

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.³ 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 34.⁴ 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,⁵ 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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³ See, Securities Exchange Act Release No. 23619 (September 15, 1986); 51 FR 33968 (September 24, 1986).

⁴ 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.

⁵ 15 U.S.C. 78o-3.