SB 262

Department of Legislative Services
Maryland General Assembly
2003 Session

FISCAL AND POLICY NOTE
Revised

Senate Bill 262 (Senators Garagiola and Giannetti)
Judicial Proceedings Judiciary

Estates and Trusts - Lawful Investments - Corporate Fiduciary

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This bill authorizes a corporate fiduciary to invest in the securities of, or interests in, a no-load closed-end management type investment company or investment trust registered under the federal Investment Company Act of 1940.

The bill is effective June 1, 2003.

Fiscal Summary

State Effect: The bill would not directly affect governmental operations or finances.

Local Effect: None.

Small Business Effect: Minimal.

Analysis

Current Law: A corporate fiduciary may invest fiduciary funds and other funds over which it has investment discretion in the securities of, or other interests in, a no-load open-end management type investment company or investment trust registered under the provisions of the federal Investment Company Act of 1940 that does not impose a contingent deferred sales charge or distribution charge on that investment or reinvestment.

Under Maryland's standard of care for fiduciaries, a fiduciary must: (1) invest and manage fiduciary assets as a "prudent investor" would, considering the purposes, terms,

distribution requirements, and other circumstances of the governing instrument and the nature of the fiduciary appointment; (2) exercise reasonable care, skill, and caution regarding the anticipated effect on the fiduciary assets as a whole under the facts and circumstances prevailing at the time of any action by the fiduciary; (3) invest and manage not in isolation but in the context of the fiduciary assets as a whole and as part of an overall investment strategy that incorporates risk and return objectives reasonably suitable under the terms of the governing instrument and the nature of the fiduciary appointment; (4) diversify investments unless, under the circumstances, the fiduciary reasonably believes it is in the best interests of the beneficiaries or furthers the purposes for which the fiduciary was appointed not to diversify; (5) review fiduciary assets within a reasonable time after acceptance of the fiduciary appointment and make and implement decisions concerning the retention or disposition of investments existing prior to the appointment in order to conform with this section; (6) pursue an investment strategy that considers both the reasonable production of income and safety of capital, consistent with the fiduciary's duty of loyalty and impartiality and the purposes for which the fiduciary was appointed; (7) act with prudence in deciding whether and how to delegate authority and in the selection and supervision of agents; and (8) incur only costs that are reasonable in amount and appropriate to the investment responsibilities of the fiduciary appointment.

Background: Generally, an "investment company" is a business entity that issues securities and is primarily engaged in the business of investing in securities. An investment company invests the money it receives from investors on a collective basis, and each investor shares in the profits and losses in proportion to the investor's interest in the investment company. The performance of the investment company will be based on (but it won't be identical to) the performance of the securities and other assets that the investment company owns. Investment companies fall into three basic categories: open-end companies, closed-end companies, and unit investment trusts. The features of open- and closed-end investment companies are discussed below.

Open-end Investment Company

An open-end investment company, commonly called a mutual fund, owns the securities of several corporations and receives dividends on the shares that it holds. Investors purchase mutual fund shares from the fund itself (or through a broker for the fund), but are not able to purchase the shares from other investors on a secondary market, such as the New York Stock Exchange or Nasdaq Stock Market.

The price investors pay for mutual fund shares is the fund's per share net asset value (NAV) plus any shareholder fees that the fund imposes at purchase (such as sales loads). Mutual fund shares are "redeemable." Thus, when mutual fund investors want to sell their fund shares, they sell them back to the fund (or to a broker acting for the fund) at

their approximate NAV, minus any fees the fund imposes at that time (such as deferred sales loads or redemption fees). Mutual funds generally sell their shares on a continuous basis, although some funds will stop selling when, for example, they become too large. The investment portfolios of mutual funds typically are managed by separate entities known as "investment advisers" that are registered with the federal Securities and Exchange Commission (SEC). All funds charge management fees for operating the fund. Some also charge for their distribution and service costs.

Closed-end Investment Company

Like mutual funds, the investment portfolios of closed-end investment companies generally are managed by separate entities known as "investment advisers" that are registered with the SEC. However, by contrast, closed-end investment companies, commonly called closed-end funds, generally do not continuously offer their shares for sale. Rather, they sell a fixed number of shares at one time (in the initial public offering), after which the shares typically trade on a secondary market, such as the New York Stock Exchange or the Nasdaq Stock Market, unlike a mutual fund.

The price of closed-end fund shares that trade on a secondary market after their initial public offering is determined by the market and may be greater or less than the shares' NAV. It is, therefore, easier to see the effects of supply and demand on the determination of the value of a closed-end fund.

Closed-end funds are permitted to invest in a greater amount of "illiquid" securities than mutual funds. An "illiquid" security generally is considered to be a security that may not be sold within seven days at the approximate price used by the fund in determining NAV. Therefore, funds that seek to invest in markets where the securities tend to be more illiquid are typically organized as closed-end funds.

Closed-end funds come in many varieties. They can have different investment objectives, strategies, and investment portfolios. They also can be subject to different risks, volatility, and fees and expenses.

Additional Information

Prior Introductions: None.

Cross File: None, but HB 207 is substantially similar.

Information Source(s): Register of Wills, Department of Assessments and Taxation, Department of Legislative Services

Fiscal Note History: First Reader - February 5, 2003
ncs/cer Revised - Enrolled Bill - April 10, 2003

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