

AMENDED IN ASSEMBLY APRIL 19, 2005

AMENDED IN ASSEMBLY MARCH 17, 2005

CALIFORNIA LEGISLATURE—2005—06 REGULAR SESSION

**ASSEMBLY BILL**

**No. 310**

**Introduced by Assembly Member Umberg**

February 10, 2005

---

---

An act to add Sections 1714.12 and 1714.13 to the Civil Code, ~~and to amend Section 25500 of the Corporations Code~~, relating to investments.

LEGISLATIVE COUNSEL'S DIGEST

AB 310, as amended, Umberg. Investment plans: defined contribution and other retirement plans: liability.

Existing law provides for the licensing and regulation of broker-dealers and investment advisers by the Department of Corporations under the Corporate Securities Law of 1968. ~~Existing law provides that any person who willfully participates in certain unlawful acts or transactions relative to securities transactions shall be liable to any other person who purchases or sells any security at a price that was affected by the act or transaction for damages sustained as a result of the act or transaction.~~

~~This bill would define the terms "willfully" and "participates" for purposes of these provisions, and would state the intent of the Legislature to abrogate certain appellate court holdings in that regard. The~~

~~This bill would also impose various qualifications and requirements on persons performing investment or management services in connection with a defined contribution plan or other retirement plan, including a requirement to be registered with the state. The bill would~~

provide that those persons owe a fiduciary duty to the plan beneficiaries, and would set forth the liability of those and other associated persons for a breach of that duty. The bill would enact other related provisions.

Vote: majority. Appropriation: no. Fiscal committee: yes.  
 State-mandated local program: no.

*The people of the State of California do enact as follows:*

1 SECTION 1. The Legislature finds and declares all of the  
 2 following:

3 (a) As part of their compensation and employee benefits, state  
 4 and local public employees are entitled to adequate, stable, and  
 5 secure retirement benefits. This right includes the right to  
 6 protection from the loss of retirement funds due to incompetent  
 7 investment advice or improper accounting of retirement funds.  
 8 Indeed, all California employees and retirees in both the private  
 9 and public sectors are entitled to minimum safeguards with  
 10 respect to their retirement investments.

11 (b) A defined contribution plan does not provide a guaranteed  
 12 benefit level at retirement and does not include disability or death  
 13 benefits. The balance in a defined contribution account may be  
 14 paid out as either a lump sum or a partial lump sum, in a set  
 15 number of installment payments, or it may be used to purchase  
 16 an annuity.

17 (c) Under a defined contribution plan, the employer is only  
 18 responsible for making the scheduled contributions, while the  
 19 employees bear all the investment risk.

20 ~~SEC. 2. The Legislature further finds and declares all of the~~  
 21 ~~following:~~

22 ~~(a) Sections 25400 and 25500 of the Corporations Code are~~  
 23 ~~intended to protect California residents and investors from~~  
 24 ~~manipulation of the financial markets, including knowing or~~  
 25 ~~reckless statements, concealments, or conduct, and California~~  
 26 ~~pension funds are the primary beneficiaries of the protections~~  
 27 ~~provided by these sections.~~

28 ~~(b) Section 25400 of the Corporations Code makes various~~  
 29 ~~acts unlawful that create a false or misleading impression~~  
 30 ~~concerning securities transactions and prices. Section 25500 of~~  
 31 ~~the Corporations Code provides a civil remedy for the willful~~

1 participation in an act or transaction in violation of Section  
2 25400 of the Corporations Code.

3 (e) The California Court of Appeal for the Sixth Appellate  
4 District, in *Kamen v. Lindly* (2001) 94 Cal.App.4th 197, held  
5 that the phrase “willfully participates” in Section 25500 of the  
6 Corporations Code does not apply to participants who are not  
7 engaged in “market activity.” This holding incorrectly and  
8 unfairly prevents California investors from seeking redress from  
9 all perpetrators of corporate and securities fraud. It is the intent  
10 of the Legislature to abrogate this holding.

11 (d) The California Court of Appeal for the Second Appellate  
12 District, in *California Amplifier, Inc. v. RLI Insurance Co.*  
13 (2001) 94 Cal.App.4th 102, held that the phrase “willfully  
14 participates” in Section 25500 of the Corporations Code requires  
15 that a participant in a violation of subdivision (d) of Section  
16 25400 of the Corporations Code, relating to intentionally or  
17 recklessly making a false or misleading statement, must  
18 knowingly and intentionally make a false or misleading  
19 statement. This holding incorrectly and unfairly increases the  
20 scienter standard required in cases of securities fraud or  
21 manipulation. It is the intent of the Legislature to abrogate this  
22 holding.

23 (e) It is also the intent of the Legislature to abrogate the  
24 holding of the California Court of Appeal for the Second  
25 Appellate District, in *California Amplifier, Inc. v. RLI Insurance*  
26 *Co.* (2001) 94 Cal.App.4th 102, to the extent that it holds that  
27 willful participation in a violation of subdivision (d) of Section  
28 25400 of the Corporations Code requires that the participant  
29 knowingly and intentionally make a false or misleading  
30 statement.

31 ~~SEC. 3.~~

32 *SEC. 2.* Section 1714.12 is added to the Civil Code, to read:

33 1714.12. (a) In order to be eligible to perform investment or  
34 management services in connection with a defined contribution  
35 plan or other retirement plan, a person shall be registered with  
36 the Commissioner of Corporations or another agency of the State  
37 of California and satisfy all of the following conditions:

- 38 (1) Have and maintain a minimum of 10 or more consecutive  
39 quarters of positive returns.

1 (2) Limit its management and service fees for employee  
2 retirement plans to one-half percent of total investments.

3 (3) Provide monthly statements itemizing all fees charged to  
4 an employee retirement account.

5 (4) Purchase insurance to cover any and all potential liability  
6 occurring by reason of any act or omission in rendering services  
7 in connection with a defined contribution plan or other retirement  
8 plan.

9 (5) Eliminate all fees for *the* opening of new defined  
10 contribution plan accounts or other new retirement plan accounts,  
11 for transferring defined contribution plan accounts or other  
12 retirement plan accounts, or for closing any of those accounts.

13 (6) Offer an education program to all customers with defined  
14 contribution plan accounts or other retirement plan accounts.

15 (b) All persons qualified to provide investment or management  
16 services as defined under this section shall provide evidence of  
17 financial strength and stability, as may be applicable, pursuant to  
18 *the* rating assigned by nationally recognized rating services that  
19 evaluate *the* financial strength of those providers of investment or  
20 management services.

21 (c) All investments made in a defined contribution plan or  
22 other retirement plan shall be rated as AAA, AA, A, BBB, or  
23 “investment grade” by either Fitch, Moody’s, or Standard &  
24 Poor’s rating services or a similar statistical rating service that is  
25 nationally recognized for rating the creditworthiness of  
26 investments.

27 (d) All persons qualified to provide investment or management  
28 services as defined under this section shall offer investment  
29 education services at their own expense to all customers with a  
30 defined contribution plan account or other retirement plan  
31 account. Investment education services shall include, but are not  
32 limited to, disseminating educational materials, providing  
33 retirement planning education, explaining the differences  
34 between the defined benefit retirement plan and the defined  
35 contribution retirement plan, and offering financial planning  
36 guidance on matters such as investment diversification,  
37 investment risks, investment costs, and asset allocation.

38 (e) All persons qualified to provide investment or management  
39 services as defined under this section shall provide written  
40 disclosure of expenses paid directly or indirectly by customers

1 with a defined contribution or other retirement plan, including,  
2 but not limited to, penalties for early withdrawals, presence of  
3 two-tier annuity features, declining or fixed withdrawal charges,  
4 and surrender or deposit charges, to those customers.

5 (f) All persons qualified to provide investment or management  
6 services as defined under this section shall provide disclosure of  
7 the range of administrative and customer services provided,  
8 including, but not limited to, asset allocation, accounting and  
9 administration of benefits for individual participants,  
10 recordkeeping for individual participants, asset purchase, control,  
11 and safekeeping, execution of a participant's instructions as to  
12 asset and contribution allocation, calculation of daily net asset  
13 values, direct access for participants to their account information,  
14 periodic reporting to participants, not less than quarterly, on their  
15 account balances and transactions, and compliance with the  
16 standard of care applicable in the provision of investment  
17 services and consistent with federal law, to customers with a  
18 defined contribution or other retirement plan.

19 ~~SEC. 4~~

20 *SEC. 3.* Section 1714.13 is added to the Civil Code, to read:

21 1714.13. (a) Any person, including a broker-dealer, as  
22 defined in Section 25004 of the Corporations Code, or an  
23 investment adviser, as defined in Section 25009 of the  
24 Corporations Code, who performs services in connection with a  
25 defined contribution plan or other contribution plan owes  
26 fiduciary duties to the plan beneficiary.

27 (b) Any person who breaches his, her, or its fiduciary duty in  
28 connection with the performance of services shall be liable to the  
29 plan beneficiary. If the breach was intentional or reckless, the  
30 fiduciary shall be liable for an amount up to treble damages for  
31 losses sustained as a result of the intentional or reckless conduct.

32 (c) Every person who directly or indirectly controls a person  
33 liable under this section, every partner in a firm so liable, every  
34 ~~principle~~ *principal* executive officer or director of a corporation  
35 so liable, every person occupying a similar status or performing  
36 similar functions, every employee of a person so liable who  
37 materially aids in the act or transaction constituting the violation,  
38 and every agent who materially aids in the act or transaction  
39 constituting the violation are also liable jointly and severally with

1 and to the same extent as that person, unless the other person  
2 shows that he or she acted in good faith.

3 (d) Every person who materially assists in any breach of duty  
4 set forth in this section with the intent to deceive or defraud is  
5 jointly and severally liable with any other person liable under this  
6 section.

7 (e) All state and local government retirement systems and state  
8 and local government employers shall have standing to assert  
9 claims under this provision on behalf of one or more employees  
10 or retirees.

11 ~~SEC. 5. Section 25500 of the Corporations Code is amended~~  
12 ~~to read:~~

13 ~~25500. (a) Any person who willfully participates in any act,~~  
14 ~~transaction, scheme, or course of conduct in violation of Section~~  
15 ~~25400 shall be liable to any other person who purchases or sells~~  
16 ~~any security at a price affected by that act, transaction, scheme,~~  
17 ~~or course of conduct for the damages sustained by the latter as a~~  
18 ~~result of that act, transaction, scheme, or course of conduct. The~~  
19 ~~damages shall be the difference between the price at which the~~  
20 ~~other person purchased or sold securities and the market value~~  
21 ~~that the securities would have had at the time of his or her~~  
22 ~~purchase or sale in the absence of the act, transaction, scheme, or~~  
23 ~~course of conduct, plus interest at the legal rate.~~

24 ~~(b) For the purposes of this section, "participates" does not~~  
25 ~~require that a person to be a market participant, to purchase or~~  
26 ~~sell a security, or to make a statement, in order for liability to~~  
27 ~~attach under this section.~~

28 ~~(c) For the purposes of this section, "willfully" does not~~  
29 ~~require a person to act knowingly and intentionally. Willful~~  
30 ~~means volitional, and it is sufficient that a person speak or act in~~  
31 ~~a reckless manner in order for liability to attach under this~~  
32 ~~section.~~

33 ~~(d) The amendments to this section enacted pursuant to the act~~  
34 ~~that amended this section in the first year of the 2005-06 Regular~~  
35 ~~Session shall apply to all cases pending or filed on or after~~  
36 ~~enactment of that act.~~