

[Release No. 34-35266; File No. SR-NASD-94-61]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by National Association of Securities Dealers, Inc., Relating to the Filing Requirements Under Article III, Section 44 of the NASD Rules Regarding Modified Guaranteed Annuity Contracts and Modified Guaranteed Life Insurance Contracts

January 23, 1995.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"), 15 U.S.C. 78s(b)(1), notice is hereby given that on January 12, 1995 the National Association of Securities Dealers, Inc. ("NASD" or "Association") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the NASD.¹ The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The NASD is proposing to amend Subsection 44(b)(8) to Article III of the NASD Rules of Fair Practice ("Corporate Financing Rule") to exempt modified guaranteed annuity contracts and modified guaranteed life insurance contracts from the filing requirements under Subsection 44(b).

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the NASD included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in item IV below. The NASD has prepared summaries, set forth in Sections (A), (B), and (C) below, of the most significant aspects of such statements.

(A) Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

The Corporate Financing Rule requires members to file with the NASD

documents and information relating to a public offering of securities for review of the fairness of underwriting compensation and arrangements. The filing requirements in the Corporate Financing Rule also apply to Schedule E of the NASD By-Laws and Article III, Section 34 of the NASD Rules of Fair Practice. The Corporate Financing Rule filing requirements apply to public offerings of debt, equity and public limited partnership securities, and provide that certain offerings of securities shall be exempt from the filing requirement under Subsection (b)(8) of the Rule. The exemptions in Subsection (b)(8) include, among others, open-end investment company securities registered under the Investment Company Act of 1940 (except closed-end investment company securities) and variable contracts. In addition, the exemptions include securities defined as "exempt securities" under Section 3(a)(12) of the Act and securities exempt from registration with the SEC pursuant to Sections 4(1), 4(2) and 4(6) of the Securities Act of 1933 ("1933 Act") and Rules 504 (unless considered a public offering), 505 and 506 adopted under the 1933 Act.

The NASD recently considered the status of "Modified Guaranteed Annuity Contracts" and "Modified Guaranteed Life Insurance Policies" (collectively, "Contracts") under the filing requirements of the Corporate Financing Rule. The Contracts are similar to variable annuity contracts in that they are issued by an insurance company, offered on a continuous basis, subject to the registration requirements and regulatory scheme of state insurance law, and, shift investment risk to the contract owner by offering variable, non-guaranteed rates of return under certain circumstances. That is, the Contracts are subject to a market value adjustment upon a Contract surrender or partial withdrawal prior to the end of a guarantee period. However, unlike variable annuities, the individual account values of the Contracts do not reflect the investment experience of one or more separate accounts registered under the Investment Company Act of 1940. Instead, like traditional fixed annuities, the Contracts are backed by the general account assets of the insurance issuer and are registered only as insurance contracts under state insurance law.

The Contracts are priced individually and issued on a continuous, open-ended basis directly by the issuer, and are sold by state-licensed insurance agents that are also registered with a member to sell such securities based on the Series 6

examination—the Limited Representative for Investment Company and Variable Contract Products. Thus, the sale of the Contracts does not resemble the traditional types of underwritings of debt, equity, closed-end investment company and public limited partnership securities with which the Corporate Financing Rule is concerned.

The Contracts do not fall within any of the current exemptions contained within the Corporate Financing Rule Filing Requirements. As a result, the Contracts are subject to the filing requirements of the Corporate Financing Rule unless the NASD amends its rules to adopt a specific exemption for such instruments. The review of the fairness and reasonableness of underwriting terms and arrangements is the central requirement of the Corporate Financing Rule. The issuance and sale of the Contracts on an open-ended basis does not raise the kinds of underwriting issues with which the Corporate Financing Rule is primarily and traditionally concerned. The structure of the instrument is that of an insurance product which has traditionally been regulated under state insurance law and the terms of the Corporate Financing Rule were not developed to address such products. The NASD is, therefore, proposing to amend the Corporate Financing Rule by adopting as new Subsection (b)(8)(E) an exemption from the filing and other requirements of the Corporate Financing Rule for "Modified Guaranteed Annuity Contracts" and "Modified Guaranteed Life Insurance Policies" and to reletter the remaining sections accordingly. The proposed rule would thus exempt such Contracts from the filing and review requirements of the Corporate Financing Rule.²

The NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,³ which requires that the rules of the Association promote just and equitable principles of trade and protect investors and the public interest in that the proposed rule change amends the filing requirements of Article III, Section 44 to the NASD Rules of Fair Practice to exempt Modified Guaranteed Annuity Contracts and Modified Guaranteed Life

² In addition, Article III, Sections 26 and 29 of the NASD Rules of Fair Practice are not applicable, since the Contracts are not within the definition of "variable contract" and do not include a separate account registered under the Investment Company Act of 1940. However, as securities, sales of the Contracts are subject to other applicable Rules of Fair Practice when sold by associated persons of a member and the rules and regulations of the Commission, particularly the antifraud provisions thereof.

³ 15 U.S.C. 78o-3.

¹ The NASD originally submitted the proposed rule change on November 21, 1994. On December 1, 1994 and January 12, 1995, the NASD filed letter amendments to its filing correcting errors in its November 21, 1994 submission. This notice reflects those amendments.

Insurance Policies from NASD review, since the issuance and sale of the Contracts on an open-ended basis does not raise the kinds of underwriting issues with which the Corporate Financing Rule is primarily and traditionally concerned; the structure of the instrument is that of an insurance product which has traditionally been regulated under state insurance law; and the terms of the Corporate Financing Rule were not developed to address such products.

(B) Self-Regulatory Organization's Statement on Burden on Competition

The NASD does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended.

(C) Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others

Written comments were neither solicited nor received.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 35 days of the date of publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

- A. By order approve such proposed rule change, or
- B. Institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street NW., Washington, D.C. 20549. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in

the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the NASD. All submissions should refer to the file number in the caption above and should be submitted by February 21, 1995.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁴

Margaret H. McFarland,

Deputy Secretary.

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[Release No. 34-35261; International Series Release No. 777 File No. SR-Phlx-95-03]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Philadelphia Stock Exchange, Inc., Relating to Customized Foreign Currency Options Transaction Size

January 23, 1995.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"), 15 U.S.C. 78s(b)(1), notice is hereby given that on January 17, 1995, the Philadelphia Stock Exchange, Inc. ("Phlx" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Phlx. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The Phlx proposes to amend Exchange Rule 1069(a) to revise the minimum transaction size for customized foreign currency options ("Customized FCOs") from 300 to 200 contracts. The text of the proposed rule change is available at the Office of the Secretary, the Phlx, and at the Commission.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the Phlx included statements concerning the purpose of and basis for the proposed rule change the discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The Phlx has prepared summaries, set forth in sections (A), (B),

and (C) below, of the most significant aspects of such statements.

(A) Self-Regulatory Organization's Statement of the Purpose of, and the Statutory Basis for, the Proposed Rule Change

On November 1, 1994, the Commission approved the Exchange's proposal to trade customized foreign currency options.¹ Customized FCOs provide users of the Exchange's FCO markets with the ability to customize the strike price and quotation method and to choose any underlying and base currency combination out of all Exchange-listed currencies, including the U.S. dollar, for their FCO transactions. The Phlx represents that Customized FCOs were introduced to attract institutional customers who enjoy the flexibility and variety offered in the over-the-counter foreign currency market but who prefer the benefits attributed to an exchange auction market for hedging their exchange rate risks.

The Exchange imposed a 300 contract minimum opening transaction size pursuant to Rule 1069(a)(6) for a number of reasons. Because the Customized FCOs are not continuously quoted and, therefore, only reported to the Options Price Reporting Authority ("OPRA") when a request for quote or responsive quote is voiced and when a trade occurs,² there is somewhat less transparency in the Customized FCO market than in the market for regular FCOs. Further, the Exchange represents that Customized FCOs are extremely labor intensive to quote, therefore making it impractical to offer the ability to request quotes for small opening transactions.

The Exchange represents that a number of mid-sized corporations and institutions have told the Exchange that the current minimum contract value is too large for their purposes. They believe that Customized FCOs would fill a market need for them but that the opening transaction size is prohibitive. The Exchange's analysis (see chart below) shows that the average value of a 300 contract trade at prevailing exchange rates is approximately \$15 million. The Exchange believes that an important corporate market segment is being priced out of the market by this excessively large opening transaction size. Therefore, the Exchange proposes to reduce the minimum opening transaction size for Customized FCO

¹ See Securities Exchange Act Release No. 34925 (November 1, 1994), 59 FR 55720 (November 8, 1994).

² See Phlx Rule 1069(h).

⁴ 17 CFR 200.30-3(a)(12).