

MEMO# 3531

February 20, 1992

INSTITUTE TESTIFIES ON MARYLAND LEGISLATION CONCERNING ESTABLISHMENT OF AN INVESTMENT ADVISER GUARANTY FUND

February 20, 1992 TO: INVESTMENT ADVISERS COMMITTEE NO. 8-92 MARYLAND
ASSOCIATE INVESTMENT ADVISER MEMBERS RE: INSTITUTE TESTIFIES ON MARYLAND
LEGISLATION CONCERNING ESTABLISHMENT OF AN INVESTMENT ADVISER GUARANTY FUND

On February 18, the Institute testified before the Maryland Senate Judicial Proceedings Committee on Senate Bill No. 607, which was recently introduced in Maryland. The bill provides for the creation of an investment adviser guaranty fund to compensate Maryland residents for losses based on acts or omissions of investment advisers or investment adviser representatives required to register in Maryland, or on acts or omissions of persons who control such advisers or representatives. An earlier draft of the proposed legislation was previously circulated to you (see Memorandum to Investment Advisers Committee No. 62-91, and to Maryland Associate Investment Adviser Members, dated December 17, 1991), but significant changes have been made. Copies of the bill and the Institute's written testimony are attached. Under the bill, every applicant for initial or renewal registration as an investment adviser would be assessed a \$300 fee, to be credited to the guaranty fund, in addition to the current \$300 filing fee. Similarly, investment adviser representative registrants would pay a \$50 fee into the fund, on top of their \$50 initial or renewal registration fee. In addition, fines paid by an investment adviser or representative in settlement of violations or alleged violations of the Maryland securities laws would go into the guaranty fund. The bill directs the Securities Commissioner to maintain the guaranty fund at a level of at least \$1,000,000, and to assess additional fees against investment advisers and representatives if the fund falls below that level. The bill also contains detailed provisions relating to the processing of claims against the fund, including among other things what happens if there is not enough money in the fund to cover a claim, who is liable to reimburse the fund for claims paid and what can be done if no such reimbursement is made. In its testimony, the Institute opposed Senate Bill 607 on several grounds. The testimony stated that the Institute questions the need for an investment adviser guaranty fund, and that even if such a need exists, the approach taken in Senate Bill 607 raises serious concerns. Most significantly, according to the Institute's testimony, the proposed funding mechanism for the guaranty fund is unfair because only registered advisers and their representatives are required to make contributions, but the actions of persons who are not registered would be covered by the fund. The Institute's testimony noted that this is especially disturbing in view of the open-ended liability involved if the fund is continually depleted. The testimony also expressed the Institute's concern that

Senate Bill 607 would enable investors to bypass the court system, without any requirement that other possible remedies be exhausted or that the person responsible for the loss be found to be insolvent or otherwise judgment-proof. Finally, the Institute's testimony indicated that the bill could have a negative impact on Maryland investors, in that (1) the expensive and unfair funding method might drive legitimate advisers out of Maryland, (2) the existence of the fund might encourage some advisers to engage in riskier strategies, (3) some advisers might rely on the fund as a substitute for private insurance and (4) advisers might mislead investors by holding themselves out as insured by the State of Maryland. We will keep you informed of developments. Frances M. Stadler Assistant General Counsel Attachments

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