

RULES AND REGULATIONS

Title 64—SECURITIES

SECURITIES COMMISSION

[64 PA. CODE CH. 102, 202—204,
207, 305 AND 606]

Banking and Savings and Loan Institutions

The Securities Commission (Commission), under the authority contained in sections 102(d), (k) and (t), 202(a), (c), (e) and (i), 203(d), (i.1), (p) and (r), 204(a), 207(l), 305(a)(ix), 606(a) and (d) and 609(a) of the Pennsylvania Securities Act of 1972 (act) (70 P. S. §§ 1-102(d), (k) and (t), 1-202(a), (c), (e) and (i), 1-203(d), (i.1), (p) and (r), 1-204(a), 1-207(l), 305(a)(ix), 1-606(a) and (d) and 1-609(a)), has adopted amendments to regulations concerning the subject matter of the act to read as set forth in Annex A.

Publication of Notice of Proposed Rulemaking

Publication of proposed rulemaking was published at 33 Pa.B. 884 (February 15, 2003).

Public Comments

No written comments were received during the public comment period. After the public comment period closed, the Commission received a telephone inquiry from Thomas Harding, Esq., Pugh, Jones & Johnson, P.C., 180 N. LaSalle St., Chicago, IL who asked for additional background information concerning § 202.010 (relating to securities issued by a governmental unit). After receiving the information and discussing it with staff, Thomas Harding indicated that he had no comment on the proposed rulemaking.

Comments of the Independent Regulatory Review Commission (IRRC)

By letter dated April 17, 2003, IRRC provided the Commission with comments on §§ 102.041, 102.112, 202.030, 203.161 and 305.011. No comments, suggestions or objections were provided by IRRC with respect to the remainder of the proposed rulemaking set forth at 33 Pa.B. 884.

With regard to § 102.041 (relating to bank holding companies; banks in organization), IRRC suggested that subsection (b)(2) be revised to use the declarative rather than subjective mood. The Commission made this change. With respect to § 102.112 (relating to SEPs, IRAs and KEOGHs as institutional investors), IRRC requested clarification of "a person knowledgeable and experienced in financial and business matters." The Commission has revised this section to require that the person be registered with the Commission as an investment adviser or be a Federally-covered adviser.

With respect to § 202.030, IRRC requested that the Commission clarify, if possible, the use of the term "Nationally recognized statistical rating organization" (NRSRO). The Commission has no legal authority to do so. First, this section is being amended to conform to Federal law as dictated by the National Securities Markets Improvement Act of 1996 (NSMIA). Second, the use of the term "NRSRO" and the determination of those firms which are to be so designated is within the exclusive jurisdiction of the United States Securities and Exchange Commission (SEC).

Since 1975, the SEC has required credit ratings by NRSROs in its net capital rule for broker-dealers which the Commission, under NSMIA, is required to follow. Initially, Standard & Poor's, Moody's Investor Services and Fitch's (the same firms that existed in 1975) were the only NRSROs. NRSRO is not defined in SEC regulations and the process for obtaining NRSRO designation from the SEC is not specified. Generally, designation of NRSROs has been done through an informal process by way of a no-action letter from the staff of the SEC Division of Market Regulation. The number of firms designated as NRSROs was expanded to four upon issuance of an SEC staff no-action on February 24, 2003, in which Dominion Bond Rating Service, Ltd. was designated as the newest NRSRO.

With regard to § 203.161 (relating to debt securities of nonprofit organizations), IRRC suggested that the reference to, and role of, the North American Securities Administrators Association (NASAA) Statement of Policy on Church Bonds be clarified. The Commission amended this section to indicate that an offering document would meet the requirements of this regulation if it includes the information elicited by the sections of that statement of policy enumerated in the regulation.

IRRC requested that the Commission clarify § 305.011 (relating to supervision of agents, investment adviser representatives and employees) by giving examples when more frequent inspections would be required. The Commission revised this section to be compliant with NSMIA. The internal inspection requirement for broker-dealers is dictated by the Conduct Rules of the National Association of Securities Dealers, Inc. (NASD). Under NSMIA, the Commission cannot adopt a rule for broker-dealers that is inconsistent with NASD conduct rules. Therefore, the Commission has incorporated examples provided in NASD Notice to Members 98-38 (May 1998) regarding frequency of internal inspections.

Changes Made by the Commission on Adoption

In response to IRRC comments, the Commission modified language in §§ 102.041, 102.112, 203.161 and 305.011 as indicated in the previous section.

The Commission also revised Item 7 to Commission Form E in § 203.041 (relating to limited offerings) to elicit information of the amount of securities to be offered in this Commonwealth. This is required so that Commission staff can accurately calculate the statutorily required filing fee in section 602(b.1)(viii) of the act (70 P. S. § 1-602(b.1)(viii)). The Commission also delegated authority in § 606.041(a) (relating to delegation and substitution) to the Director of the Division of Enforcement, Litigation and Compliance to institute a proceeding under sections 512, 513 and 514 of the act (70 P. S. §§ 1-512—1-514).

Summary and Purpose of the Final-Form Rulemaking

Section 102.041. This section states that a "bank," as defined in the act, does not include a person organized as a holding company and codifies the Commission's interpretation of when a "bank-in-organization" becomes a "bank" for purposes of the act.

Section 102.112. The Commission's published position on when this definition would include IRAs, SEPs and KEOGHs has been codified into a separate regulation.

Section 102.202. This section includes a statement of when the offer and sale of real property would be a

"security" under the act, deletes references to the Unit Property Act (68 P. S. §§ 700.101—700.805) and follows SEC staff no-action letters which base the existence of a security on participation in a mandatory rental pool arrangement.

Section 102.241. This section has been conformed to make the definition similar to the Federal securities laws.

Section 202.010. The section makes it clear that all securities that are exempt securities under section 3(a)(2) of the Securities Act of 1933 (1933 Act) (15 U.S.C.A. § 77c(a)(2)) are exempt under section 202(a) of the act except where a separate security exists by application of SEC Rule 131.

Section 202.030. The section states that all section 3(a)(3) exempt securities under the 1933 Act, as interpreted by SEC Release 33-4412, are eligible for the section 202(c) exemption; defines "prime quality" as being in one of the three highest ratings of a NRSRO; prohibits use of public media advertising and mass mailings; and requires that commercial paper issued by bank holding companies contain disclosures that the paper is not issued by a "bank" and, therefore, is not covered by FDIC insurance.

Section 202.051. This section was amended to correct a citation.

Section 202.092. This section defines the term "guaranty" and includes only issuers located in this Commonwealth or any issuer where the guaranty would be deemed a separate security under SEC Rule 131.

Section 203.041. The Commission has adopted a minor revision to Form E to distinguish the amount of securities to be offered in this Commonwealth to assess the correct filing fee established in section 602(b.1)(viii) of the act.

Section 203.091. As required by Act 108 of 2002, the section deletes the filing requirement and Form 203-I.

Section 203.161. This section permits issuers relying on this section to comply with the trust indenture and offering circular requirements of section 203(p) of the act by satisfying Parts V-VII of the NASAA Statement of Policy on Church Bonds.

Section 203.189. The definition of "accredited investor" in § 204.010 (relating to Increasing number of purchasers and offerees) has been added to this section and is the same definition as set forth in SEC Rule 501(a).

Section 204.010. Since Act 109 of 1998 enacted an accredited investor exemption in section 203(t) of the act, the definition of "accredited investor" in § 204.010 has been repealed.

Section 207.120. NSMIA prohibits states from registering securities issued by registered investment companies. This sections relates to registration of investment company securities and, under NSMIA, is no longer applicable. Therefore, the section has been reserved.

Section 305.011. NSMIA prohibits states from maintaining rules governing recordkeeping or financial or operational reporting requirements for broker-dealers that are inconsistent with rules established by the SEC under the Securities Exchange Act of 1934 (15 U.S.C.A. §§ 78a—78kk). These generally are NASD conduct rules which are subject to SEC approval. This section has been revised to mirror inspection requirements for broker-dealers of their offices of supervisory jurisdiction, branch offices and nonbranch locations in accordance with criteria in NASD Rule 3010(g) and NASD Notice to Members 98-38.

Section 606.011. Act 108 of 2002 gave the Commission authority to require, by rule, that persons purchasing securities from a nonprofit issuer under section 203(p) of the act receive annual financial information from the issuer. The section was amended to include securities sold under section 203(p) of the act.

Section 606.041. The section has been amended to permit the Assistant Director of the Division of Corporation Finance to exercise authority delegated to the Director in his absence and also to delegate to the Director of the Division of Enforcement, Litigation and Compliance the authority to institute a proceeding under sections 512—514 of the act.

Persons Affected by the Final-Form Rulemaking

Issuers of municipal securities in this Commonwealth and issuers of commercial paper will be affected by the final-form rulemaking. Registered broker-dealers will be affected by the changes to inspection requirements for various offices maintained by the broker-dealer. Nonprofit organizations issuing debt securities secured by a first lien mortgage shall comply with certain disclosure requirements in the use of an offering circular and in annual financial information to be given to security holders in this Commonwealth.

Fiscal Impact

The final-form rulemaking reduces compliance costs by eliminating the filing of Form 203-I. The only new compliance cost is that nonprofit organizations which sell debt securities to Commonwealth residents that are secured by a first lien mortgage on property owned by the issuer must provide annual financial information to those purchasers. The Commission does not believe the compliance cost to be unreasonable when balanced against an investor's need to know the financial health of the issuer and the security of bonds the investor purchased. No additional compliance cost is envisioned for broker-dealer inspection of their offices as the regulatory requirement mirrors that which already exists in NASD conduct rules.

Paperwork

The Commission has eliminated Form 203-I. The only new paperwork requirement is the provision of annual financial information to Commonwealth residents who have purchased debt securities from a nonprofit organization which are secured by a first lien mortgage on property owned by the organization.

Regulatory Review

Under section 5(a) of the Regulatory Review Act (71 P. S. § 745.5(a)), on February 3, 2003, the Commission submitted a copy of the notice of proposed rulemaking, published at 33 Pa.B. 884, to IRRC and to the Chairpersons of the House Committee on Commerce and Economic Development and the Senate Committee on Banking and Insurance for review and comment.

Under section 5(c) of the Regulatory Review Act, IRRC and the Committees were provided with copies of the comments received during the public comment period, as well as other documents when requested. In preparing this final-form rulemaking, the Commission has considered the comments received from IRRC, the Committees and the public.

Under section 5.1(d) of the Regulatory Review Act (71 P. S. § 745.5a(d)), on June 11, 2003, this final-form rulemaking was deemed approved by the House and Senate Committees. Under section 5.1(e) of the Regula-

tory Review Act, IRRC met on June 12, 2003, and approved the final-form rulemaking.

Availability in Alternative Formats

The final-form rulemaking may be made available in alternative formats upon request. TDD users should use the AT&T Relay Center (800) 854-5984. To make arrangements for alternative formats, contact George Spiess, ADA Coordinator, (717) 787-6828.

Contact Person

The contact person for an explanation of the final-form rulemaking is G. Philip Rutledge, Chief Counsel, Securities Commission, Eastgate Building, 1010 N. Seventh Street, 2nd Floor, Harrisburg, PA 17102-1410, (717) 783-5130.

Findings

The Commission finds that:

(1) Public notice of intention to adopt the amendment adopted by this order has been given under sections 201 and 202 of the act of July 31, 1968 (P. L. 769, No. 240) (45 P. S. §§ 1201 and 1202) and the regulations promulgated thereunder, 1 Pa. Code §§ 7.1 and 7.2.

(2) A public comment period was provided, and no comments were received.

(3) The adoption of the amendment of the Commission in the manner provided in this order is necessary and appropriate for administration and enforcement of the authorizing statutes.

Order

The Commission, acting under the authorizing statute, orders that:

(a) The regulations of the Commission, 64 Pa. Code, Chapters 102, 202—204, 207, 305 and 606, are amended by amending §§ 102.202, 102.241, 202.010, 202.030, 202.051, 202.092, 203.189, 204.010, and 606.011 and deleting §§ 202.032 and 207.120 to read as set forth at 33 Pa.B. 884; and by amending §§ 102.041, 203.041, 203.161, 305.011 and 606.041 and adding § 102.112 to read as set forth in Annex A, with ellipses referring to the existing text of the regulations.

(b) The Secretary of the Commission shall submit this order, 33 Pa.B. 884 and Annex A to the Office of Attorney General for approval as to form and legality.

(c) The Secretary of the Commission shall certify this order, 33 Pa.B. 884 and Annex A and deposit them with the Legislative Reference Bureau as required by law.

(d) This order shall take effect upon publication in the *Pennsylvania Bulletin*.

M. JOANNA CUMMINGS,
Secretary

(Editor's Note: For the text of the order of the Independent Regulatory Review Commission, relating to this document, see 33 Pa.B. 3092 (June 28, 2003).)

Fiscal Note: Fiscal Note 50-118 remains valid for the final adoption of the subject regulations.

Annex A

TITLE 64. SECURITIES

PART I. SECURITIES COMMISSION

Subpart A. DEFINITIONS

CHAPTER 102. DEFINITIONS

§ 102.041. Bank holding companies; banks in organization.

(a) The definition of "bank" in section 102(d) of the act (70 P. S. § 1-102(d)) does not include a holding company for a bank.

(b) The definition of "bank" in section 102(d) of the act (70 P. S. § 1-102(d)) does not include a bank-in-organization. Whether an entity is a "bank" or a "bank-in-organization" shall be determined in accordance with the interpretation of the primary regulatory authority responsible for administration of the banking laws under which the entity is being formed or with which it shall otherwise comply.

§ 102.112. SEPs, IRAs and KEOGHs as institutional investors.

Institutional investor, as defined in section 102(k) of the act (70 P. S. § 1-102(k)), includes a Qualified Pension and Profit Sharing and Stock Bonus Plan under section 401 of the Internal Revenue Code of 1986 (KEOGH), an Individual Retirement Account under section 408 of the Internal Revenue Code of 1986 (IRA) and a Simplified Employee Pension under section 408(k) of the Internal Revenue Code of 1986 (SEP) if the KEOGH, IRA or SEP has one of the following:

- (1) Plan assets of \$5 million or more.
- (2) Retained, on an ongoing basis, the services of an investment adviser registered under section 301 of the act (70 P. S. § 1-301) or a Federally-covered adviser to render professional investment management advice and has investments of \$500,000 or more in securities.

Subpart B. REGISTRATION OF SECURITIES

CHAPTER 203. EXEMPT TRANSACTIONS

§ 203.041. Limited offerings.

(a) The notice required by section 203(d) of the act (70 P. S. § 1-203(d)) shall be filed with the Commission within the time period specified by that section on the following form, designated by the Commission as Form E.

* * * * *
COMMISSION FORM E
* * * * *

7. Description of securities to be sold
Describe type of securities proposed to be sold, price per unit and expected net proceeds to the issuer. Indicate the aggregate offering amount and the amount to be offered in Pennsylvania. ___ Check here if responding to this item by incorporating items C.1-4 of SEC Form D attached hereto (the amount to be offered in Pennsylvania either must be shown here or on SEC Form D).

* * * * *

§ 203.161. Debt securities of nonprofit organizations.

(a) A person proposing to offer debt securities under section 203(p) of the act (70 P. S. § 1-203(p)) shall complete and file with the Commission two copies of the following notice, designated by the Commission as Form

203-P not later than 5 business days before the issuer receives from any person an executed subscription agreement or other contract to purchase the securities being offered or the issuer receives consideration from any person therefor, whichever is earlier.

(b) Except in cases when the delivery of an offering document is not required by order of the Commission, every offering of debt securities pursuant to section 203(p) shall be made by an offering document containing all material information about the securities being offered and the issuer. An offering document will be deemed to meet the requirements of this section if it includes the information that is elicited by Part VII of the Statement of Policy Regarding Church Bonds adopted April 14, 2002, by the North American Securities Administrators Association, Inc. and any successor policy thereto (NASAA Guidelines) and is in the format set forth therein. A copy of the offering document and any offering literature to be used in connection with the offer or sale of securities under section 203(p) shall be filed with the Commission at the same time the notice required by subsection (a) must be filed.

(c) The offering document required by subsection (b) shall meet the following conditions:

(1) Contain a notice of a right to withdraw that complies with § 207.130 (relating to notice to purchasers under section 207(m) of the act (70 P. S. § 1-207(m))).

(2) Contain financial statements of the issuer that comply with § 609.034(b) (relating to financial statements).

(3) Demonstrate compliance with the trust indenture standards and trustee qualification standards and associated disclosure requirements as set forth in Parts V and VI of the NASAA Guidelines if the total amount of securities to be offered exceeds \$250,000.

(4) Include whatever data may be necessary to establish that investors will receive a first lien on real estate of the issuer, that the issuer has not defaulted on prior obligations and that the total amount of securities offered does not exceed 75% of the current fair market value of the real property covered by the securities.

**Subpart C. REGISTRATION OF
BROKER-DEALERS, AGENTS, INVESTMENT
ADVISERS AND INVESTMENT ADVISER
REPRESENTATIVES AND NOTICE FILINGS BY
FEDERALLY-COVERED ADVISERS**

**CHAPTER 305. DENIAL, SUSPENSION,
REVOCATION AND CONDITIONING OF
REGISTRATION**

§ 305.011. Supervision of agents, investment adviser representatives and employees.

* * * * *

(c) As evidence of compliance with the supervisory obligations imposed by this section, every broker-dealer and investment adviser shall implement written procedures, a copy of which shall be kept in each location at which the broker-dealer or investment adviser conducts business, and shall establish, maintain and enforce those written procedures designed to achieve compliance with the act and this title and to detect and prevent violations described in subsection (a). These written procedures, at a minimum, shall address:

* * * * *

(10) The periodic inspection of each location in this Commonwealth from which business is conducted to

ensure that the written procedures and systems are enforced. In establishing an inspection cycle, the broker-dealer and investment adviser shall give consideration to the nature and complexity of the securities activities for which the location is responsible, the volume of business done and the number of agents or investment adviser representatives assigned to the location. The obligation of diligent supervision required by this section may require that one or more locations of a broker-dealer or investment adviser in this Commonwealth receive more inspections or be on a periodic inspection cycle different than other locations of the broker-dealer or investment adviser in this Commonwealth and that inspections be unannounced. In acquitting their obligations under this section, registrants are to consult NASD Notice to Members 98-38 (May 1998) and SEC Release No. 34-38174 (January 15, 1997). In accordance with NASD Notice to Members 98-38, unannounced visits may be appropriate when there are indicators of misconduct such as receipt of significant customer complaints; personnel with disciplinary records; or excessive trade corrections, extensions, liquidations, or variable contract replacements.

(i) An office of supervisory jurisdiction of a broker-dealer shall be inspected at least annually. Branch offices and nonbranch locations of a broker-dealer shall be inspected in accordance with an inspection cycle established in the broker-dealer's written supervisory procedures.

(ii) It is the responsibility of the broker-dealer or investment adviser to ensure through inspections of each location in this Commonwealth that the written procedures and systems are enforced and the supervisory obligations imposed by this section are being honored.

(iii) Written records shall be maintained reflecting each inspection conducted.

(iv) For purposes of this section, the terms "office of supervisory jurisdiction" and "branch office" shall have the same meaning as those terms are defined in NASD Conduct Rule 3010(g) or any successor thereto. The term "nonbranch location" means any location at which a broker-dealer is conducting a securities business that does not come within the definition of "office of supervisory jurisdiction" or "branch office."

Subpart F. ADMINISTRATION

**CHAPTER 606. MISCELLANEOUS POWERS OF
COMMISSION**

§ 606.041. Delegation and substitution.

(a) The Commission delegates to the Director and Assistant Director of the Division of Enforcement, Litigation and Compliance:

* * * * *

(5) The power to institute a proceeding under sections 512—514 of the act (70 P. S. §§ 1-512—1-514) to do one of the following:

(i) Impose a statutory bar under section 512 of the act (70 P. S. § 1-514).

(ii) Mandate a rescission offer under section 513 of the act (70 P. S. § 1-513).

(iii) Compel the return of sales commissions under section 514 of the act (70 P. S. § 1-514).

* * * * *

(e) The Commission authorizes the following:

(1) The Chief Counsel, Deputy Chief Counsel or the Assistant Director of the Division of Corporation Finance may exercise the delegations given in this section in the absence of the Director of the Division of Corporation Finance.

(2) The Chief Counsel and Deputy Chief Counsel may exercise the delegations given in this section in the absence of the Director of the Division of Licensing.

[Pa.B. Doc. No. 03-1350. Filed for public inspection July 11, 2003, 9:00 a.m.]
