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 Maryland General Assembly
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FISCAL AND POLICY NOTE
Third Reader - Revised

House Bill 1149
 Economic Matters

(Delegate Kramer)

Judicial Proceedings

Maryland Securities Act - Vulnerable Adults

This bill makes changes to the Maryland Securities Act (MSA). The bill expands MSA to regulate federal exempt broker-dealers under specified circumstances and prohibits specified business practices under MSA. The bill also imposes mandatory reporting requirements for certain individuals who suspect a vulnerable adult is the subject of financial exploitation. The bill authorizes specified broker-dealers or investment advisors to impose a delay on disbursements from an account of an eligible adult if financial exploitation is suspected, and it provides qualified immunity for those individuals under specified circumstances. The bill also establishes the Securities Registration Fund to administer and enforce MSA. In addition, the bill makes other technical, clarifying, and stylistic changes.

Fiscal Summary

State Effect: Net general fund revenues increase by approximately \$36,800 in FY 2018 and \$49,000 annually thereafter due to changes in the imposition of fees. General fund expenditures increase by \$185,700 for the Department of Human Resources (DHR) to hire additional staff to investigate additional reports of abuse generated under the bill. Special fund revenues increase by approximately \$2.25 million in FY 2018 and \$3.0 million annually thereafter due to the increased agent registration fee. Special fund expenditures increase by \$521,900 in FY 2018 for the Securities Division of the Office of the Attorney (OAG) to hire additional staff to enforce the bill’s requirements and prohibitions.

(in dollars)	FY 2018	FY 2019	FY 2020	FY 2021	FY 2022
GF Revenue	\$36,800	\$49,000	\$49,000	\$49,000	\$49,000
SF Revenue	\$2,250,000	\$3,000,000	\$3,000,000	\$3,000,000	\$3,000,000
GF Expenditure	\$185,700	\$233,500	\$243,900	\$254,800	\$266,300
SF Expenditure	\$521,900	\$589,500	\$608,300	\$628,100	\$649,000
Net Effect	\$1,579,200	\$2,225,900	\$2,196,800	\$2,166,100	\$2,133,700

Note: () = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate increase; (-) = indeterminate decrease

Local Effect: The bill’s mandatory reporting requirement may increase reports of abuse of vulnerable adults to local agencies, requiring additional investigations. However, a specific estimate of any such increase is not available at this time. Revenues are not affected.

Small Business Effect: Potential meaningful.

Analysis

Bill Summary/Current Law:

Defined Terms

“Eligible adult” means an individual who lives in the State and is at least 65 years old, or is a “vulnerable adult” as defined in § 14-101 of the Family Law Article, where the term applies to an adult who lacks the physical or mental capacity to provide for the adult’s daily needs.

“Federal exempt broker-dealer” means a person who qualifies for the exemption from registration as a broker or dealer under Section 4(c) of the federal Securities Act of 1933. Generally, a broker-dealer means a person engaged in the business of effecting transactions in securities for others or for him or herself.

“Financial exploitation” means the wrongful or unauthorized taking, withholding, appropriation, or use of money, assets, or property of an eligible adult, or an act or omission by a person, including through the use of a power of attorney, guardianship, or conservatorship of an eligible adult, to (1) obtain control, through deception, intimidation, or undue influence, over the eligible adult’s money, assets, or property in order to deprive the eligible adult of the ownership, use, benefit, or possession of the money, assets, or property or (2) convert money, assets, or property of the eligible adult in order to deprive the eligible adult of the ownership, use, benefit, or possession of the money, assets, or property.

“Law enforcement agency” means a State, county, or municipal police department, bureau, or agency.

“Local department” means the local department of social services that has jurisdiction in the county where the vulnerable adult lives or where abuse is alleged to have taken place.

“Private fund adviser” means an investment adviser that provides advice solely to one or more qualifying private funds, as defined by the Securities and Exchange Commission.

“Qualified individual” means an agent, an investment adviser representative, or a person who serves in a supervisory, compliance, or legal capacity for a broker-dealer or an investment adviser.

Registration Requirement

Federal Exempt Broker-dealer: The bill exempts a federal exempt broker-dealer from the general requirement that broker-dealers register with the State before transacting business. The bill also exempts a federal exempt broker-dealer from the general prohibition against a broker-dealer or issuer employing or associating with an agent unless the agent is registered.

The bill exempts a federal exempt broker-dealer from the general requirement that, when an agent terminates a connection with a broker-dealer or issuer, or terminates those activities which make the individual an agent, the agent and the broker-dealer or issuer must promptly notify the Securities Commissioner of the Division of Securities.

However, the bill establishes that any broker-dealer or issuer engaged in offering, offering to purchase, purchasing, or selling securities in the State or an investment adviser offering or providing investment advice in Maryland, whether directly or indirectly, may not employ or associate with an individual who is participating in the securities transaction or investment advice if (1) the individual’s registration is suspended or revoked or (2) the individual is barred from employment or association with a broker-dealer, an issuer, an investment adviser, or a federal covered adviser by an order of the Securities Commissioner, the Securities and Exchange Commission, or a self-regulatory organization. However, it is not a violation if the individual did not know, or could not have known, of the suspension, revocation, or bar. Additionally, on request from a broker-dealer, an investment adviser, or an issuer, and for good cause, the commissioner may modify or waive the prohibitions.

Private Fund Adviser: The bill newly requires a private fund adviser, who is not a federal covered adviser, to pay a \$300 fee, on initial application and renewal, and file specified documents before acting as a private fund adviser.

Denial, Revocation, or Suspension of Registration

The bill expands the authority of the Securities Commissioner to deny, suspend, or revoke any registration if the commissioner finds that a registrant (or the broker-dealer or investment adviser, including any person directly or indirectly controlling the broker-dealer or investment adviser):

- is subject to a request from the Child Support Enforcement Administration to suspend or revoke a registration based on failure to pay support obligations;
- refuses to allow the Securities Commissioner to conduct an audit or inspection; or
- is the subject of a cease and desist order issued by the Securities and Exchange Commission or issued under the securities, commodities, investment, franchise, banking, finance, or insurance laws of a state.

The bill specifies that the Securities Commissioner may perform an audit or inspection at any time and without prior notice. The bill also extends, from 90 days to one year after the effective date of an initial registration, the time during which the Securities Commissioner may institute a suspension or revocation proceeding based on specified information.

Misrepresentations

The bill specifies that a person must have *willfully*, instead of *knowingly*, made an untrue statement of material fact or omitted to state a material fact when soliciting or dealing with advisory clients, in order to have violated MSA.

Prohibition against Dishonest or Unethical Practices

The bill prohibits a person who engages in the business of effecting transactions in securities for the account of others, for the person's own account, or who acts as a broker-dealer or agent, from engaging in dishonest or unethical practices in the securities or investment advisory business.

Mandatory Reporting Requirement

The bill requires agents, investment advisers, investment adviser representatives, broker-dealers, and other qualified individuals, as specified to report suspected financial exploitation of a vulnerable adult. A broker-dealer, an investment adviser, or a qualified individual that reasonably believes that an eligible adult has been, is currently, or will be the subject of financial exploitation or attempted financial exploitation must notify the Securities Commissioner and a local department of social services as outlined under § 14-302 of the Family Law Article. A broker-dealer, an investment adviser, or a qualified individual *may* notify a third party designated by the eligible adult and any other third party permitted under State or federal law or regulations, or the rules of a self-regulatory organization, so long as the third party is not suspected of financial exploitation, abuse, neglect, or other exploitation of the eligible adult.

The required notice must be given (1) within five days after the broker-dealer, investment adviser, or qualified individual develops the reasonable belief that the eligible adult has been, is currently, or will be the subject of financial exploitation or attempted financial

exploitation or (2) immediately on confirmation that the eligible adult has been, is currently, or will be the subject of financial exploitation or attempted financial exploitation, if the confirmation is made before the five-day period expires. More than one such notification is not required for each occurrence.

Delay of Disbursement

A broker-dealer or an investment adviser may delay a disbursement from an account of an eligible adult or an account on which an eligible adult is a beneficiary if:

- the broker-dealer, the investment adviser, or a qualified individual reasonably believes, after initiating an internal review of the requested disbursement and any suspected financial exploitation, that the requested disbursement may result in the financial exploitation of an eligible adult; and
- the broker-dealer, the investment adviser, or a qualified individual, (1) within two business days after the requested disbursement, with specified exception, provides written notice of the reason for the delay to all parties authorized to transact business on the account and notifies the Securities Commissioner and the local department of social services and (2) continues an internal review of the suspected financial exploitation of the eligible adult.

The broker-dealer, investment adviser, or qualified individual (1) may not provide the required written notice to a party the broker-dealer, investment adviser, or qualified individual reasonably believes is engaging in the financial exploitation of the eligible adult but (2) must provide, on request, a status report of the internal review to the Securities Commissioner and the local department.

A delay of disbursement expires when the broker-dealer or investment adviser determines that the disbursement will not result in the financial exploitation of the eligible adult, or 15 business days after the date of the disbursement request, whichever occurs first. The Securities Commissioner or the local department may request the delay of a disbursement for up to 25 business days after the date of the original request. If a request is made, the delay must continue for 25 business days after the date of the original disbursement request unless the Securities Commissioner, the local department, or a court of competent jurisdiction enters an order that terminates or extends the delay.

Immunity from Civil Liability

A broker-dealer, an investment adviser, or a qualified individual who provides notice to the Securities Commissioner or a local department in good faith and by exercising reasonable care has immunity from any administrative or civil liability that might otherwise result from providing the notice. A broker-dealer or an investment adviser that delays a

disbursement in good faith and exercising reasonable care also has immunity from any administrative or civil liability that might otherwise result from the delay.

Required Access to Records

A broker-dealer or an investment adviser must provide access to records that are relevant to the suspected financial exploitation of an eligible adult as part of the referral to the Securities Commissioner and a local department or – at the request of the commissioner – to a local department or a law enforcement agency. The records may include historical records as well as records that relate to the most recent transactions that may demonstrate the financial exploitation of an eligible adult. Any record made available under the bill is not a public record under Title 4 of the General Provisions Article.

The bill authorizes the Securities Commissioner to perform an audit or inspection at any time without prior notice. The bill further authorizes the commissioner to make copies of specified records and to remove those records for audit or inspection.

The bill specifies that the required access to records may not be interpreted to limit the authority under current law of the Securities Commissioner to access or examine the books or records of a broker-dealer or investment adviser.

Exempt Securities

The bill exempts from existing registration and filing requirements any investment contract or other security issued in connection with an employee's stock purchase, savings, pension, profit-sharing, stock option, equity compensation, or similar benefit plan if no commission or other payment is paid in connection with the offering and (1) the plan is qualified under the Internal Revenue Code; (2) the plan complies with Rule 701 under the Securities Act of 1933; or (3) the security is effectively registered under specified sections of the Securities Act of 1933 and is offered and sold in compliance with that Act. OAG advises that the fee assessed for such contracts is \$400.

Registration and Filing Fees

The bill increases, from \$35 to \$50, the fee that an agent must pay for initial, renewal, or transfer of a registration, and it directs the additional \$15 collected to the Securities Act Registration Fund established under the bill.

The bill establishes a \$500 late fee for failure to file notice with the Securities Commissioner related to specified mutual fund fees, in addition to other required filing fees.

The bill establishes an additional \$150 late fee for any specified private placement filings made after the filing deadline.

The bill also requires a private fund adviser filing the required notice before providing advice solely to one or more qualifying private funds to pay an initial fee of \$300, as well as a renewal fee of \$300.

Securities Act Registration Fund

The bill establishes the Securities Act Registration Fund as a special, nonlapsing fund that consists of (1) specified broker-dealer and investment adviser filing fees; (2) money appropriated in the State budget; and (3) any other money from any other source accepted for the benefit of the fund. The fund is intended to help fund the direct and indirect costs of administering and enforcing MSA, and money from the fund may only be used to administer and enforce MSA. Expenditures from the fund may only be made in accordance with the State budget. The fund must be administered by the Securities Commissioner.

The State Treasurer must invest the money in the fund, and any interest earnings are credited to the general fund. Money expended from the fund is supplemental to and not intended to take the place of funding that would otherwise be appropriated to administer and enforce MSA.

Miscellaneous Provisions

The bill repeals the authority of the Securities Commissioner to define what it means to engage in honest or unethical practices.

The bill repeals the requirement that the Securities Commissioner provide a specified list of broker-dealers and investment advisers to the State Department of Assessments and Taxation.

The bill expands instances when the Securities Commissioner may take specified actions, including issuing a summary order directing a person to cease and desist from engaging in specified activity, to include instances when a person has knowingly or recklessly provided substantial assistance to another person in connection with an act, practice, or course of business constituting a violation of MSA or a rule adopted or an order issued under MSA. In those instances where it appears to the Securities Commissioner that any person has engaged in any act or practice constituting a violation or is about to do so, the bill authorizes the commissioner to bring action to obtain:

- a temporary restraining order;
- a temporary or permanent injunction;

- a civil penalty up to a maximum amount of \$5,000 for any single violation;
- a declaratory judgment;
- the appointment of a receiver or conservator for the defendant or the defendant's assets;
- a freeze of the defendant's assets;
- rescission;
- restitution;
- disgorgement;
- payment of prejudgment and postjudgment interest; and
- any other relief as the court deems just.

The bill specifies that such an action is not subject to § 5-107 of the Courts and Judicial Proceedings Article which otherwise imposes a one-year statute of limitations on an action to obtain fines, penalties, and forfeitures.

Background: Exploitation of a vulnerable adult is a criminal offense, as set forth in § 8-801 of the Criminal Law Article. A person may not knowingly and willfully obtain, by deception, intimidation, or undue influence, the property of an individual that the person knows or reasonably should know is at least age 68 or is a vulnerable adult with intent to deprive the vulnerable adult of the vulnerable adult's property. Penalties for the offense vary based on the value of the property, as shown in **Exhibit 1**. A sentence imposed for the offense may be separate from and consecutive to or concurrent with a sentence for any crime based on the act or acts establishing the violation.

Exhibit 1
Penalties for the Exploitation of a Vulnerable Adult as of October 1, 2017

<u>Property Value</u>	<u>Maximum Penalty</u>
Less than \$1,500	Misdemeanor – 1 year and/or \$500
\$1,500 to less than \$25,000	Felony – 5 years and/or \$10,000
\$25,000 to less than \$100,000	Felony – 10 years and/or \$15,000
\$100,000 or more	Felony – 20 years and/or \$25,000

Source: Department of Legislative Services

In addition to the penalties listed above, a violator must restore the property taken or its value to the owner or, if the owner is deceased, restore the property or its value to the owner's estate. If a defendant fails to restore fully the property taken or its value as ordered, HB 1149/ Page 8

the defendant is disqualified, to the extent of the defendant's failure to restore the property or its value, from inheriting, taking, enjoying, receiving, or otherwise benefiting from the estate, insurance proceeds, or property of the victim of the offense, whether by operation of law or pursuant to a legal document executed or entered into by the victim before the defendant has been convicted. The defendant has the burden of proof with respect to establishing that the defendant has fully restored the property taken or its value.

Chapter 114 of 2016 authorizes the OAG Division of Consumer Protection to bring a civil action for damages against a person who violates the State's prohibitions on exploitation of a vulnerable adult on behalf of a victim of the offense or, if the victim is deceased, the victim's estate. This authorization is in addition to any other available legal action.

State Revenues:

General Fund Revenues

OAG advises that general fund revenues increase by a net total of \$49,000 annually due to an \$85,000 increase from late filing fees for mutual funds and private placement filings and a \$36,000 decrease due to the elimination of a specified securities registration fee. Due to the bill's October 1, 2017 effective date, this analysis assumes that the net impact is \$36,750 in fiscal 2018. OAG assumes, based on historical data, that it will receive 120 late mutual fund fees, collecting an additional fee of \$500 for each, and 150 private placement filing fees, collecting an additional fee of \$150 for each. OAG further assumes that it will forego approximately 90 securities registration fees at \$400 each.

Additional general fund revenues may be attained, due to other new registration fees established by the bill that are not included in the fiscal impact for this analysis. A specific estimate of impact is not available, as OAG was unable to provide any relevant data. However, OAG advises that the impact of these additional new fees is likely to be minimal.

Special Fund Revenues

OAG advises that special fund revenues increase by approximately \$3.0 million annually due to the \$15 increase in the agent registration fee that is required to be deposited in the special fund established under the bill; given the bill's effective date, special funds increase by \$2.25 million in fiscal 2018. This estimate is based on historical data that shows approximately 160,000 agents are registered at any one time and further assumes approximately 25% agent turnover in a fiscal year, resulting in approximately 40,000 additional registrations each year.

State Expenditures:

Office of the Attorney General

Special fund expenditures for OAG increase by \$521,857 in fiscal 2018, which accounts for the bill’s October 1, 2017 effective date. This estimate reflects the cost of hiring two assistant Attorneys General, one investigator/examiner, one senior outreach coordinator, and one administrative officer to enforce the bill’s requirements and prohibitions, investigate complaints, coordinate educational outreach efforts, and handle other administrative tasks as required under the bill. It includes salaries, fringe benefits, one-time start-up costs, and ongoing operating expenses, including rent.

Positions	5
Regular Salaries and Fringe Benefits	\$308,713
One-time Start-up Costs	23,200
Operating Expenses	<u>189,944</u>
Total FY 2018 Special Fund Expenditures	\$521,857

Future year expenditures reflect full salaries with annual increases and employee turnover and ongoing operating expenses.

Because the bill specifies that the special funds are supplemental to existing funding for MSA, this analysis does not assume any reduction in general fund expenditures for that purpose.

Department of Human Resources

General fund expenditures for DHR increase by \$185,669 in fiscal 2018, which accounts for the bill’s October 1, 2017 effective date. This estimate reflects the cost of hiring one social worker supervisor, one level one social worker, and one level two social worker to handle additional reports of financial abuse anticipated as a result of the bill’s mandatory reporting requirements. It includes salaries, fringe benefits, one-time start-up costs, and ongoing operating expenses. DHR advises that this estimate is based on the cumulative increase in reports of financial exploitation by 9% following the implementation of Chapter 325 of 2012 that included a mandatory reporting requirement for employees of financial institutions in 2012.

Positions	3
Regular Salaries and Fringe Benefits	\$164,718
One-time Start-up Costs	13,920
Operating Expenses	<u>7,031</u>
Total FY 2018 General Fund Expenditures	\$185,669

Future year expenditures reflect full salaries with annual increases and employee turnover and ongoing operating expenses.

Small Business Effect: In addition to the imposition of additional fees, the bill's reporting requirements may impose both an administrative and financial burden on small business securities firms.

Additional Information

Prior Introductions: None.

Cross File: SB 951 (Senator Smith, *et al.*) - Judicial Proceedings.

Information Source(s): Maryland Department of Aging; Office of the Attorney General (Securities Division); Judiciary (Administrative Office of the Courts); Department of Health and Mental Hygiene; Department of Human Resources; Department of Labor, Licensing, and Regulation; Department of State Police; State Department of Assessments and Taxation; Maryland Insurance Administration; Department of Legislative Services

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