

will also be available for inspection and copying at the principal office of the above-mentioned self-regulatory organization. All submissions should refer to the file number in the caption above and should be submitted by June 28, 1995.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>7</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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[Release No. 34-35788; File No. SR-NASD-95-21]

**Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by National Association of Securities Dealers, Inc. Relating to Freely Tradeable Direct Participation Program Securities**

May 31, 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 May 23, 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.<sup>1</sup> 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 herewith filing a proposed rule change to Article III, Section 34 of the Rules of Fair Practice. Below is the text of the proposed rule change. Proposed new language is italicized; proposed deletions are in brackets.

**Direct Participation Programs**

*Sec. 34.*

\* \* \* \* \*

**Suitability**

(3)(A) A member or person associated with a member shall not underwrite or participate in a public offering of a direct participation program unless standards of suitability have been established by the program for participants therein and such standards are fully disclosed in the prospectus and are consistent with the provisions of subparagraph (B) of this section.

(B) In recommending to a participant the purchase, sale or exchange of an interest in a direct participation program, a member or person associated with a member shall:

(i) have reasonable grounds to believe, on the basis of information obtained from the participant concerning his investment objectives, other investments, financial situation and needs, and any other information known by the member or associated person, that:

a. the participant is or will be in a financial position appropriate to enable him to realize to a significant extent the benefits described in the prospectus, including the tax benefits where they are a significant aspect of the program;

b. the participant has a fair market net worth sufficient to sustain the risks inherent in the program, including loss of investment and lack of liquidity; and

c. the program is otherwise suitable for the participant; and

(ii) maintain in the files of the member documents disclosing the basis upon which the determination of suitability was reached as to each participant.

(C)[D] Notwithstanding the provisions of subparagraphs (A) and (B) hereof, no member shall execute any transaction in a direct participation program in a discretionary account without prior written approval of the transaction by the customer.

(D)[C] Subparagraphs 3(A) and 3(B), and, only in situations where the member is not affiliated with the direct participation program, Subparagraph 3(C), shall not apply to:

(i) a secondary public offering of or a secondary market transaction in a unit, depositary receipt, or other interest in a direct participation program for which quotations are displayed on Nasdaq or which is listed on a registered national securities exchange, or

(ii) an initial public offering of a unit, depositary receipt or other interest in a direct participation program for which an application for inclusion on Nasdaq or listing on a registered national securities exchange has been approved by Nasdaq or such exchange and the applicant makes a good-faith

representation that it believes such inclusion on Nasdaq or listing on an exchange will occur within a reasonable period of time following the formation of the program.

\* \* \* \* \*

**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*

Article III, Section 34 of the Rules of Fair Practice regulates participation by members and persons associated with a member in direct participation programs and limited partnership rollup transactions ("DPP rule"). The DPP rule generally prohibits a member or a person associated with a member from participating in a public distribution of a direct participation program or a limited partnership rollup transaction unless the distribution or transaction conforms to certain suitability and disclosure requirements and standards of fairness and reasonableness.

Since the adoption of the DPP rule in 1982,<sup>2</sup> an increasing number of direct participation programs, such as master limited partnerships, have issued partnership units, depositary receipts for such units, or assignee units of limited partnership units that are freely tradeable in a manner generally analogous to common stock and are quoted on Nasdaq and listed on registered national stock exchanges. A direct participation program security is considered freely-tradeable under Section 34 if it is either (1) a secondary public offering of or a secondary market transaction in a direct participation program security for which quotations are displayed on Nasdaq or which is listed on a registered national securities exchange, or (2) a primary offering of a direct participation program for which

<sup>2</sup>The DPP rule was initially approved by the Commission as Appendix F to Article III, Section 34 on September 16, 1982 (Securities Exchange Act Release No. 19054); 47 FR 42226 (September 24, 1982).

<sup>7</sup> 17 CFR 200.30-3(a)(12) (1994).

<sup>1</sup> The proposal was originally filed with the Commission on May 10, 1995. The NASD subsequently submitted Amendment No. 1 to the filing which amends Subsections (b)(3)(C) (i) and (ii) to Article III, Section 34 of the Rules of Fair Practice, by replacing the phrase "the NASDAQ System" in Subsections (i) and (ii) and the word "NASDAQ" in Subsection (ii) with the word "Nasdaq." Letter from Suzanne E. Rothwell, Associate General Counsel, NASD, to Mark P. Barracca, Branch Chief, Over-the-Counter Regulation, Division of Market Regulation, SEC, dated May 22, 1995.

an application for inclusion on Nasdaq or listing on a registered national securities exchange has been approved.

In order to address the increased transparency and liquidity associated with the nature of the secondary markets for freely tradeable direct participation program securities, the NASD amended the DPP rule to, among other things, exempt freely tradeable direct participation program securities from the suitability requirements of Subsections 34(b)(3) (A) and (B) of the DPP rule.<sup>3</sup> At the time, the NASD determined that since the disclosure requirements in the DPP rule were primarily designed for direct participation program securities that lacked liquidity and marketability, no purpose was served by applying the same criteria to freely tradeable direct participation program securities.

Freely tradeable direct participation program securities, however, continue to be subject to the discretionary account prohibitions of Article III, Section 34. Currently, Subsection 34(b)(3)(D) of the DPP rule states, in part, that “\* \* \* no member shall execute any transaction in a direct participation program in a discretionary account without prior written approval of the transaction by the customer.” The provision applies to transactions in all direct participation program securities, whether freely tradeable or not. The NASD considers discretionary transactions in direct participation program securities which are illiquid and for which no ready market exists to be an improper use of discretionary power. Recently, the NASD considered whether Monthly Income Preferred Securities (“MIPS”), a new financial instrument which is a freely tradeable direct participation program security, ought to be subject to the discretionary account restrictions in Article III, Section 34.<sup>4</sup> In its consideration, the NASD determined that the concerns which attach to the use of discretionary authority for illiquid, unmarketable direct participation program securities are not present with freely tradeable

direct participation program securities. Therefore, the NASD is proposing reversing the order of current Subsections (b)(3)(C) and (D) to Section 34 and to add a reference to Subparagraph 3(C) in new Subparagraph 3(D) to exclude freely-tradeable direct participation program securities from the prohibition on transactions in discretionary accounts without written approval. The exclusion for freely tradeable direct participation program securities in newly designated Subparagraph (3)(D) also restricts the availability of the exclusion to members that are not affiliated with the direct participation program. Where such an affiliation is present, the NASD believes that substantial conflict of interest and regulatory concerns continue to exist and the exclusion should not be made available.

The NASD believes that recognizing the use of discretionary authority for transactions in freely tradeable direct participation program securities is consistent with 1986 amendments to Section 34 exempting freely tradeable participation program securities from the suitability and disclosure requirements of Section 34. Such suitability and disclosure requirements, which are necessary where direct participation program securities lack liquidity and marketability, were found to be unnecessary where a ready, liquid market exists.

Notwithstanding the relief provided by the proposed rule from the prohibition in Article III, Section 34 against discretionary transactions in freely tradeable direct participation program securities, such transactions would, however, remain subject to the general discretionary account requirements contained in Article III, Section 15 of the Rules of Fair Practice.

The NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,<sup>5</sup> which require that the rules of the Association be designed to prevent fraudulent and manipulative acts and promote just and equitable principles of trade, in that the proposed rule change relieves members of their obligation to comply with prohibitions against discretionary transactions in direct participation program securities in situations which do not present the regulatory concerns that the prohibitions were intended to address, and provides for regulatory consistency in the treatment of discretionary transactions in freely tradeable securities.

#### *(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, N.W., 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 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 File No. SR-NASD-95-21 and should be submitted by June 28, 1995.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority, 17 CFR 200.30-3(a)(12).

**Margaret H. McFarland,**  
*Deputy Secretary.*

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<sup>3</sup> See, Securities Exchange Act Release No. 23619 (September 15, 1986); 51 FR 33968 (September 24, 1986).

<sup>4</sup> MIPS are preferred securities issued by a parent company's subsidiary, which is structured as a limited partnership or limited liability company. The subsidiary issues MIPS to investors and invests the proceeds in convertible subordinated debentures of the parent. Interest on the debentures of the parent are paid to the subsidiary, which in turn pays the equivalent rate of interest to MIPS holders in the form of dividends. MIPS are eligible to be listed on a national securities exchange or The Nasdaq Stock Market and have flow-through tax consequences for investors, which means that they are considered direct participation programs and, therefore, subject to Section 34.

<sup>5</sup> 15 U.S.C. 78o-3.