of Montana and the decision of the Board of Trustees shall be final.

RULE 12 - RIGHTS TO PAYMENT FROM FUND

No person shall have any right to payment from the Fund as a claimant, third party beneficiary, or otherwise. All reimbursements of losses from the Client Security Fund shall be a matter of grace in the sole discretion of the Board.

RULE 13 - CONFLICT OF INTEREST

A member of the Board who has had a lawyer-client relationship or financial relationship with a claimant or lawyer who is the subject of a claim shall not participate in the investigation or adjudiciation of a claim involving that claimant or lawyer.

RULE 14 - IMMUNITY

The members of the Board and staff persons assisting those members are absolutely immune from civil liability for all acts in the course of their official duties.

RULE 15 - CONFIDENTIALITY

A. Applications, proceedings and reports involving applications for reimbursement are confidential until reimbursement to the claimant is approved by the Board of Trustees of the State Bar of Montana, except as provided below.

B. If the lawyer whose alleged conduct gave rise to the claim requests that the matter be made public, the requirement of confidentiality is waived.

C. Section A shall not be construed to deny access to relevant information by professional discipline agencies or law enforcement authorities as the Board shall authorize, or the release of statistical information which does not disclose the identity of the lawyer or the parties.

D. Both the claimant and the lawyer shall be advised of the status of the Board's consideration of the claim and shall be informed of the final determination.

RULE 16 - COMPENSATION FOR REPRESENTING CLAIMANTS

Except as approved by the Board for good cause, no lawyer shall charge for or accept compensation for prosecuting a claim on behalf of a claimant.

RULE 17 - AMENDMENT

These Rules may be amended at any time by a majority vote of the Board at a duly held meeting, subject to reversal by the Board of Trustees of the State Bar of Montana, said amendments will be effective immediately following the next regular or special meeting of the Board.

Rules on Voluntary Arbitration of Fee Disputes

PURPOSE

(1) The purpose of these Rules is to provide for the voluntary arbitration of fee disputes between attorneys maintaining offices in Montana, and their clients.

ARBITRATION PANELS

(2) The Executive Director, with the advice and recommendation of the President(s) of the local Bar Association of the respective Judicial districts, will appoint not less than twelve (12) nor more than twenty (20) members of the Legal Fee Arbitration Panel in each judicial district, composed of equal numbers of lawyers and laypersons who reside in said district. The initial term of appointment shall be three (3) years, and such term shall automatically renew for a successive term or terms, unless or until the panel member declines reappointment or a request is made by the local Bar President (or any thereof) for replacement of the panel member.

The term of any member which ends for any reason while an arbitration is pending before the Arbitration Board of which he or she is a member shall be extended until such arbitration is concluded, but such extension shall not interfere with the Executive Director's power to appoint a successor to the panel.

The members of the Legal Fee Arbitration Panel shall be appointed from as broad a spectrum of the practicing Bar and general public, respectively, as possible.

INITIATION OF PROCEEDINGS

3.1 Proceedings for fee arbitration shall be initiated by a written Petition in the form attached hereto. The Petition must be signed by one of the parties to the dispute and filed with the Office of the Executive Director of the State Bar of Montana. When filing the Petition, the petitioners shall also sign and file two copies of a Submission To Arbitration Agreement, in the form attached hereto. In said Submission To Arbitration Agreement the petitioner shall indicate whether he/she elects to have the Submission entered as an order of the District Court in the manner set out in 8.1 et.seq.

Specifically excluded from the fee arbitration process, and the operation of these Rules, are disputes:

(1) concerning fees which by statute are to be determined by a Court or administrative agency;

(2) which are the subject of pending litigation; or

(3) which assert, in whole or in part, alleged legal malpractice, professional negligence, breach of fiduciary relationship or any other non-fee dispute matters.

Nothing herein is intended to interfere with or supersede the powers and authority of the Commission on Practice, the Professional Conduct and Ethics Committee, or with the applicable statutes of limitation. The Executive Director or the Board of Arbitrators may at any time refer to the Commission on Practice those issues which involve questions of professional responsibility.

3.2 Upon receipt of the Petition and Submission to Arbitration Agreement signed by petitioner the Executive Director of the State Bar of Montana shall promptly forward by certified mail, return receipt requested, a copy of the Petition and a signed copy of the Submission to Arbitration Agreement to the other party named in the Petition. If the other party desires to submit the dispute to arbitration, he/she shall sign the signed copy of the Submission To Arbitration Agreement, indicate either concurrence or disagreement with the petitioners election, if any, that the Submission be entered as an order of the District Court in the manner set out in 8.1 et.seq. and return it to the office of the Executive Director of the State Bar of Montana within twenty (20) days after receipt. Failure to sign and return the Submission To Arbitration Agreement within the specified time shall be deemed a rejection of arbitration.

3.3 These fee arbitration proceedings are voluntary and shall not be operative until and unless both the attorney and the client execute and file the Submission To Arbitration Agreement, in accordance with these rules; however, following the joint execution and filing of the Submission To Arbitration Agreement as aforesaid, neither party may withdraw without consent of the other party.

AMOUNTS IN DISPUTE

4.1 Any amount in controversy in excess of $250.00 may be arbitrated. Disputed amounts less than $1,500.00 shall be arbitrated by an Arbitration Board consisting of one panel member. Disputed amounts of $1,500.00 or more shall be arbitrated by an Arbitration Board of three panel members.

4.2 If five arbitrators cannot be appointed in a case from the Arbitration Panel of the Judicial District in which a dispute involving less than $1,500.00 is pending, or if seven arbitrators cannot be appointed in a case from an Arbitration Panel of the Judicial District in which the dispute involves $1,500.00 or more, then additional arbitrators shall be appointed under the procedures set out in 5.5.

SELECTION OF ARBITRATORS AND RECORDS

5.1 The Executive Director shall mail or deliver to each party to the dispute, copies of the Petition and Submission To Arbitration Agreement, together with a numbered list of names, addresses and occupations of seven members of the Arbitration Board selected to hear the dispute, in the case of a three member board, and five names in the case of a one member board. The names making up said list shall be determined by the Executive Director in the following manner: When appointed, each of the panel members shall be assigned a consecutive number, with the lawyer and lay members having alternate numbers. The initial list of board members shall consist of those panel members having the lowest numbers, commencing with the number one. Succeeding lists shall be selected, commencing with the next higher number, and continuing in rotation. The arbitration panel having jurisdiction over a dispute shall be the panel appointed for the Judicial District in which the attorney to the dispute maintains his or her law office, unless the parties agree that the matter should be referred to a panel in another judicial district.

5.2 A panel member selected for service on the Arbitration Board to hear the dispute will be disqualified by the Executive Director on his own initiative, or at the written request of any party, upon showing of any of the grounds for challenge applicable to a trial juror, as set forth in Section 25-7-223 M.C.A. If a panel member is so disqualified, the Executive Director shall immediately advise the parties of the name of another panel member to replace the disqualified member.

5.3 Each party shall within ten (10) days of receipt of said list notify the Executive Director of the names of one lawyer and one layman to be eliminated from the list. The Arbitration Board shall consist of the remaining one member, or three members, whichever is required, having the lowest assigned number(s). Notice of the name(s) of the Board members thus selected shall be given by the Executive Director to the parties and to the arbitrators selected.

5.4 A one arbitrator board may be either a layperson or a lawyer. A three arbitrator board shall consist of at least one lawyer and one layperson. The board shall elect its own chairperson.

5.5 When there are an insufficient number of qualified and available arbitrators in any judicial district, arbitrators can be appointed by the Executive Director from the arbitration panel of an adjacent judicial district.

5.6 The Office of the Executive Director of the State Bar of Montana will accept and file the Petition and Submission To Arbitration Agreement signed by both parties, notice of challenges to the panel, the final award and all other instruments and/records received and prepared in the matter.

ARBITRATION HEARING

6.1 The arbitrator(s) appointed shall determine a convenient time and place for the arbitration hearing to be held, and cause written notice thereof to be mailed to the parties not less than then (10) days before the hearing. Appearance at the hearing waives the right to notice.

6.2 The hearing may be postponed or continued from time to time by the presiding arbitrator upon his or her own motion or upon request of a party for good cause shown.

6.3 The chairperson or the sole arbitrator shall preside at the hearing. He or she shall be the judge of the admissibility of the evidence offered and shall rule on questions of procedure. He or she shall exercise all powers relating to the conduct of the hearing, and conformity to legal rules of evidence shall not be necessary.

6.4 The parties to the arbitration are entitled to be heard, to present evidence and to cross-examine witnesses appearing at the hearing. Any party to an arbitration has the right to be represented at his or her own expense by an attorney-at-law at the hearing and at all other stages of the arbitration.

6.5 The testimony of witnesses shall be given under oath or affirmation. The presiding arbitrator shall administer oaths to witnesses testifying at the hearing.

6.6 Upon request of one party, and with the consent of both parties, the arbitrator(s) shall decide the dispute upon verified written statements of position and supporting documents submitted by each party, without personal attendance at the arbitration hearing.

6.7 If any party to an arbitration who has been duly notified, fails to appear at the hearing, the presiding arbitrator may either postpone the hearing or proceed with the hearing and determine the controversy upon the evidence produced, notwithstanding such failure to appear.

6.8 Either party or the Executive Director may have the entire proceeding recorded by a reporter or by mechanical means, at his or her expense. In such event, the other party to the arbitration or the Executive Director shall be entitled to a copy of the reporter's transcript or recording at such party's own expense.

6.9 A hearing on any dispute shall be held within ninety (90) days after receipt by the State Bar of Montana of the Submission To Arbitration Agreement signed by both parties, subject to postponement or continuance as provided in 6.2.

ARBITRATION DECISION

7.1 The written award of the arbitrator(s) shall be rendered within fifteen (15) days after the matter has been submitted for decision.

7.2 The arbitration award shall be made and signed by a majority of the arbitrators where heard by three members, or by the sole arbitrator. It shall state the amount of the award, if any, and the terms of payment, if applicable. The award may also contain a statement of the reasons for the award.

7.3 The award shall be forwarded to the Executive Director of the State Bar of Montana, who shall mail a copy of the award to each party to the arbitration.

7.4 Except when otherwise ordered by the Court in the case of Submission entered as an order of court (8.1 et.seq.), if a majority of the arbitrators cannot agree upon an award, the matter shall be resubmitted, to a new arbitration board within thirty (30) days of the failure of the majority of the arbitrators to agree.

7.5 In a case where the Submission has not been entered as a court order pursuant to 8.1 et.seq., the arbitration award shall nevertheless be final and binding upon all of the parties thereto; and by submitting to such arbitration the parties thereby agree that the award shall be admissible in evidence as conclusive proof of the matters therein determined, subject only to the Court's right to vacate, modify or correct the award, and to the right of appeal, as provided by Sections 27-5-301, 27-5-302 and 27-5-304 M.C.A.

SUBMISSION ENTERED AS ORDER OF COURT

8.1 If all parties to the dispute agree in the Submission To Arbitration Agreement, the fee arbitration dispute may be entered and filed as an order of the District Court, in accordance with the provisions of Parts1,2 and 3, Chapter 5, Title 27, M.C.A. In such case, the submissions cannot be revoked without consent of both parties, the arbitrators may be compelled by the Court to make an award, and the award may be enforced by the Court in the same manner as a judgment.

8.2 Upon receipt of a fully executed Submission To Arbitration Agreement, wherein the parties have agreed that it be entered as an order of Court, the Executive Director of the State Bar of Montana shall in addition to the other required mailings, notifications and action, cause a signed copy of such Submission to be filed with the Clerk of the District Court of the County where the petitioner resides, or in such other county as the parties may in such Submission mutually designate. At the time of such filing the Executive Director shall notify said clerk of court that the parties have stipulated the Submission be filed as an order of court pursuant to the foregoing statutory authority. The Executive Director shall obtain proof of such filing and furnish copies thereof to the parties.

8.3 Upon receipt of the written Award of the arbitrators, either party may cause a signed copy of the Award to be filed with the office of the clerk of court wherein the Submission was filed. After the expiration of five days from the filing of the Award, such party may file an affidavit showing that notice of filing the Award has been served on the other party at least four days prior to such application and that no order staying the entry of judgment has been served. The clerk shall then enter the Award in the Judgment Book and thereupon it has the effect of a judgment.

8.4 The other provisions of these Rules shall apply to a Submission entered as an order of court, except as modified by or in conflict with 8.1 through 8.3 and Parts 1, 2 and 3 of Chapter 5, Title 27, M.C.A.

Supreme Court of the State of Montana
Rules for Lawyer Disciplinary Enforcement

Table of Contents