release (Securities Exchange Act Release No. 35788, May 31, 1995) and by publication in the **Federal Register** (60 FR 30133, June 7, 1995). No comment letters were received. The Commission is approving the proposed rule change.

I. Background

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

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 exempt freely tradeable direct participation program securities from the suitability requirements of Subsections 34(b)(3) (A) and (B) of the DPP rule.[5]

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.[6] 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.

II. The Terms of Substance of the Proposed Rule Change

The proposed rule change reverses the order of current Subsections (b)(3)(C) and (D) to Section 34 and adds 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. However, the exclusion for freely tradeable direct participation program securities in newly designated Subparagraph (3)(D) restricts the exclusion to members that are not affiliated with the direct participation program.

III. Discussion

The Commission believes that the rule change is consistent with the provisions of Section 15A(b)(6) of the Act,[7] which require that the rules of the Association be designed to prevent fraudulent and manipulative acts and promote just and equitable principles of trade. The rule change relieves members of their obligation to comply with the prohibitions against discretionary transactions in freely tradeable direct participation program securities without written approval because the transactions do not present the substantial conflicts of interest and regulatory concerns that the prohibitions were intended to address. Furthermore, freely tradeable direct participation securities that are included on Nasdaq or listed on a registered national securities exchange provide investors with a liquid and available market for trading surplus securities placed in their discretionary accounts without written approval.

The exclusion for freely tradeable direct participation program securities is limited to members that are not affiliated with the direct participation program. Where such an affiliation is present, the Commission agrees with the NASD that substantial conflict of interest and regulatory concerns continue to exist and the exclusion should not be made available.

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

In addition, discretionary transactions in freely tradeable direct participation program securities would remain subject to the general discretionary account requirements contained in Article III, Section 15 of the Rules of Fair Practice.[8]

It is therefore ordered, pursuant to Section 19(b)(2) of the Act, that the proposed rule change SR–NASD–95–21 be, and hereby is, approved.

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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[4] 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).

[5] *See* Securities Exchange Act Release No. 23619 (September 15, 1986); 51 FR 33968 (September 24, 1986). However, freely tradeable direct participation program securities are still subject to the general suitability rules of the NASD. *See* NASD's Rules of Fair Practice, Article III, Section 2. Section 2(a) states:

[I]n recommending to a customer the purchase, sale or exchange of any security, a member shall have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his other security holdings and as to his financial situation and needs.

[6] 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.

[7] 15 U.S.C. 78*o*-3.

[8] Article III, Section 15(a) of the Rules of Fair Practice provides that ''[n]o member shall effect with or for any customer's account in respect to which such member or his agent or employee is vested with any discretionary power any transactions of purchase or sale which are excessive in size or frequency in view of the financial resources and character of the account.''