SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–45338; File No. SR–MSRB–2001–07]

Self-Regulatory Organizations; Municipal Securities Rulemaking Board; Order Granting Approval of Proposed Rule Change Relating to Minimum Denominations

January 25, 2002.

On October 16, 2001, the Municipal Securities Rulemaking Board (''MSRB'') filed with the Securities and Exchange Commission (''Commission''), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Exchange Act'') and Rule 19b–4 thereunder,[1] a proposed rule change (File No. SR–MSRB–2001–07) concerning minimum denominations consisting of an amendment to its rule G–15 on confirmation, clearance and settlement of transactions with customers, an amendment to its rule G–8 on books and records to be made by brokers, dealers and municipal securities dealers, and an interpretation of its rule G–17 on conduct of municipal securities activities.

The proposed rule change was published for comment in the **Federal Register** on December 28, 2001.[2] The Commission received fifteen comment letters on the MSRB's proposed rule change. This order approves the proposal.

I. Description of the Proposed Rule Change

The MSRB proposed this rule change as a measure to ensure that dealers observe the minimum denominations stated in the official documents of municipal securities issues. Official documents for municipal securities issues may state a ''minimum denomination'' larger than the normal $5,000 par value. For example, an issuer may state a high minimum denomination (typically $100,000) to qualify for one of several exemptions from Rule 15c2–12's [3] requirement to file certain disclosure documents. Additionally, an issuer may set high minimum denominations because of a concern that the securities may not be appropriate for those retail investors who would be likely to purchase securities in relatively small amounts.

Several issuers have expressed concern to the MSRB upon discovering that their issues with high minimum denominations were trading in the secondary market in transaction amounts much lower than the stated minimum denomination. Based on information obtained from the MSRB Transaction Reporting Program, it appears that there are significant numbers of these types of transactions. In the past, brokers, dealers and municipal securities dealers (collectively ''dealers'') effecting such transactions likely would have noticed the problem when attempting to make delivery of a certificate to the customer. Generally, the transfer agent would not have been able to honor a request for a certificate with a par value below the minimum denomination. However, the increased use of book-entry deliveries and safekeeping arrangements for retail customers largely preclude the need for individual certificates for customers and there is no other systemic screening to identify transactions that are in below-minimum denomination amounts. Today, municipal securities predominantly stay in a book-entry environment, with ownership recorded on the books and records of depositories and other nominees, a restriction on the par value of certificates does not effectively restrict the size of transactions.

The MSRB believes that it is appropriate for the rule to be prospective in this manner so that issuers, dealers and other market participants will be aware of the secondary market implications of high minimum denominations at the time the decision is made to incorporate them into an issue's terms. Accordingly, the proposed rule change includes an amendment to MSRB rule G–15 that would prohibit transactions in below-minimum denomination amounts for securities issued after June 1, 2002, with two limited exceptions.

The general prohibition of the rule G–15 amendment is designed to prevent dealers from effecting transactions that break up securities positions into amounts below the issue's denomination. The two exceptions in the amendment to rule G–15 are designed to help preserve liquidity of customers' below-minimum denomination positions that may occur through actions other than a dealer effecting transactions in below-minimum denomination amounts.[4] First, a dealer may purchase a below-minimum denomination position from a customer provided that the customer liquidates his/her entire position. Second, a dealer may sell such a liquidated position to another customer but would be required to provide written disclosure, either on the confirmation or separately, to the effect that the security position is below the minimum denomination and that liquidity may be adversely affected by this fact.

Under MSRB rule G–8, on books and records, customer confirmations must be kept for three years in a dealer's books and records. To ensure consistency in the recordkeeping requirements for separate written disclosures given to a customer under the rule G–15 amendment and the recordkeeping requirements for customer confirmations, the proposed rule change includes an amendment to rule G–8 that would require dealers to keep a record of these separate written disclosures for a minimum of three years.

Although certain written disclosures would be required, after the trade, for those transactions done under the second exemption to the rule G–15 amendment, the MSRB also seeks to address a more general need for time-of-trade disclosure in the proposed rule change. Rule G–17 states: ''In the conduct of its municipal securities activities, each broker, dealer, and municipal securities dealer shall deal fairly with all persons and shall not engage in any deceptive, dishonest, or unfair practice.'' The MSRB has interpreted this rule to mean, among other things, that dealers are required to disclose, at or before the sale of municipal securities to a customer, all material facts concerning the transaction, including a complete description of the security. The proposed rule change includes an interpretation of rule G–17 stating that any time a dealer is selling to a customer a quantity of municipal securities below the minimum denomination for the issue, the dealer should consider this to be a material fact about the transaction. The MSRB believes that a dealer's failure to disclose such a material fact to the customer, and to explain how this could affect the liquidity of the customer's position, generally would constitute a violation of the dealer's duty under rule G–17 to disclose all material facts about the transaction to the customer.

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[1] 15 U.S.C. 78s(b)(1) and 17 CFR 240.19b–4 thereunder.

[2] See Release No. 34–45174 (December 19, 2001), 66 FR 67342.

[3] 17 CFR 240.15c2–12.

[4] A below-minimum denomination position may be created, for example, by call provisions that allow calls in amounts less than the minimum denomination, investment advisors who may split positions they purchase among several clients or the division of an estate as a result of a death or divorce. Such below-minimum denomination positions also may be created as a result of a gift.

While the rule G–15 amendment applies only to municipal securities issued after June 1, 2002, the interpretation of rule G–17 applies to all transactions in municipal securities regardless of the date of issuance of the security traded. This helps ensure that all future investors are made aware at or prior to the time of trade that the securities position they are about to purchase is below the minimum denomination and that the liquidity of that position may be adversely affected by this fact.

II. Summary of Comments

The Commission received fifteen comments letters on the proposal.[5] All of the letters received favored the proposal. Collectively, the comment letters asserted that the proposal balanced the enforcement of bondholder protections without impairing liquidity of bonds currently held in unauthorized denominations by unsuspecting investors.[6] All but three of the commenters preferred a retroactive application; nevertheless, they supported the proposal's prospective enforcement of bondholders' protections.[7]

III. Discussion

The Commission must approve a proposed MSRB rule change if the Commission finds that the MSRB's proposal is consistent with the requirements of the Exchange Act and the rules and regulations thereunder that govern the MSRB.[8] The language of section 15(b)(2)(C) of the Exchange Act requires that the MSRB's rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principals of trade, to foster cooperation and coordination with persons engaged in regulating, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national system, and, in general, to protect investors and the public interest.[9]

After careful review, the Commission finds that the MSRB's proposed rule change concerning minimum denominations meets this standard. The minimum denominations proposal consists of an amendment to MSRB Rule G–15 on confirmation, clearance and settlement of transactions with customers, an amendment to MSRB Rule G–8 on books and records to be made by brokers, dealers and municipal securities dealers, and an interpretation of MSRB Rule G–17 on conduct of municipal securities activities. The Commission believes that this proposed rule change is consistent with the requirements of the Exchange Act, and the rules and regulations thereunder, in particular, section 15B(b)(2)(C).

IV. Conclusion

It is therefore ordered, pursuant to section 19(b)(2) of the Exchange Act that the proposed rule change (SR–MSRB–2001–07) be, and hereby is, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[10]

Margaret H. McFarland,

Deputy Secretary.

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[5] See letter from Rebecca Floyd, Executive Vice President and General Counsel, Kansas Development Finance Authority to Office of the Secretary, Commission, dated January 14, 2002; letter from Neil P. Moss, Executive Director, Idaho Health Facilities Authority to Office of the Secretary, Commission, dated January 14, 2002; letter from Corinne M. Johnson, Executive Director, Colorado Health Facilities Authority to Office of the Secretary, Commission, dated January 14, 2002; letter from Edith F. Behr, President, National Council of Health Facilities Finance Authorities to Office of the Secretary, Commission, dated January 14, 2002; letter from Edith F. Behr, Executive Director, New Jersey Health Care Facilities Financing Authority to Office of the Secretary, Commission, dated January 14, 2002; letter from Larry Nines, Executive Director, Wisconsin Health and Educational Facilities Authority to Office of the Secretary, Commission, dated January 15, 2002; letter form Christopher B. Taylor, Auditor and Advisor, Department of Health and Human Services, The North Carolina Medical Care Commission to Office of the Secretary, Commission, dated January 15, 2002; letter from Don A. Templeton, Executive Director, South Dakota Health and Educational Facilities Authority to Office of the Secretary, Commission, dated January 15, 2002; letter from Robert E. Donovan, Executive Director, Rhode Island Health and Educational Building Corporation to Office of the Secretary, Commission, dated January 15, 2002; letter from David C. Bliss, Executive Director, New Hampshire Health and Education Facilities Authority to Office of the Secretary, Commission, dated January 15, 2002; letter from Malcolm S. Rode, Executive Director, Vermont Educational and Health Buildings Financing Agency, dated January 15, 2002; letter from Jill H. Tanner, Executive Director, Indiana Health Facilities Financing Authority to Office of the Secretary, Commission, dated January 16, 2002; letter from Kim Herman, Executive Director, Washington Higher Education Facilities Authority to Office of the Secretary, Commission, dated January 16, 2002; letter from Mary R. Jeka, Acting Executive Director, Massachusetts Health and Educational Facilities Authority to Office of the Secretary, Commission, dated January 16, 2002; and letter from Michael J. Stanard, Executive Director, Missouri Health and Educational Facilities Authority to Office of the Secretary, Commission, dated January 16, 2002.

[6] *See* note 4, *supra.*

[7] *See* note 4, *supra* (not including the letter from Missouri Health and Educational Facilities Authority; the letter from National Council of Health Facilities Finance Authority, and the letter from Washington Higher Education Facilities Authority).

[8] Additionally, in approving this rule, the Commission notes that it has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

[9] 15 U.S.C. 78o–4(b)(2)(c).

[10] 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–45421; File No. SR–Phlx–2001–114]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Philadelphia Stock Exchange, Inc. Relating to Aggregation of Individual Violations of Exchange Order Handling Rules and Option Floor Procedure Advices

February 7, 2002.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 (''Act''),[1] and Rule 19b–4 thereunder,[2] notice is hereby given that on December 18, 2001, 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 Exchange. 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 Exchange proposes to amend Exchange Rule 960.2(f), Determination to Initiate Charges, and Exchange Rule 970 concerning the Exchange's minor rule violation enforcement and reporting plan (''Minor Rule Plan''),[3] by clarifying that the Exchange may aggregate, or ''batch,'' individual violations of Exchange order handling rules and Option Floor Procedure

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] Exchange Rule 970 sets forth the criteria for the imposition of a fine (not to exceed $2,500) on any member, member organization, or any partner, officer, director or person employed by or associated with any member or member organization, for any violation of a Floor Procedure Advice, which violation the Exchange shall have determined is minor in nature. Such a fine is imposed in lieu of commencing a ''disciplinary proceeding'' as that term is used in Exchange Rules 960.1–960.12. Minor Rule Plan fines are subject to Rule 19d–1 under the Act.