this chapter has been paid.'' The direct final rule revised the wording as follows: ''Each person who applies for airmen certification services to be administered outside the United States for any certificate or rating issued under this part must show evidence that the fee prescribed in appendix A of part 187 of this chapter has been paid.''

Conclusion

The FAA did not receive any adverse or negative comments or a written notice of intent to file an adverse or negative comment and therefore the rulemaking became effective on June 11, 2007.

Issued in Washington, DC on September 24, 2007.

John M. Allen,

Acting Director, Flight Standards Service.

[FR Doc. E7–19246 Filed 9–27–07; 8:45 am]

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SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 275

[Release No. IA–2653; File No. S7–23–07]

RIN 3235–AJ96

Temporary Rule Regarding Principal Trades With Certain Advisory Clients

AGENCY: Securities and Exchange Commission.

ACTION: Interim final temporary rule; request for comments.

SUMMARY: The Commission is adopting a temporary rule under the Investment Advisers Act of 1940 that establishes an alternative means for investment advisers who are registered with the Commission as broker-dealers to meet the requirements of section 206(3) of the Advisers Act when they act in a principal capacity in transactions with certain of their advisory clients. The Commission is adopting the temporary rule on an interim final basis as part of its response to a recent court decision invalidating a rule under the Advisers Act, which provided that fee-based brokerage accounts were not advisory accounts and were thus not subject to the Advisers Act. As a result of the Court's decision, which takes effect on October 1, fee-based brokerage customers must decide whether they will convert their accounts to fee-based accounts that are subject to the Advisers Act or to commission-based brokerage accounts. We are adopting the temporary rule to enable investors to make an informed choice between those accounts and to continue to have access to certain securities held in the principal accounts of certain advisory firms while remaining protected from certain conflicts of interest. The temporary rule will expire and no longer be effective on December 31, 2009.

DATES: *Effective Date:* September 30, 2007, except for 17 CFR 275.206(3)–3T will be effective from September 30, 2007 until December 31, 2009.

Comment Date: Comments on the interim final rule should be received on or before November 30, 2007.

ADDRESSES: Comments may be submitted by any of the following methods:

Electronic Comments

- Use the Commission's Internet comment form (*http://www.sec.gov/rules/final.shtml*); or
- Send an e-mail to *rule-comments@sec.gov.* Please include File Number S7–23–07 on the subject line; or
- Use the Federal eRulemaking Portal (*http://www.regulations.gov*). Follow the instructions for submitting comments.

Paper Comments

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549–1090.

All submissions should refer to File Number S7–23–07. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (*http://www.sec.gov/rules/final.shtml*). Comments are also available for public inspection and copying in the Commission's Public Reference Room, 100 F Street, NE., Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

FOR FURTHER INFORMATION CONTACT: David W. Blass, Assistant Director, Daniel S. Kahl, Branch Chief, or Matthew N. Goldin, Attorney-Adviser, at (202) 551–6787 or *IArules@sec.gov*, Office of Investment Adviser Regulation, Division of Investment Management, U.S. Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549–5041.

SUPPLEMENTARY INFORMATION: The Securities and Exchange Commission (''Commission'') is adopting temporary rule 206(3)–3T [17 CFR 275.206(3)–3T] under the Investment Advisers Act of 1940 [15 U.S.C. 80b] as an interim final rule.

We are soliciting comments on all aspects of the rule. We will carefully consider the comments that we receive and respond to them in a subsequent release.

I. Background

A. The FPA Decision

On March 30, 2007, the Court of Appeals for the District of Columbia Circuit (the ''Court''), in *Financial Planning Association* v. *SEC* (''*FPA* decision''), vacated rule 202(a)(11)–1 under the Investment Advisers Act of 1940 (''Advisers Act'' or ''Act'').[1] Rule 202(a)(11)–1 provided, among other things, that fee-based brokerage accounts were not advisory accounts and were thus not subject to the Advisers Act.[2] As a consequence of the *FPA* decision, broker-dealers offering fee-based brokerage accounts became subject to the Advisers Act with respect to those accounts, and the client relationship became fully subject to the Advisers Act. Broker-dealers would need to register as investment advisers, if they had not done so already, act as fiduciaries with respect to those clients, disclose all potential material conflicts of interest, and otherwise fully comply with the Advisers Act, including the Act's restrictions on principal trading.

We filed a motion with the Court on May 17, 2007 requesting that the Court temporarily withhold the issuance of its mandate and thereby stay the effectiveness of the *FPA* decision.[3] We estimated at the time that customers of broker-dealers held $300 billion in one million fee-based brokerage accounts.[4] We sought the stay to protect the interests of those customers and to provide sufficient time for them and their brokers to discuss, make, and implement informed decisions about the assets in the affected accounts. We also informed the Court that we would use

[1] 482 F.3d 481 (D.C. Cir. 2007).

[2] Fee-based brokerage accounts are similar to traditional full-service brokerage accounts, which provide a package of services, including execution, incidental investment advice, and custody. The primary difference between the two types of accounts is that a customer in a fee-based brokerage account pays a fee based upon the amount of assets on account (an asset-based fee) and a customer in a traditional full-service brokerage account pays a commission (or a mark-up or mark-down) for each transaction.

[3] May 17, 2007, Motion for the Stay of Mandate, in *FPA* v. *SEC.*

[4] *Id.*

the period of the stay to consider whether further rulemaking or interpretations were necessary regarding the application of the Act to fee-based brokerage accounts and other issues arising from the Court's decision. On June 27, 2007, the Court granted our motion and stayed the issuance of its mandate until October 1, 2007.[5]

B. Section 206(3) of the Advisers Act and the Issue of Principal Trading

We and our staff received several letters regarding the *FPA* decision and about particular consequences to customers who hold fee-based brokerage accounts.[6] Our staff followed up with, and has been engaged in an ongoing dialogue with, representatives of investors, financial planners, and broker-dealers regarding the implications of the *FPA* decision. During that process, firms that offered fee-based brokerage accounts informed us that, unless the Commission acts before October 1, 2007, one group of fee-based brokerage customers is particularly likely to be harmed by the consequences of the *FPA* decision: Customers who depend both on access to principal transactions with their brokerage firms and on the protections associated with a fee-based (rather than transaction-based) compensation structure. Firms explained that section 206(3) of the Advisers Act, the principal trading provision, poses a significant practical impediment to continuing to meet the needs of those customers.

Section 206(3) of the Advisers Act makes it unlawful for any investment adviser, directly or indirectly ''acting as principal for his own account, knowingly to sell any security to or purchase any security from a client * * *, without disclosing to such client in writing before the completion of such transaction the capacity in which he is acting and obtaining the consent of the client to such transaction.'' [7] Section 206(3) requires an adviser entering into a principal transaction with a client to satisfy these disclosure and consent requirements on a transaction-by-transaction basis.[8] An adviser may provide the written disclosure to a client and obtain the client's consent at or prior to the completion of the transaction.[9]

During our discussions, firms informed our staff that the written disclosure and the client consent requirements of section 206(3) act as an operational barrier to their ability to engage in principal trades with their clients. Firms that are registered both as broker-dealers and investment advisers generally do not offer principal trading to current advisory clients (or do so on a very limited basis), and the rule vacated in the *FPA* decision had allowed broker-dealers to offer fee-based accounts without complying with the Advisers Act, including the requirements of section 206(3). Most informed us that they plan to discontinue fee-based brokerage accounts as a result of the *FPA* decision because of the application of the Advisers Act. They also informed us of their view that, unless they are provided an exemption from, or an alternative means of complying with, section 206(3) of the Advisers Act, they would be unable to provide the same range of services to those fee-based brokerage customers who elect to become advisory clients and would expect few to elect to do so.[10]

Several broker-dealers and the Securities Industry and Financial Markets Association (''SIFMA'') contended that providing written disclosure before completion of each securities transaction, as required by section 206(3) of the Advisers Act, makes it not feasible for an adviser to offer customers principal transactions for several reasons. Firms explained that there are timing and mechanical

[5] *See* June 27, 2007, Order of the U.S. Court of Appeals for the District of Columbia Circuit, in *FPA* v. *SEC.*

[6] *See, e.g.,* Letter from Barbara Roper, Director of Investor Protection, Consumer Federation of America, et al., to Christopher Cox, Chairman, U.S. Securities and Exchange Commission, dated April 24, 2007; E-mail from Timothy J. Sagehorn, Senior Vice President—Investments, UBS Financial Services Inc., to Christopher Cox, Chairman, U.S. Securities and Exchange Commission, dated May 15, 2007; Letter from Kurt Schacht, Managing Director, CFA Institute Centre for Financial Market Integrity, to Christopher Cox, Chairman, U.S. Securities and Exchange Commission, dated May 23, 2007; Letter from Joseph P. Borg, President, North American Securities Administrators Association, Inc., to Christopher Cox, Chairman, U.S. Securities and Exchange Commission, dated June 18, 2007; Letter from Daniel P. Tully, Chairman Emeritus, Merrill Lynch & Co., Inc., to Christopher Cox, Chairman, U.S. Securities and Exchange Commission, dated June 21, 2007; Letter, with Exhibit, from Ira D. Hammerman, Senior Managing Director and General Counsel, Securities Industry and Financial Markets Association, to Robert E. Plaze, Associate Director, Division of Investment Management, U.S. Securities and Exchange Commission, and Catherine McGuire, Chief Counsel, Division of Market Regulation, U.S. Securities and Exchange Commission, dated June 27, 2007 (''SIFMA Letter''); Letter from Raymond A. ''Chip'' Mason, Chairman and CEO, Legg Mason, Inc., to Christopher Cox, Chairman, U.S. Securities and Exchange Commission, dated July 10, 2007; Letter from Robert J. McCann, Vice Chairman and President—Global Private Client, Merrill Lynch, to Christopher Cox, Chairman, U.S. Securities and Exchange Commission, dated July 11, 2007; Letter from Samuel L. Hayes, III, Jacob Schiff Professor of Investment Banking Emeritus, Harvard Business School, to Christopher Cox, Chairman, U.S. Securities and Exchange Commission, dated July 12, 2007; Letter from Duane Thompson, Managing Director, Washington Office, Financial Planning Association, to Robert E. Plaze, Associate Director, Division of Investment Management, U.S. Securities and Exchange Commission, dated July 27, 2007 (''FPA Letter''); Letter from Richard Bellmer, Chair, and Ellen Turf, CEO, National Association of Personal Financial Advisors, to Robert E. Plaze, Associate Director, Division of Investment Management, U.S. Securities and Exchange Commission, dated August 14, 2007 (''NAPFA Letter''); Letter from Congressman Dennis Moore, et al., to Christopher Cox, Chairman, U.S. Securities and Exchange Commission, dated July 13, 2007; and Letter from Congressman Spencer Bachus, Ranking Member, Committee on Financial Services, to Christopher Cox, Chairman, U.S. Securities and Exchange Commission, dated July 10, 2007. Each of these letters is available at: *www.sec.gov/comments/s7–23–07.*

[7] 15 U.S.C. 80b–6(3). Section 206(3) also addresses ''agency cross transactions,'' imposing the same procedural requirements regarding prior disclosure and consent on those transactions as it imposes on principal transactions. Agency cross transactions are transactions for which an investment adviser provides advice and the adviser, or a person controlling, controlled by, or under common control with the adviser, acts as a broker for that advisory client and for the person on the other side of the transaction. *See Method for Compliance with Section 206(3) of the Investment Advisers Act of 1940 with Respect to Certain Transactions,* Investment Advisers Act Release No. 557 (Dec. 2, 1976) [41 FR 53808] (''Rule 206(3)–2 Proposing Release'').

[8] *See Commission Interpretation of Section 206(3) of the Investment Advisers Act of 1940,* Investment Advisers Act Release No. 1732 (July 17, 1998) [63 FR 39505 (July 23, 1998)] (''Section 206(3) Release'') (''[A]n adviser may comply with Section 206(3) either by obtaining client consent prior to execution of a principal or agency transaction, or after execution but prior to settlement of the transaction.''). *See also* Investment Advisers Act Release No. 40 (Jan. 5, 1945) [11 FR 10997] (''[T]he requirements of written disclosure and of consent contained in this clause must be satisfied before the completion of each separate transaction. A blanket disclosure and consent in a general agreement between investment adviser and client would not suffice.'').

[9] Section 206(3) Release (''Implicit in the phrase 'before the completion of such transaction' is the recognition that a securities transaction involves various stages before it is 'complete.' The phrase completion of such transaction' on its face would appear to be the point at which all aspects of a securities transaction have come to an end. That ending point of a transaction is when the actual exchange of securities and payment occurs, which is known as 'settlement.''').

[10] The firms explained that they plan to consult with their customers and obtain customers' consent to convert the fee-based accounts to one or more other types of accounts already operating on pre-existing business platforms. We understand that in most cases customers will be able to choose among different types of brokerage accounts, paying commissions for securities, and advisory accounts, paying asset-based fees. Firms indicated to us that, if we provide an alternative means of complying with section 206(3), they believe a significant number of their fee-based brokerage customers will elect to convert their accounts to non-discretionary advisory accounts. Those accounts operate in many respects like fee-based brokerage accounts, but fiduciary duties apply to the adviser, and the other obligations of the Advisers Act also apply. Firms offering these accounts provide investment advice, but clients retain decision making authority over their investment selections.

impediments to complying with section 206(3)'s written disclosure requirement. SIFMA explained that, for example, the combination of rapid electronic trading systems and the limited availability of many of the securities traded in principal markets means that an adviser may be unable to provide written disclosure and obtain consent in sufficient time to obtain such securities at the best price or, in some cases, at all.[11] Similarly, SIFMA contended that trade-by-trade written disclosure prior to execution is not practicable because ''discussions between investment advisers and non-discretionary clients about a trade or strategy may occur before a particular transaction is effected, but at the time that discussion occurs the representative may not know whether the transaction will be effected on an agency or a principal basis.''[12]

Firms also explained that they engage in thousands—in many cases, tens of thousands—of principal trades a day and that, due to the sheer volume of transactions, providing a written notice to all the clients with whom they conduct trades in a principal capacity may only be done using automated systems.[13] One such automated system is the system broker-dealers use to provide customers with transaction-specific written notifications, or trade confirmations, that include the information required by rule 10b–10 under the Exchange Act.[14] Under rule 10b–10, a broker-dealer must disclose on its confirmation if it acts as principal for its own account with respect to a transaction.[15] However, confirmations are provided to customers too late to satisfy the requirements of section 206(3). This is because trade confirmations are *sent,* rather than *delivered,* at completion of a transaction and much of the information required to be disclosed by rule 10b–10 may only be available at completion of a transaction, not before. Thus, even if firms were to rely on the Commission's 1998 interpretation of section 206(3), under which disclosure and consent may be obtained after execution but before settlement of a transaction,[16] no automated system currently exists that could ensure compliance.[17]

Additionally, even if an automated system existed to enable the disclosure and consent after execution of a trade but before its completion in satisfaction of section 206(3), firms indicated that they would be unlikely to trade on such a basis. The firms explained that they do not seek post-execution consent because allowing a client until settlement to consent to a trade that has already been executed creates too great a risk that intervening market changes or other factors could lead a client to withhold consent to the disadvantage of the firm.

Access to securities held in a firm's principal accounts is important to many investors. We believe, based on our discussions with industry representatives and others throughout the transition process, that many customers may wish to access the securities inventory of a diversified broker-dealer through their non-discretionary advisory accounts.[18] For example, the Financial Planning Association (''FPA'') noted that principal trades in a fiduciary relationship could be beneficial to investors, stating:

> Depending on the circumstances, clients may benefit from principal trades, but only in the context of a fiduciary relationship with the best interests of the client being paramount. In favorable circumstances, advisers may obtain access to a broader range of investment opportunities, better trade execution, and more favorable transaction prices for the securities being bought or sold than would otherwise be available.[19]

As a result of the *FPA* decision, customers must elect on or before October 1, 2007, to convert their fee-based brokerage accounts to advisory accounts or to traditional commission-based brokerage accounts. Several firms emphasized to our staff that the inability of a client to access certain securities held in the firm's principal accounts—particularly municipal securities and other fixed income securities that they contend have limited availability and are dealt through a firm's account using electronic communications networks—may be a determinative factor in whether the client selects (or the firm makes available) a non-discretionary advisory account to replace the client's fee-based brokerage account. As discussed in this Release, many firms informed us that, because of the practical difficulties with complying with the trade-by-trade written disclosure requirements of section 206(3) discussed above, they simply refrain from engaging in principal trading with their advisory clients. Accordingly, customers who wish to access firms' principal inventories may, as a practical matter, have no choice but to open a traditional brokerage account in which they will pay transaction-based compensation, rather than convert their fee-based brokerage account to an advisory account.

While we do not agree with SIFMA that an exemption from section 206(3) of the Act in its entirety is appropriate, we do believe that there may be substantial benefits to many of the investors holding an estimated $300 billion in approximately one million fee-based brokerage accounts if their accounts are converted to advisory accounts instead of traditional brokerage accounts.[20] Those investors will continue to be able

[11] SIFMA Letter, at 21 (''Many fixed income securities, including municipal securities, that have limited availability are quoted, purchased and sold quickly through electronic communications networks utilized by bond dealers. * * * In today's principal markets, investment advisers do not necessarily have 'sufficient opportunity to secure the client's specific prior consent' and provide trade-by-trade disclosure, and opportunities to achieve best execution may be lost if the adviser does not act immediately on current market prices.'') (quoting Rule 206(3)–2 Proposing Release).

[12] *Id.*

[13] Firms asserted that, while possible, providing written notifications by fax or email prior to a transaction is impractical. Clients may not have ready access to either at the time they wish to conduct a trade and delaying the trade in order to provide the written notification likely would not be in the client's best interest, in particular as market prices may change rapidly.

[14] 17 CFR 240.10b–10. Rule 10b–10 under the Exchange Act requires a broker-dealer, at or before completion of a transaction, to give or send to its customer a written confirmation containing specified information about the transaction.

[15] Rule 10b–10(a)(2) under the Exchange Act [17 CFR 240.10b–10(a)(2)].

[16] *See* Section 206(3) Release.

[17] It may be possible for firms to upgrade their confirmation delivery systems to provide an additional written disclosure that satisfies the content and chronological requirements of section 206(3) of the Act. Based on our experience with changes to confirmation delivery systems (largely in response to our changes to Exchange Act rule 10b–10), any such upgrade could take years to accomplish and would not be available by October 1, 2007, the date the *FPA* decision becomes effective. Furthermore, even if an automated system were developed to provide those written disclosures at or before completion of the transaction, no such automated system exists to obtain the required consent from advisory clients. We also are mindful of the burdens associated with such a system change. SIFMA has submitted to us that ''[t]rade confirmation production systems are among the most expensive and most difficult to alter anywhere in the brokerage industry, because of the mass nature of confirmations, the sensitive and private nature of the information, and the extremely short deadlines for their production and mailing.'' Letter from Ira D. Hammerman, Senior Vice President and General Counsel, Securities Industry and Financial Markets Association, to Jonathan G. Katz, Secretary, U.S. Securities and Exchange Commission, U.S. Securities and Exchange Commission, dated April 4, 2005, available at: *www.sec.gov/rules/proposed/s70604/ihammerman040405.pdf.*

[18] We have previously expressed our view that some principal trades may serve clients' best interests. *See* Section 206(3) Release.

[19] FPA Letter, at 3.

[20] SIFMA asserted that firms should be exempt entirely from section 206(3) of the Act in order to ''preserve the [fee-based brokerage] client's ability to access certain securities that are best—or only—available through trades with the adviser or an affiliate of the adviser.'' SIFMA Letter, at 3. SIFMA further requested that we provide broker-dealers an exemption from all of the provisions of the Advisers Act with respect to their fee-based brokerage accounts. We are not adopting such a broad exemption.

to avoid transaction-based compensation and the incentives such a compensation arrangement creates for a broker-dealer, a reason they may have initially opened fee-based brokerage accounts.[21] They also will enjoy, as the Court pointed out in the *FPA* decision, the protections of the ''federal fiduciary standard [that] govern[s] the conduct of investment advisers.'' [22]

To address the concerns described above and to protect the interests of customers who previously held fee-based brokerage accounts, we are adopting a temporary rule, on an interim final basis, that provides an alternative method for advisers who also are registered as broker-dealers to comply with section 206(3) of the Act. We believe this rule both protects investors' choice—fee-based brokerage customers would be able to choose an account that offers a similar set of services (including access to the same securities) that were available to them in fee-based brokerage accounts—and avoids disruption to, and confusion among, investors who may wish to access and sell securities only available through a firm acting in a principal capacity and who, as a result, may no longer be offered any fee-based account. We believe the temporary rule will allow fee-based brokerage customers to maintain their existing relationships with, and receive roughly the same services from, their broker-dealers. We believe further that making the rule temporary allows us an opportunity to observe how those firms use the alternative means of compliance provided by the rule, and whether those firms serve their clients' best interests.

[21] A brokerage industry committee formed in 1994 at the suggestion of then-Commission Chairman Arthur Levitt concluded that fee-based compensation would better align the interests of broker-dealers and their customers and allow registered representatives to focus on what the committee described as their most important role—providing investment advice to individual customers, not generating transaction revenues. *See Report of the Committee on Compensation Practices* (Tully Report) (Apr. 10, 1995). We already have sought and received public comment on the potential benefits to investors of fee-based accounts, *see Certain Broker-Dealers Deemed Not to be Investment Advisers,* Investment Advisers Act Release No. 2376 (Apr. 12, 2005) [70 FR 20424 (Apr. 19, 2005]; *Certain Broker-Dealers Deemed Not to be Investment Advisers,* Investment Advisers Act Release No. 2340 (Jan. 6, 2005) [70 FR 2716 (Jan. 14, 2005)]; and *Certain Broker-Dealers Deemed Not to be Investment Advisers,* Investment Advisers Act Release No. 1845 (Nov. 4, 1999) [64 FR 61226 (Nov. 10, 1999)].

[22] *FPA* decision, at 16, citing *Transamerica Mortgage Advisors Inc.* v. *Lewis,* 444 U.S. 11, 17 (1979).

II. Discussion

A. Overview of Temporary Rule 206(3)–3T

Congress intended section 206(3) of the Advisers Act to address concerns that an adviser might engage in principal transactions to benefit itself or its affiliates, rather than the client.[23] In particular, Congress appears to have been concerned that advisers might use advisory accounts to ''dump'' unmarketable securities or those the advisers fear may decline in value.[24] Congress chose not to prohibit advisers from engaging in principal and agency transactions, but rather to prescribe a means by which an adviser must disclose and obtain the consent of its client to the conflicts of interest involved. Congress's concerns were and continue to be significant. Self-dealing by investment advisers involves serious conflicts of interest and a substantial risk that the proprietary interests of the adviser will prevail over those of its clients.[25]

In light of these concerns and the important protections provided by section 206(3) of the Advisers Act, rule 206(3)–3T provides advisers an alternative means to comply with the requirements of that section that is consistent with the purposes, and our prior interpretations, of the section. The temporary rule continues to provide the protection of transaction-by-transaction disclosure and consent, subject to several conditions.[26] Specifically, temporary rule 206(3)–3T permits an adviser, with respect to a non-discretionary advisory account, to comply with section 206(3) of the Advisers Act by, among other things: (i) Providing written prospective disclosure regarding the conflicts arising from principal trades; (ii) obtaining written, revocable consent from the client prospectively authorizing the adviser to enter into principal transactions; (iii) making certain disclosures, either orally or in writing, and obtaining the client's consent before each principal transaction; (iv) sending to the client confirmation statements disclosing the capacity in which the adviser has acted and disclosing that the adviser informed the client that it may act in a principal capacity and that the client authorized the transaction; and (v) delivering to the client an annual report itemizing the principal transactions. The rule also requires that the investment adviser be registered as a broker-dealer under section 15 of the Exchange Act and that each account for which the adviser relies on this rule be a brokerage account subject to the Exchange Act, and the rules thereunder, and the rules of the self-regulatory organization(s) of which it is a member.[27]

These conditions, discussed below, are designed to prevent overreaching by advisers by requiring an adviser to disclose to the client the conflicts of interest involved in these transactions, inform the client of the circumstances in which the adviser may effect a trade on a principal basis, and provide the client with meaningful opportunities to refuse to consent to a particular transaction or revoke the prospective general consent to these transactions. We note that we have previously stated that ''Section 206(3) should be read together with Sections 206(1) and (2) to require the adviser to disclose facts necessary to alert the client to the adviser's potential conflicts of interest in a principal or agency transaction.'' [28] We request comment generally on the need for the rule and its potential impact on clients of the advisers. Will the advantages described above that we believe accompany rule 206(3)–3T be beneficial to investors? Have we struck an appropriate balance between investor choice and investor protection? Does the alternative means of compliance

[23] *See* Investment Trusts and Investment Companies: Hearings on S. 3580 Before the Subcomm. of the Comm. on Banking and Currency, 76th Cong., 3d Sess. 320 (1940) (statement of David Schenker, Chief Counsel, Securities and Exchange Commission Investment Trust Study) (''Senate Hearings''). As noted above, section 206(3) also addresses agency cross transactions, which raise similar concerns regarding an adviser engaging in transactions to benefit itself or its affiliates, as well as the concern that an adviser may be subject to divided loyalties.

[24] *See* Senate Hearings at 322 (''[i]f a fellow feels he has a sour issue and finds a client to whom he can sell it, then that is not right. * * *'') (statement of David Schenker, Chief Counsel, Securities and Exchange Commission Investment Trust Study).

[25] As we have stated before ''where an investment adviser effects a transaction as principal with his advisory account client, the terms of the transaction are necessarily not established by arm's-length negotiation. Instead, the investment adviser is in a position to set, or to exert influence potentially affecting, the terms by which he participates in such trade. The pressures of self-interest which may be present in such principal transactions may require the prophylaxis of the disclosures [required by section 206(3)].'' Rule 206(3)–2 Proposing Release.

[26] We similarly provided, in a rule of analogous scope and structure to rule 206(3)–3T, an alternative means of compliance with the disclosure and consent requirements of section 206(3) relating to ''agency cross transactions.'' *See* rule 206(3)–2 under the Advisers Act.

[27] *See* Section II.B.7 of this Release.

[28] Section 206(3) Release. For a further discussion, see Section II.B.8 of this Release.

contained in rule 206(3)–3T provide all the necessary investor protections? [29]

B. Section-by-Section Description of Rule 206(3)–3T

Rule 206(3)–3T deems an investment adviser to be in compliance with the provisions of section 206(3) of the Advisers Act when the adviser, or a person controlling, controlled by, or under common control with the investment adviser, acting as principal for its own account, sells to or purchases from an advisory client any security, provided that certain conditions discussed below are met. The scope and structure of the rule are similar to our rule 206(3)–2 under the Advisers Act, which, as noted above, provides an alternative means of complying with the limitations on ''agency cross transactions,'' also contained in section 206(3).

We have applied section 206(3) not only to principal transactions engaged in or effected by an adviser, but also to certain situations in which an adviser causes a client to enter into a principal transaction that is effected by a broker-dealer that controls, is controlled by, or is under common control with the adviser.[30] Accordingly, rule 206(3)–3T would be available if the adviser acts as principal by causing the client to engage in a transaction with a broker-dealer that is an affiliate of the adviser—that is, a broker-dealer that controls, is controlled by, or is under common control with the investment adviser.

1. Non-Discretionary Accounts

Rule 206(3)–3T applies to principal trades with respect to accounts over which the client has not granted ''investment discretion, except investment discretion granted by the advisory client on a temporary or limited basis.'' [31] Availability of the rule to discretionary accounts would be inconsistent with the requirement of the rule, discussed below, that the adviser obtains consent (which may be oral consent) from the client for each principal transaction.[32] In addition, we are of the view that the risk of relaxing the procedural requirements of section 206(3) of the Advisers Act when a client has ceded substantial, if not complete, control over the account raises significant risks that the client will not be, or is not in a position to be, sufficiently involved in the management of the account to protect himself or herself from overreaching by the adviser.

The rule would apply to all non-discretionary advisory accounts, not only those that were originally established as fee-based brokerage accounts.[33] As noted above, some portion of the customers converting fee-based brokerage accounts into advisory accounts will be converting those accounts into non-discretionary accounts offered by the same firm. We understand from our discussions with broker-dealers that maintaining principal trading distinctions between advisory accounts that were once fee-based brokerage accounts and those that were not would be very difficult. Trade execution routing for investment advisory programs often is derived through unified programs or electronic codes allowing or prohibiting certain kinds of trades uniformly for all accounts that are of the same type. As such, limiting relief to accounts that were formerly in fee-based brokerage programs would make the requested relief impractical for firms and would neither serve the best interests of clients (because the effect would be to limit their ability to continue to access the inventory of securities held by their brokerage firm) nor be administratively feasible to firms affected by the Court's ruling with respect to the transition and ongoing servicing of these and other accounts subject to the Advisers Act. We accordingly determined not to limit the availability of the temporary rule only to those non-discretionary advisory accounts that were fee-based brokerage accounts.

We welcome comment on this aspect of our interim final rule. Are we correct that the potential for abuse through self-dealing is less in non-discretionary accounts, where clients may be better able to protect themselves and monitor trading activity, than in accounts where clients have granted discretion and may not be in a position to protect themselves sufficiently? Should we further limit the availability of the rule so that it is only available for transactions with wealthy or sophisticated clients who, for other purposes under the Act, we have presumed are capable of protecting themselves? For example, should it apply only with respect to transactions with a ''qualified client'' as defined in Advisers Act rule 205–3?

Should we limit the relief provided by the rule to accounts that originally were fee-based brokerage accounts? Do the operational burdens and complexities identified by the broker-dealers support application of the rule to all non-discretionary advisory accounts?

2. Issuer and Underwriter Limitations

Rule 206(3)–3T is not available for principal trades of securities if the investment adviser or a person who controls, is controlled by, or is under common control with the adviser (''control person'') is the issuer or is an underwriter of the security.[34] The rule includes one exception—an adviser may rely on the rule for trades in which the adviser or a control person is an underwriter of non-convertible investment-grade debt securities.

One benefit an investor may gain by establishing a brokerage account with a

[29] In this regard, see NAPFA Letter (''express[ing] its strong reservations regarding the possible grant of principal trading relief'').

[30] *See* Section 206(3) Release at n. 3.

[31] Rule 206(3)–3T(a)(1). For purposes of the rule, the term ''investment discretion'' has the same meaning as in section 3(a)(35) of the Exchange Act [15 U.S.C. 78c(a)(35)], except that it excludes investment discretion granted by a customer on a temporary or limited basis. Section 3(a)(35) of the Exchange Act provides that a person exercises ''investment discretion'' with respect to an account if, directly or indirectly, such person: (A) Is authorized to determine what securities or other property shall be purchased or sold by or for the account; (B) makes decisions as to what securities or other property shall be purchased or sold by or for the account even though some other person may have responsibility for such investment decisions; or (C) otherwise exercises such influence with respect to the purchase and sale of securities or other property by or for the account as the Commission, by rule, determines, in the public interest or for the protection of investors, should be subject to the operation of the provisions of this title and rules and regulations thereunder.

We would view a broker-dealer's discretion to be temporary or limited within the meaning of rule 206(3)–3T(a)(1) when the broker-dealer is given discretion: (i) As to the price at which or the time to execute an order given by a customer for the purchase or sale of a definite amount or quantity of a specified security; (ii) on an isolated or infrequent basis, to purchase or sell a security or type of security when a customer is unavailable for a limited period of time not to exceed a few months; (iii) as to cash management, such as to exchange a position in a money market fund for another money market fund or cash equivalent; (iv) to purchase or sell securities to satisfy margin requirements; (v) to sell specific bonds and purchase similar bonds in order to permit a customer to take a tax loss on the original position; (vi) to purchase a bond with a specified credit rating and maturity; and (vii) to purchase or sell a security or type of security limited by specific parameters established by the customer.

[32] Rule 206(3)–3T(a)(4). *See* Section II.B.4 of this Release.

[33] We have not extended the rule to advisory accounts that are held only at investment advisers, as opposed to firms that are both investment advisers and registered broker-dealers. *See* Section II.B.7 of this Release.

[34] Rule 206(3)–3T(a)(2). The term ''underwriter'' is defined in section 202(a)(20) of the Advisers Act to mean ''any person who has purchased from an issuer with a view to, or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking; but such term shall not include a person whose interest is limited to a commission from an underwriter or dealer not in excess of the usual and customary distributor's or seller's commission.''

large broker-dealer is the ability to obtain access to potentially profitable public offerings of securities. These securities are typically purchased by the broker-dealer participating in the underwriting as part of its allotment of the offering and then sold to customers in principal transactions. As noted above, many broker-dealers have not made such offerings available to advisory clients because of the requirements of section 206(3).

A broker-dealer participating in an underwriting typically has a substantial economic interest in the success of the underwriting, which might be different from the interests of investors. When a broker-dealer acts as an underwriter with respect to a security, it is compensated precisely for the service of distributing that security.[35] A successful distribution not only offers the possibility of a concession on the securities (the spread between the underwriter's purchase price from the issuer and the public offering price), but also often an over-allotment option, and potentially future business (whether as an underwriter, lender, adviser or otherwise) with the issuer. The incentives may bias the advice being provided or lead the adviser to exert undue influence on its client's decision to invest in the offering or the terms of that investment. As such, the broker-dealer's incentives to ''dump'' securities it is underwriting are greater for sales by a broker-dealer acting as an underwriter than for sales by a broker-dealer not acting as an underwriter of other securities from its inventory.

A broker-dealer acting as an issuer has similar, if not greater, proprietary interests that are likely to adversely affect the objectivity of its advice. We therefore are of the view that an investment adviser who (or whose affiliate) is the issuer or underwriter of a security has such a significant conflict of interest as to make such a transaction, with one exception, an inappropriate subject of the relief we are providing today.

We have, however, provided an exception for principal transactions in non-convertible investment grade debt securities underwritten by the adviser or a person who controls, is controlled by, or is under common control with the adviser.[36] Non-convertible investment grade debt securities may be less risky and therefore less likely to be ''dumped'' on clients. Also, it may be easier for clients to identify whether the price they are being quoted for a non-convertible investment grade debt security is fair given the relative comparability, and the significant size, of the non-convertible investment grade debt markets.

Moreover, as the staff has discussed the effects of the *FPA* decision with broker-dealers, those broker-dealers have asserted that it is in the interest of investors to permit them to conduct principal trades with their advisory clients involving these securities, even where they or their affiliates are underwriters. Those firms argue that clients may face difficulties and higher costs in obtaining these debt instruments, particularly municipal bonds, through an advisory account if the adviser is not permitted to rely on the interim final rule's alternative means of complying with section 206(3).

The limitation on issuer transactions makes the rule unavailable for principal transactions in traditional equity or debt offerings of the investment adviser or a control person of the adviser. It also makes the rule unavailable in connection with—and thus requires compliance with section 206(3)'s trade-by-trade written disclosure requirements before—non-discretionary placement by an adviser of a proprietary structured product, such as a structured note, with an advisory client.[37] We request comment on whether we should consider expanding the availability of the rule to apply to structured products, and if so, on what terms.

We also request comment on our exclusion for securities issued or underwritten by the adviser or its control persons. Do commenters agree with our assessment of the risks to clients and our interpretation of the purposes of section 206(3)? Should we consider making the rule available for principal transactions in all securities (including those issued or subject to an underwriting by the adviser or a control person) in light of the clients' interest in obtaining access to public offerings? Alternatively, is there an approach we might take that could distinguish types of underwriting arrangements that do not present unacceptable risks of conflicts for the adviser? In this regard, we request comment on the one exception we have provided for non-convertible investment grade debt securities. Is the exception appropriate under the circumstances? Are there other circumstances in which an adviser should be able to rely on the rule when it (or a control person) is an issuer or underwriter of securities in certain circumstances?

3. Written Prospective Consent Following Written Disclosure

An adviser may rely on rule 206(3)–3T only after having secured its client's written, revocable consent prospectively authorizing the adviser directly or indirectly acting as principal for its own account, to sell any security to or purchase any security from such client.[38] The consent must be obtained only after the adviser provides the client with written disclosure about: (i) The circumstances under which the investment adviser may engage in principal transactions with the client; (ii) the nature and significance of the conflicts the investment adviser has with its clients' interests as a result of those transactions; and (iii) how the investment adviser addresses those conflicts.[39] We anticipate that this consent normally would be obtained by the adviser when the client establishes the advisory account.[40]

Rule 206(3)–3T is not exclusive. An adviser would still be able to effect principal trades with a client who either never grants the prospective consent required under paragraph (a)(3) of the rule 206(3)–3T, or subsequently revokes

[35] The act of underwriting is purchasing ''with a view to * * * the distribution of any security.'' Section 202(a)(20) of the Advisers Act [17 CFR 275.202(a)(20)].

[36] ''Investment grade debt securities'' are defined in the rule to mean any non-convertible debt security that is rated in one of the four highest rating categories of at least two nationally recognized statistical rating organizations (as defined in section 3(a)(62) of the Exchange Act [15 U.S.C. 78c(a)(62)]). Rule 206(3)–3T(c).

[37] There is no uniform definition of what constitutes a structured product and the term is not defined in the temporary rule. Structured products include, among other things, securitizations of pools of assets, such as asset-backed securities which are supported by a discrete pool of financial assets (*e.g.*, mortgages or other receivables). *See generally* Securities Act Release No. 8518 (Dec. 22, 2004) [70 FR 1506 (Jan. 7, 2005)]. The Financial Industry Regulatory Authority, Inc. (''FINRA''), the self-regulatory organization that oversees broker-dealers, defines structured products as ''securities derived from or based on a single security, a basket of securities, an index, a commodity, a debt issuance and/or a foreign currency.'' FINRA Notice to Members 05–59 (Sept. 2005). FINRA has notified its members that they should consider only recommending structured products to customers who have been approved for options trading. *Id.* at 4. *See also* FINRA Notice to Members 03–71 (Nov. 2003) (expressing concern that investors, particularly retail investors, may not fully understand the risks associated with non-conventional investments—such as structured securities—and cautioning members to ensure that their sales conduct procedures fully and accurately address any of the special circumstances presented by the sale of these products).

[38] Rule 206(3)–3T(a)(3).

[39] The FPA recommended a similar condition. *See* FPA Letter, at 3.

[40] No additional disclosure regarding the principal capacity in which the adviser may be acting need be made pursuant to rule 206(3)–3T(a)(3) at the time of the transaction, provided the disclosure required by paragraph (a)(3) of the rule has been made and is correct in all material respects.

that consent after having granted it, so long as the adviser complies with the terms of section 206(3) of the Act.

Will the disclosure required by paragraph (a)(3) be meaningful for clients in understanding the conflicts and risks inherent in principal trading by a fiduciary counterparty? Are there alternative approaches that we could adopt to make the prospective disclosures more meaningful to clients? Should we require disclosure to be prominent or, alternatively, require disclosure in a separately executed document to assure that the client has separately given attention to the request for consent?

With each written disclosure, confirmation, and request for written prospective consent, the investment adviser must include a conspicuous, plain English statement clarifying that the prospective general consent may be revoked at any time.[41] Thus, the client must be able to revoke his or her prospective consent at any time, thereby preventing an adviser from relying on rule 206(3)–3T with respect to that account going forward.[42] Do these provisions adequately ensure that client consent is voluntary? Will advisers make a client's consent a condition to participation in non-discretionary advisory accounts they offer? If so, should we add a provision to the rule to address this issue, such as prohibiting advisers from doing so?

The written prospective consent need only be executed once. Should we require that the client's consent be renewed periodically? What benefit would be gained by such a provision in light of the client's right to revoke his or her consent at any time?

4. Trade-by-Trade Consent Following Disclosure

The temporary rule requires an investment adviser, before the execution of *each* principal transaction, to: (i) Inform the client of the capacity in which the adviser may act with respect to the transaction; and (ii) obtain consent from the client for the investment adviser to act as principal for its own account with respect to each such transaction.[43] The trade-by-trade disclosure and consent may be written or oral. Although representatives of the brokerage industry have requested that we eliminate the requirement for transaction-by-transaction disclosure and consent,[44] we have determined that such disclosure and consent continues to be important to alert clients to the potential for conflicted advice they may be receiving on individual transactions. In light of the conflicts inherent in these transactions, generally notifying the client that a transaction may be effected on a principal basis close in time to the carrying out of such a trade is appropriate.

Given the frequency and speed of trading in some advisory accounts as well as the increasing complexity of securities products available in the marketplace, trade-by-trade disclosure and consent, even if oral, might be a more effective protection against misunderstanding by advisory clients of the nature of a transaction and the conflicts inherent in it as well as a meaningful safeguard for investment advisers seeking to comply with their fiduciary obligations. We understand, however, that in many instances the adviser may not know whether a particular transaction will be effected on a principal basis. Accordingly, the rule permits advisers to disclose to clients that they ''may'' act in a principal capacity with respect to the transaction.

We do not believe the obligation to make oral disclosure will impose a significant burden on investment advisers of non-discretionary accounts who must, in most cases, obtain consent for each transaction regardless of whether the transaction will be done on a principal basis.[45] We are interested in learning from investors whether this consent requirement is informative and helpful. We also are interested in learning from advisers whether they intend to document receipt of the oral consent and, if so, whether they will be able to do so efficiently.

We request comment regarding whether investment advisers find useful the flexibility to provide oral instead of written disclosure on a trade-by-trade basis. Or, will advisers instead view the relief as unworkable?

5. Written Confirmation

The investment adviser must send to each client with which it effects a principal trade pursuant to rule 206(3)–3T a written confirmation, at or before the completion of the transaction.[46] In addition to the other information required to be in a confirmation by Exchange Act rule 10b–10,[47] the confirmation must include a conspicuous, plain English statement informing the advisory client that the adviser disclosed to the client prior to the execution of the transaction that the adviser may act in a principal capacity in connection with the transaction, that the client authorized the transaction, and that the adviser sold the security to or bought the security from the client for its own account.[48] An investment adviser need not send a duplicate confirmation. An adviser may satisfy its obligations under paragraph (a)(5) by including, or causing an affiliated broker-dealer to include, the additional required disclosure on a confirmation otherwise sent to the client with respect to a particular principal transaction.

The requirement to provide a trade-by-trade confirmation is designed to ensure that clients are given a written notice and reminder of each transaction that the investment adviser effects on a principal basis and that conflicts of interest are inherent in such transactions.[49] We request comment on our written confirmation condition. Is there additional information that should be included in the confirmation? Are there circumstances in which commenters believe it is appropriate for us to permit investment advisers to rely on rule 206(3)–3T and also deliver confirmations to clients pursuant to the alternative periodic reporting provisions of rule 10b–10(b)?

6. Annual Summary Statement

The investment adviser must deliver to each client, no less frequently than once a year, written disclosure containing a list of all transactions that were executed in the account in reliance on rule 206(3)–3T, including the date and price of such transactions.[50] The annual summary statement is designed to ensure that clients receive a periodic record of the principal trading activity in their accounts and are afforded an opportunity to assess the frequency with which their adviser engages in such trades. As with each other disclosure required pursuant to rule 206(3)–3T, to be able to rely on the rule the investment adviser must include a

[41] Rule 206(3)–3T(a)(8). The FPA recommended a similar condition. *See* FPA Letter, at 4.

[42] The right to revoke prospective consent is not intended to allow a client to rescind, after execution but prior to settlement, a particular trade to which the client provided specific consent prior to execution.

[43] Rule 206(3)–3T(a)(4).

[44] SIFMA Letter, at 3.

[45] *See* rule 206(3)–3T(a)(1) (limiting the availability of the rule to accounts over which the adviser does not exercise discretionary authority).

[46] For a discussion of the meaning of ''completion'' of the transaction, see Section 206(3) Release. The temporary rule does not permit advisers to deliver confirmations using the alternative periodic reporting provisions of rule 10b–10(b) under the Exchange Act.

[47] 17 CFR 240.10b–10.

[48] Rule 206(3)–3T(a)(5).

[49] Rule 206(3)–2 under the Advisers Act, our agency cross transaction rule, requires similar confirmation disclosure.

[50] Rule 206(3)–3T(a)(6). Rule 206(3)–2(a)(3) contains a similar annual report requirement with respect to agency cross transactions. In addition, the FPA recommended a similar condition. *See* FPA Letter, at 4.

conspicuous, plain English statement that its client's written prospective consent may be revoked at any time.[51]

We request comment generally on this aspect of the interim final rule. Should a summary statement be provided more or less frequently than annually? Is there additional information that we should require to be included in each summary statement? For example, we are not requiring advisers to disclose in an annual statement the total amount of all commissions or other remuneration they receive in connection with transactions with respect to which they are relying on this rule. Although that disclosure is required with respect to agency cross transactions pursuant to rule 206(3)–2(a)(3), we are concerned that disclosure of such amounts for principal trades may not accurately reflect the actual economic benefit to the adviser with respect to those trades or the consequence to the client for consenting to those trades. Are our concerns justified? Commenters are invited to submit suggestions for possible enhancements to the disclosures in annual statements that could enhance the disclosure to clients of the significance of their consenting to principal trades.

7. Advisory Account Must Be a Brokerage Account

Rule 206(3)–3T is only available to an investment adviser that also is registered with us as a broker-dealer. Each account for which the investment adviser relies on this section must be a brokerage account subject to the Exchange Act, the rules thereunder, and the rules of applicable self-regulatory organizations (*e.g.*, FINRA).[52] The rule therefore requires that the protections of both the Advisers Act and the Exchange Act apply when advisers enter into principal transactions with clients in reliance on the rule.

The temporary rule permits, subject to compliance with the rule's conditions, an adviser that also is registered as a broker-dealer to execute a principal trade directly (out of its own account) or indirectly (out of an account of another person who is a control person of the adviser). Because we have decided to apply the rule only to advisers who also are registered as broker-dealers, an adviser who is not also a registered broker-dealer would be unable to rely on rule 206(3)–3T if it causes a client to enter into a principal trade with a control person, even if that control person is a registered broker-dealer.

Our decision not to extend the rule to advisory accounts that are held only at investment advisers, as opposed to entities that are both investment advisers and broker dealers, is based on several considerations. First, firms that are both broker-dealers and investment advisers and their employees must comply with the comprehensive set of Commission and self-regulatory organization sales practice and best execution rules that apply to the relationship between a broker-dealer and its customer in addition to the fiduciary duties an adviser owes a client. We believe that it is important to maintain the application of the laws and rules regarding broker-dealers to these accounts.[53] Second, as a practical matter, advisory clients most frequently need and desire principal trading services from firms that are dually registered as an adviser and a broker-dealer because they generally carry large inventories of securities. Providing a variation in the method of complying with section 206(3) of the Advisers Act for advisers that also are registered as broker-dealers thus addresses a large category of the situations in which clients are likely to benefit from access to the inventory of the adviser/broker-dealer without sacrificing pricing or other sales practice protections.

We request comment on this aspect of the interim final rule. What will be the benefit to customers of maintaining the sales practice rules of self-regulatory organizations? What will be the impact of the rule on advisers that are not themselves registered as broker-dealers? Would they choose to register as a broker-dealer in order to take advantage of the new rule? Are there particular requirements of broker-dealer regulation that are clearly duplicative or clearly inapplicable to the regulation of investment advisers and so are unnecessary in this context?

8. Other Obligations Unaffected

Rule 206(3)–3T(b) clarifies that the temporary rule does not relieve in any way an investment adviser from its obligation to act in the best interests of each of its advisory clients, including fulfilling the duty with respect to the best price and execution for a particular transaction.[54] Compliance with rule 206(3)–3T also does not relieve an investment adviser from its fiduciary obligation imposed by sections 206(1) or (2) of the Advisers Act or by other applicable provisions of federal law.[55]

We note specifically that an adviser engaging in principal transactions is subject to rule 206(4)–7, which, among other things, requires an investment adviser registered with us to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act (and the rules thereunder) by the adviser or any of its supervised persons.[56] Thus, an adviser relying on rule 206(3)–3T as an alternative means of complying with section 206(3) must have adopted and implemented written policies and procedures reasonably designed to comply with the requirements of the rule. In addition, rule 204–2,[57] as well as Exchange Act rules 17a–3 [58] and 17a–4,[59] requires the adviser to make, keep, and retain records relating to the principal trades the adviser effects.

9. Limited Duration of Relief

Rule 206(3)–3T(d) contains a sunset provision. Absent further action by the Commission, the temporary rule will expire on December 31, 2009, which is about 27 months from its effective date.[60] Setting a termination date for the rule will necessitate further Commission action no later than the end of that period if the Commission intends to continue the same or similar relief.

We believe limiting the duration of the rule will give us an opportunity to observe how firms comply with their disclosure obligations under the rule, and whether, when they conduct principal trades with their clients, they put their clients' interests first. A significantly shorter period than the one we have established, however, may have disadvantaged former fee-based brokerage customers because of the uncertainty about the continuation of access through their advisory accounts to the securities in the inventory of their

[51] Rule 206(3)–3T(a)(8).

[52] Rule 206(3)–3T(a)(7).

[53] We note that fee-based brokerage accounts have been subject to Commission and self-regulatory organization sales practice and best execution rules since their inception.

[54] Rule 206(3)–2(e) contains a similar provision.

[55] Section 206(3) Release. *See also* SIFMA Memo at Exhibit page 23 (noting that, in connection with any relief provided under section 206(3), ''[t]he adviser will continue to act in the best interests of the client, including a duty to provide best execution, and will be required to meet all disclosure obligations imposed by Sections 206(1) and (2) of the Advisers Act and by other applicable provisions of the federal securities laws and rules of SROs''); section 406 of the Employee Retirement Income Security Act of 1974 (''ERISA'') (describing ''prohibited transactions'' of fiduciaries subject to ERISA); section 4975(c)(1) of the Internal Revenue Code (the ''Code'') (describing ''prohibited transactions'' of fiduciaries governed by the Code).

[56] Rule 206(4)–7(a) [17 CFR 275.206(4)–7(a)].

[57] 17 CFR 275.204–2.

[58] 17 CFR 240.17a–3.

[59] 17 CFR 240.17a–4.

[60] The FPA recommended a similar condition *See* FPA Letter, at 2.

brokerage firm. Those customers also could have faced renewed disruption and confusion if the rule on principal trades were abolished or substantially modified in the short term. Similarly, broker-dealers would have faced the same uncertainty about the continuation of the rule, which could have caused some broker-dealers to decide not to make the necessary expenditures and investments to offer advisory accounts with access to principal trades.

We request comment on whether the 27-month time frame is appropriate. We also welcome comment on any other aspects of the rule that commenters believe should be modified.

10. Other Matters

This rulemaking action must be: (i) Necessary or appropriate in the public interest; (ii) consistent with the protection of investors; and (iii) consistent with the purposes fairly intended by the policy and provisions of the Advisers Act.[61] We also need to consider the effect of the rule on competition, efficiency, and capital formation, which we address below in Section VII of this Release. For the reasons described in this Release, we believe that the rule is necessary or appropriate in the public interest and consistent with the protection of investors. We also believe that the temporary rule is consistent with the purposes fairly intended by the policy and provisions of the Advisers Act.

In the *FPA* decision, the Court described the purposes of the Act, emphasizing that the ''overall statutory scheme of the [Advisers Act] addresses the problems identified to Congress in two principal ways: First, by establishing a federal fiduciary standard to govern the conduct of investment advisers, broadly defined, * * * and second, by requiring full disclosure of all conflicts of interest.'' [62] The Congressional intent was to eliminate or expose all conflicts of interest that might incline an investment adviser, consciously or unconsciously, to render advice that was not disinterested.[63] The Court further noted that Congress's purpose in enacting the Advisers Act was to establish fiduciary standards and require full disclosure of all conflicts of interests of investment advisers.[64]

The temporary rule adopted today meets those purposes and adheres closely to the text of section 206(3), which reflects the basic conflict disclosure purposes of the Act. That section provides that an adviser, before engaging in a principal trade with an advisory client, must disclose to the client in writing before completion of the transaction the capacity in which the adviser is acting and must obtain the consent of the client to the transaction. As we have stated before, ''[i]n adopting Section 206(3), Congress recognized the potential for [abuses such as price manipulation or the placing of unwanted securities into client accounts], but did not prohibit advisers entirely from engaging in all principal and agency transactions with clients. Rather, Congress chose to address these particular conflicts of interest by imposing a disclosure and client consent requirement in Section 206(3) of the Advisers Act.'' [65]

The temporary rule complies with Congressional intent. It provides an alternative procedural means of complying with section 206(3) that retains transaction-by-transaction disclosure and consent (as required by section 206(3) of the Act), but adds additional investor protections measures by requiring an adviser:

- At the outset of the relationship with the client, to disclose in writing the circumstances under which the investment adviser directly or indirectly may engage in principal transactions, the nature and significance of conflicts with its client's interests as a result of the transactions, and how the investment adviser addresses those conflicts;
- To obtain prospective written consent of the client in response to that initial disclosure;
- Before each transaction, to inform the advisory client, orally or in writing, that the adviser may act in a principal capacity with respect to the transaction and to obtain the consent from the advisory client, orally or in writing, for the transaction;
- To send to the client, at or before completion of the transaction, a written trade confirmation that, in addition to the information required by rule 10b-10 under the Exchange Act, discloses that the adviser informed the client prior to the execution of the transaction that the adviser may be acting in a principal capacity in connection with the transaction, that the client authorized the transaction, and that the adviser sold the security to, or bought the security from, the client for its own account;
- To send to the advisory client an annual statement listing each principal transaction during the preceding year and the date and price of each such transaction; and
- To acknowledge explicitly in each required disclosure the right of the client to revoke his or her prospective consent at any time.

We believe that these transaction-specific steps, taken together, fulfill the Congressional purpose behind section 206(3) of the Act.

Another significant protection is that, as we discuss in Section II.B.7 above, to benefit from the rule, the investment adviser must also be a broker-dealer registered with us. Therefore, the firm must comply with the comprehensive set of Commission and self-regulatory organization sales practice and best execution rules that apply to the relationship between a broker-dealer and customer in addition to the fiduciary duties an adviser owes a client.

We further believe that the temporary nature of the rule will give us an opportunity to observe how firms comply with their obligations, and whether, when they conduct principal trades with their clients, they put their clients' interests first. The rule therefore employs a range of features to achieve the transaction-by-transaction conflict disclosure and consent purposes and policies of the Advisers Act. The rule additionally enables the adviser to discharge its fiduciary duties by bolstering them with broker-dealer responsibilities.

11. Effective Date

This temporary rule takes effect on September 30, 2007. For several reasons, including those discussed above, we have acted on an interim final basis.

In the time since the *FPA* decision, the Commission staff has had numerous communications with affected customers, broker-dealers, and investment advisers about areas in which Commission action or relief might be required to protect the interests of investors as a result of the Court's decision. One area of significance identified as our deliberative process continued was the area of principal trades. Under the rule vacated in the *FPA* decision, principal trades in fee-based brokerage accounts were not subject to section 206(3) of the Act. Through the process of discussions with interested parties, it was brought to our attention that a large number of fee-based brokerage customers favor having the choice of advisory accounts with access to the inventory of a diversified broker-dealer and that for certain customers the access to such securities—many of which would otherwise be unavailable—was a critical

[61] *See* 15 U.S.C. 80b–6a.

[62] *FPA* decision, at 490.

[63] *Id.*

[64] *Id.*

[65] Section 206(3) Release at text accompanying note 5.

component of their investment strategy. We also learned that, as discussed above, the traditional method for complying with the principal trading restrictions on an adviser in section 206(3)—written disclosure and consent before completion of each securities transaction—made it not feasible for an adviser to engage in principal trading with its clients. The Commission received requests for principal trading relief from firms and the staff engaged in discussions with representatives of investors, financial planners, and broker-dealers about the terms of relief, considered their specific comments, and took those comments into account in developing the temporary rule we are adopting today.

Because of the *FPA* decision and the October 1, 2007 expiration of the stay of the issuance of the Court's mandate to vacate the former rule, investors with fee-based brokerage accounts must now consider whether they should convert their accounts to advisory accounts or to traditional commission-based brokerage accounts. It is not possible for those customers to make a meaningful, well-informed decision if they do not know what services will be offered in advisory accounts. For example, it would be critical to a customer who invests primarily in fixed income securities (which generally are traded by firms on a principal basis) to know whether he or she could continue to access a firm's inventory of those securities (or sell those securities to the firm) in an advisory account. But firms informed us that they would not permit that kind of trading without a rule that is effective and that provides an alternative means of complying with section 206(3) of the Act. Until we could publish a rule for comment, receive and analyze those comments, and adopt a final rule, that customer would be left with the choice between a traditional brokerage account without the ability to pay a fee based on assets—presumably the customer's preferred manner of payment—or a fee-based advisory account without the ability to invest in fixed income products.

Changing accounts and methods of payments can be highly disruptive and confusing to many investors, requiring a series of communications between the investor and one or more firms about the options available to give the investor the information he or she needs to make informed decisions about the services available in each type of account. We believe that it serves such investors' interests best to adopt the rule on an interim final basis, which permits them to continue the same kind of account, with similar services, that they had when they were fee-based brokerage customers.

We are aware that, as a result of the *FPA* decision, the process for converting as many as one million fee-based brokerage accounts to non-discretionary advisory or other accounts requires a great deal of time and imposes significant conversion costs on firms. For example, in order to comply with the October 1 deadline, those firms needed to draft or revise agreements, policies, and other documents, hire and train employees, and make changes to data and recordkeeping, order entry, billing, and other systems. The firms offering fee-based brokerage accounts urged us to reduce the burdens that apply to them by adopting a rule that is effective on or before October 1 and that permits an alternative method of complying with section 206(3) of the Act (or, alternatively, to exempt them from section 206(3) altogether). They informed us that this would simplify the process of communicating with their customers and reduce investor confusion. This is mostly because the services and manner of payments would be substantially similar in non-discretionary advisory accounts as they were in fee-based brokerage accounts—the firms would not have to explain why the services a customer has become accustomed to are changing, or why the manner of payment is changing.

The firms also were concerned that, without a rule that is effective by the date the *FPA* decision takes effect, fee-based brokerage customers may elect (or the firm may recommend) a commission-based brokerage account in order to have access to their firm's inventory of securities, then elect an advisory account only after a rule subject to notice and comment is finalized. This type of serial account change is costly to firms for the same reasons it is costly for them to convert accounts pursuant to the *FPA* decision. Moreover, such switching of account types can be confusing to customers if it is the firm that is recommending the changes.

Those factors led to this rule and similarly explain why the rule needs to be available at the same time the broker-dealers complete the transition from fee-based brokerage to advisory or other accounts. Otherwise, the risk of disrupting services to the investors, depriving them of the choice of an advisory account with a broker-dealer, and confusing them with a series of changes to the services available to them would have been substantial. Obtaining a further postponement of the stay of the mandate to allow advance notice and comment rulemaking did not appear feasible. For these reasons, issuance of an immediately effective rule is necessary to ameliorate the likely harm to investors.

Furthermore, we emphasize that we are requesting comments on the rule and will carefully consider and respond to them in a subsequent release. Moreover, this is a temporary rule. Setting a 27-month termination date for the rule will necessitate further Commission action no later than the end of that period if the Commission intends to continue the same or similar relief. The sunset provision will result in the Commission assessing the operation of the rule and intervening developments, as well as public comment letters, and considering whether to continue the rule with or without modification or not at all.

A significantly shorter period than the 27-month period we have established could have disadvantaged investors. They would have faced uncertainty about the continuation of having access through their advisory accounts to the securities in the inventory of their brokerage firm and could have faced renewed disruption and confusion if the rule on principal trades were abolished or substantially modified in the short term. Similarly, broker-dealers would have faced the same uncertainty about the continuation of the rule, which could have caused some broker-dealers to decide not to make the necessary expenditures and investments to offer advisory accounts with access to principal trades.

As a result, the Commission finds that it has good cause to have the rule take effect on September 30, 2007, and that notice and public procedure in advance of the effectiveness of the rule are impracticable, unnecessary, and contrary to the public interest. In addition, the rule in part has interpretive aspects and is a rule that recognizes an exemption and relieves a restriction.

III. Request for Comments

The Commission is requesting comments from all members of the public during the next 60 days. We will carefully consider the comments that we receive and respond to them in a subsequent release.

In addition, we are awaiting a report being prepared by RAND Corporation comparing how the different regulatory systems that apply to broker-dealers and advisers affect investors (the ''RAND Study''). As we have previously announced, the Commission commissioned a study comparing the levels of protection afforded customers of broker-dealers and investment advisers under the federal securities laws.[66] The Commission will have another opportunity to assess the operation and terms of the rule when it receives the results of the RAND Study comparing how the different regulatory systems that apply to broker-dealers and advisers affect investors. The RAND Study is expected to be delivered to the Commission no later than December 2007, several months ahead of schedule. The results of the RAND Study are expected to provide an important empirical foundation for the Commission to consider what action to take to improve the way investment advisers and broker-dealers provide financial services to customers. One option then available to the Commission will be making the RAND Study results available to the public and seeking comments on them and their bearing on the terms of this rule.

IV. Transition Guidance

We are today providing guidance to assist broker-dealers who have offered fee-based brokerage accounts and are seeking the consent of their clients to convert those accounts to advisory accounts and meet the requirements of this rule by October 1, 2007.

A. Client Consent

Broker-dealers have asked whether they must, before October 1, 2007, obtain written consent from each of their fee-based brokerage customers to enter into an advisory agreement that meets the requirements of the Advisers Act, in particular section 205 of the Act. Broker-dealers have informed us that, as a practical matter, it is not feasible for them to do so and, if written consent is required, many fee-based brokerage customers will experience interrupted service or will be placed in traditional commission-based brokerage accounts, which may not be best for them.

Interim final rule 206(3)–3T(a)(3) requires an adviser wishing to rely on the rule's alternative means for complying with section 206(3) of the Act to obtain a written prospective consent from each client authorizing the investment adviser to engage in principal transactions with the client. We understand that it likely will be impossible for advisers to obtain these written consents from fee-based brokerage customers who convert their accounts to non-discretionary advisory accounts prior to October 1, 2007. To make the alternative means provided in the interim final rule useful immediately upon its effective date to those customers, we will not object if an adviser obtains the required written consent no later than January 1, 2008 from each fee-based customer who converts his or her account to a non-discretionary advisory account. During this transitional period, investment advisers must comply with the other conditions of rule 206(3)–3T, including the condition in paragraph (a)(4) of the rule, which requires that the adviser make certain disclosures and obtain client consent before effecting a principal trade with the client. They also must provide a client with the written disclosure required by paragraph (a)(3) of the temporary rule prior to effecting the first trade with that client in reliance on this rule.

B. Client Brochures

Advisers Act rule 204–3 requires an investment adviser to furnish its advisory clients with a disclosure statement, or brochure, containing at least the information required to be in Part II of Form ADV at the time of, or prior to, entering into an advisory contract.[67] In light of the time constraints firms face in complying with the October 1st deadline, we will not object if, with respect to the fee-based brokerage customers that convert to non-discretionary advisory accounts, advisers deliver this statement no later than January 1, 2008.

V. Paperwork Reduction Act

A. Background

Rule 206(3)–3T contains ''collection of information'' requirements within the meaning of the Paperwork Reduction Act of 1995.[68] The collection of information is new. We submitted these requirements to the Office of Management and Budget (''OMB'') for review in accordance with 44 U.S.C. 3507(j) and 5 CFR 1320.13. Separately, we have submitted the collection of information to OMB for review and approval in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. The OMB has approved the collection of information on an emergency basis with an expiration date of March 31, 2008. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid OMB control number. The title for the collection of information is: ''Temporary rule for principal trades with certain advisory clients, rule 206(3)–3T'' and the OMB control number for the collection of information is 3235–0630.

Rule 206(3)–3T provides an alternative method for investment advisers that are registered with us as broker-dealers to meet the requirements of section 206(3) when they act in a principal capacity with respect to transactions with certain of their advisory clients. In the absence of this rule, an adviser must provide a written disclosure and obtain consent for each transaction in which the adviser acts in a principal capacity. Rule 206(3)–3T permits an adviser, with respect to a non-discretionary advisory account, to comply with section 206(3) by: (i) Making certain written disclosures; (ii) obtaining written, revocable consent from the client prospectively authorizing the adviser to enter into principal trades; (iii) making oral or written disclosure that the adviser may act in a principal capacity and obtaining the client's consent orally or in writing prior to the execution of each principal transaction; (iv) sending to the client confirmation statements disclosing the capacity in which the adviser has acted and indicating that the adviser disclosed to the client that it may act in a principal capacity and that the client authorized the transaction; and (v) delivering to the client an annual report itemizing the principal transactions.

B. Collections of Information and Associated Burdens

Under rule 206(3)–3T, there are four distinct collection burdens. Our estimate of the burden of each of the collections reflects the fact that the alternative means of compliance provided by the rule is substantially similar to the approach advisers currently employ to comply with the disclosure and consent obligations of section 206(3) of the Advisers Act and the approach that broker-dealers employ to comply with the confirmation requirements of rule 10b–10 under the Exchange Act. Thus, as discussed below, we estimate that rule 206(3)–3T will impose only small additional burdens.

Providing the information required by rule 206(3)–3T is necessary to obtain the benefit of the alternative means of complying with section 206(3) of the Advisers Act. The rule contains two types of collections of information: Information provided by an adviser to its advisory clients and information

[66] *Commission Seeks Time for Investors and Brokers to Respond to Court Decision on Fee-Based Accounts,* SEC Press Release No. 2007–95 (May 14, 2007).

[67] The Advisers Act does not specify any means by which a client must execute a new advisory contract or agree to changes in an existing one. For purposes of transitioning clients from fee-based brokerage accounts, advisers presumably must look to the terms of the contracts they have in place, as well as applicable contract law, to determine the manner in which they need to enter into new contract or amend existing contracts in order to come into compliance with the Act.

[68] 44 U.S.C. 3501 *et seq.*

collected from advisory clients by an adviser. With respect to each type of collection, the information would be maintained by the adviser. Under Advisers Act rule 204–2(e), an adviser must preserve for five years the records required by the collection of information pursuant to rule 206(3)–3T. Although the rule does not call for any of the information collected to be provided to us, to the extent advisers include any of the information required by the rule in a filing, such as Form ADV, the information will not be kept confidential. The collection of information delivered by investment advisers pursuant to rule 206(3)–3T would be provided to clients and also would be maintained by investment advisers. The collection of information delivered by clients to advisers would be subject to the confidentiality strictures that govern those relationships, and we would expect them to be confidential communications.

Collections of Information

Prospective Disclosure and Consent: Pursuant to paragraph (a)(3) of the rule, an investment adviser must provide written, prospective disclosure to the client explaining: (i) The circumstances under which the investment adviser directly or indirectly may engage in principal transactions; (ii) the nature and significance of conflicts with its client's interests as a result of the transactions; and (iii) how the investment adviser addresses those conflicts. Pursuant to paragraph (a)(8) of the rule, the written, prospective disclosure must include a conspicuous, plain English statement that a client's written, prospective consent may be revoked without penalty at any time by written notice to the investment adviser from the client. And, for the adviser to be able to rely on rule 206(3)–3T with respect to an account, the client must have executed a written, revocable consent after receiving such written, prospective disclosure.

The first part of this collection of information involves the preparation and distribution of a written disclosure statement, which we anticipate will be largely uniform for clients in non-discretionary advisory accounts with a particular firm. This collection of information is necessary to explain to investors how their interests might be different from the interests of their investment adviser when the adviser engages in principal trades with them. It is designed to provide investors with sufficient information to be able to decide whether to consent to such trades.

We anticipate that the cost of this collection will mostly be borne upfront as advisers develop and deliver the required disclosure. This will require drafting and distributing the required disclosure to clients with respect to the accounts for which the investment adviser seeks to rely on the rule.[69] Once the disclosure has been developed and is integrated into materials provided upon opening a non-discretionary advisory account, the ongoing burden will be minimal.

We estimate that the average burden for drafting the required prospective disclosure for each eligible adviser, taking into account both those advisers that previously engaged in principal trades with their non-discretionary advisory clients, will be approximately 5 hours on average. We expect that some advisers, particularly the large financial services firms, may take significantly longer to draft the required disclosure because they may have more principal trading practices, and potentially more conflicts, to describe.[70] Other advisers may take significantly less time and some eligible advisers may choose not to rely on rule 206(3)–3T. Further, we expect the drafting burden will be uniform with respect to each eligible adviser regardless of how many individual non-discretionary advisory accounts that adviser administers or seeks to engage with in principal trading. As of August 1, 2007, there were 634 advisers that were eligible to rely on the temporary rule (*i.e.*, also registered as broker-dealers), 395 of which indicate that they have non-discretionary advisory accounts.[71] We estimate that 90 percent of those 395 advisers, or a total of 356 of those advisers, will rely on this rule.[72] Of the 239 eligible advisers that do not currently provide non-discretionary advisory services, we estimate that 10 percent of these advisers, or 24 advisers, will create non-discretionary advisory programs and rely on the alternative means of compliance provided by this rule.[73] Thus, the total number of advisers we anticipate will rely on the rule is 380.[74] Accordingly, we estimate that the total drafting burden for the prospective disclosure statement for the estimated 380 advisers that will rely on the rule will be 1,900 hours.[75]

The prospective disclosure will need to be distributed to all clients who have non-discretionary advisory accounts for which an adviser seeks to rely on rule 206(3)–3T. Registration data indicates that there are approximately 3,270,000 existing non-discretionary advisory accounts held with eligible advisers.[76] Discussions with eligible advisers indicate that approximately: (i) 90 percent of these non-discretionary advisory accounts administered by them, or 2,943,000 accounts, are in programs to which the rule will not apply, such as mutual fund asset allocation programs; and (ii) 40 percent of the remaining 327,000 non-discretionary advisory accounts administered by them, or 130,800 accounts, are retirement accounts, and thus unlikely to participate in principal trading,[77] leaving 196,200 existing non-retirement non-discretionary advisory accounts administered by eligible advisers.[78]

[69] We note that disclosure about the conflicts of interest for an adviser that engages in principal trades already is required to be disclosed by investment advisers in Form ADV. *See* Item 8 of Part 1A of Form ADV; Item 9 of Part II of Form ADV; Item 7(l) of Schedule H to Part II of Form ADV.

[70] The opportunities to engage in principal trades with advisory clients will vary greatly among eligible investment advisers. We believe many of these advisers are registered as broker-dealers for limited purposes and do not engage in market-making activities or otherwise carry extensive inventories of securities. These firms likely would limit their principal trading operations significantly. For example, they may choose to engage only in riskless principal trades, which may pose limited conflicts of interest resulting in brief disclosures. Investment advisers with large inventories of securities and multi-faceted operations, however, likely will have much more extensive disclosure.

[71] IARD data as of August 1, 2007, for Items 6.A(1) and 5.F(2)(e) of Part 1A of Form ADV.

[72] We anticipate that most dually-registered advisers will make use of the rule to engage in, at a minimum, riskless principal transactions to limit the need for these advisers to process trades for their advisory clients with other broker-dealers. We estimate that 10% of these firms will determine that the costs involved to comply with the rule are too significant in relation to the benefits that the adviser, and their clients, will enjoy.

[73] We estimate that 10% of the dually-registered advisers that do not currently have non-discretionary advisory programs will create them due to a combination of market forces and the ability to enter into principal trades more efficiently as a result of the rule. We base this estimate on discussions with industry representatives.

[74] 356 dually-registered advisers that currently have non-discretionary advisory account programs + 24 dually-registered advisers that do not currently have non-discretionary advisory programs, but we expect will initiate them = 380 eligible advisers that will have non-discretionary advisory programs.

[75] 5 hours per adviser × 380 eligible advisers that will rely on the rule = 1,900 total hours.

[76] IARD data as of August 1, 2007, for Item 5.F(2)(e) of Part 1A of Form ADV.

[77] We have based this estimate on discussions with industry representatives. The Code and ERISA impose restrictions on certain types of transactions involving certain retirement accounts. We do not take a position on whether the Code or ERISA limits the availability of rule 206(3)–3T.

[78] 3,270,000 existing non-discretionary advisory accounts among eligible advisers − 2,943,000 accounts in wrap fee and other programs to which the rule will not apply − 130,800 retirement accounts = 196,200 non-retirement, non-

Continued

As noted in Section I.B of this Release and confirmed by discussions with several firms, we anticipate that most fee-based brokerage accounts will be converted to non-discretionary advisory accounts. For purposes of our analysis, we have assumed that all of the estimated 1 million fee-based brokerage accounts will be converted to non-discretionary advisory accounts.[79] Of those accounts, we estimate that substantially all of them are held at investment advisers that also are registered as broker-dealers.[80] Discussion with broker-dealers that have fee-based brokerage programs have informed us that approximately 40 percent of the existing fee-based brokerage accounts are retirement accounts, and are unlikely to engage in principal trading. We anticipate that all eligible advisers that are converting fee-based brokerage accounts to non-discretionary advisory accounts will conduct principal trading in reliance on the rule. Thus, we estimate that eligible investment advisers will distribute the prospective disclosure to approximately 600,000 former fee-based brokerage customers. When aggregated with the 196,200 existing non-retirement, non-discretionary advisory accounts we believe likely will receive the prospective disclosure, we estimate the total number of accounts for which clients will receive prospective disclosure to be 796,200.[81]

We estimate that the burden for administering the distribution of the prospective disclosure will be approximately 0.1 hours (six minutes) for every account. Based on the discussion above, we estimate that the prospective disclosure will be distributed to a total of approximately 796,200 eligible existing non-discretionary advisory accounts and eligible former fee-based brokerage accounts. We estimate the total hour burden under paragraph (a)(3) of rule 206(3)–3T for distribution of the prospective written disclosure to be 79,620 hours.[82]

We estimate an average one-time cost of preparation of the prospective disclosure to include outside legal fees for approximately three hours of review to total $1,200 per eligible adviser on average,[83] for a total of $456,000.[84] As we discuss above, advisers that rely on the rule will face widely varying numbers and severity of conflicts of interest with their clients. We believe that those advisers that engage in riskless principal trading, are unlikely to seek outside legal services in drafting the prospective disclosure. On the other hand, advisers with more significant conflicts are likely to engage outside legal services to assist in preparation of the prospective written disclosure. We also estimate a one-time average cost for printing and physical distribution of the various disclosure documents, including a disclosure and consent form and, if necessary, a revised account agreement, to be approximately $1.50 per account,[85] for a total of $1,194,300.[86]

The second part of this burden is that the adviser must receive from each client an executed written, revocable consent prospectively authorizing the investment adviser, or a broker-dealer affiliate of the adviser, to act as principal for its own account, to sell any security to or purchase any security from the advisory client. This collection of information is necessary to verify that a client has provided the required prospective consent. It is designed to ensure that advisers that wish to engage in principal trades with their clients in reliance on the rule inform their clients that they have a right not to consent to such transactions.

Compliance with this part of the temporary rule will require advisers to collect executed written, prospective consent from advisory clients. We anticipate that the bulk of the burden of this collection will be borne upfront. We expect that the consent solicitation for existing non-discretionary advisory accounts and fee-based brokerage accounts being converted to non-discretionary advisory accounts will be integrated into the prospective written disclosure. For new clients, we anticipate that the consent solicitation provision will be included in the account agreement signed by a client upon opening a non-discretionary advisory account. Once the consent solicitation has been integrated into the account-opening paperwork, the ongoing burden will be minimal.

We believe that the burden and costs to advisers of soliciting consent is included in the burdens and costs of drafting and distributing the notices described above. This is because we expect the consent solicitation to be integrated into the firm's prospective written disclosure. We estimate an average burden per accountholder of 0.05 hours (three minutes) in connection with reviewing the consent solicitation, asking questions, providing consent, and, for those that so wish, revoking that consent at a later date. Assuming that there are 796,200 accountholders who receive prospective disclosure and a prospective consent solicitation we estimate a total burden of 39,810 hours on accountholders for reviewing and/or returning consents.[87] We further estimate that 90 percent of these accountholders, or 716,580 accountholders, will execute and return the consent.[88]

Finally, we estimate that the burden of updating the disclosure, maintaining records on prospective consents provided, and processing consent revocations and prospective consents granted subsequent to the initial solicitation will be approximately 100 hours per eligible adviser per year. We estimate that the total burden for all advisers to keep prospective consent information up to date will be 38,000 hours.[89]

Trade-By-Trade Disclosure and Consent: Pursuant to paragraph (a)(4) of the rule, an investment adviser, prior to the execution of each principal

discretionary advisory accounts among eligible advisers.

[79] This assumption may result in the estimated paperwork burdens and costs of proposed rule 206(3)–3T being overstated.

[80] Industry representatives have informed us that substantially all fee-based brokerage accounts are held with twelve broker-dealers, all of which also are registered as investment advisers according to IARD data as of August 1, 2007.

[81] 196,200 existing non-retirement, non-discretionary advisory accounts we estimate are likely to receive prospective disclosures + 600,000 fee-based brokerage accounts we estimate will be converted to non-discretionary advisory accounts = 796,200 total accounts we expect to receive the prospective disclosure addressed in paragraph (a)(3) of rule 206(3)–3T.

[82] 0.1 hours (six minutes) per account × 796,200 accounts = 79,620 hours.

[83] Outside legal fees are in addition to the projected 5 hour per adviser burden discussed in note 75 and accompanying text.

[84] $400 per hour for legal services × 3 hours per adviser × 380 eligible advisers that we expect to rely on the rule = $456,000. The hourly cost estimate is based on our consultation with advisers and law firms who regularly assist them in compliance matters.

[85] This estimate is based on discussions with firms. It represents our estimate of the average cost for printing and distribution, which we expect will include distribution of hard copies for approximately 85% of accounts and distribution of electronic copies for approximately 15% of accounts.

[86] $1.50 per account × 796,200 accounts = $1,194,300.

[87] 0.05 hours (three minutes) per accountholder × 796,200 accountholders executing and returning the consent = 39,810 total burden hours on accountholders with respect to returning consents.

[88] 796,200 eligible accountholders × 90 percent = 716,580 accountholders who will return their prospective consents. We refer herein to these 716,580 accountholders who return their consents, and whose advisers are therefore eligible to rely on the rule with respect to them, as "eligible accountholders."

[89] 100 hours per eligible adviser × 380 eligible advisers that will rely on the rule = a total burden of 38,000 hours for updating disclosure, maintaining records, and processing new consents and revocations.

transaction, must inform the advisory client, orally or in writing, of the capacity in which it may act with respect to such transaction. Also pursuant to paragraph (a)(4) of the rule, an investment adviser, prior to the execution of each principal transaction, must obtain oral or written consent from the advisory client to act as principal for its own account with respect to such transaction. This collection of information is necessary to alert an advisory client that a specific trade may be executed as principal and provide the client with the opportunity to withhold its authorization for the trade to be executed on a principal basis.

We note that section 206(3) of the Advisers Act requires written trade-by-trade disclosure in connection with principal trades. We believe that complying with this part of rule 206(3)–3T provides an alternative method of compliance that is likely to be less costly than compliance with section 206(3) in many situations. However, to the extent that advisers are not currently engaging in principal trades with non-discretionary advisory accountholders (and thus are not preparing and providing written disclosure regarding conflicts of interest associated with principal trading in particular securities), advisers electing to rely on the rule will need to begin to prepare such disclosure and communicate it to clients. Based on discussions with industry and their experience with fee-based brokerage accounts and existing non-discretionary advisory programs, we estimate conservatively that non-discretionary advisory accountholders at eligible advisers engage in an average of approximately 50 trades per year and that, for purposes of this analysis, all those trades are principal trades for which the investment adviser seeks to rely on rule 206(3)–3T.[90] We estimate, based on our discussions with broker-dealers, a burden of 0.0083 hours (approximately 30 seconds) per trade on average for preparation and communication of the requisite disclosure to a client, and for the client to consent, for an estimated total burden of approximately 297,381 hours per year.[91]

Trade-By-Trade Confirmations: Pursuant to paragraph (a)(5) of the rule, an investment adviser must deliver to its client a written confirmation at or before completion of each principal transaction that includes, in addition to the information required by rule 10b–10 under the Exchange Act [17 CFR 240.10b–10], a conspicuous, plain English statement that the investment adviser: (i) Informed the advisory client that it may be acting in a principal capacity in connection with the transaction and the client authorized the transaction; and (ii) owned the security sold to the advisory client (or bought the security from the client for its own account). Pursuant to paragraph (a)(8) of the rule, each confirmation must include a conspicuous, plain English statement that the written, prospective consent described above may be revoked without penalty at any time by written notice to the investment adviser from the client. This collection of information is necessary to ensure that an advisory client is reminded that a particular trade was made on a principal basis and is given the opportunity to revoke prospective consent to such trades.

The majority of the information required in this collection of information is already required to be assembled and communicated to clients pursuant to requirements under the Exchange Act. As such, we do not believe that there will be an ongoing hour burden associated with this requirement. We estimate a one-time cost burden for reprogramming computer systems that generate confirmations to ensure that all the information required for purposes of paragraphs (a)(5) and (a)(8) of rule 206(3)–3T is included in such confirmations of $20,000 per eligible adviser for a total of $7,600,000.[92]

Principal Transactions Report: Pursuant to paragraph (a)(6) of the rule, the investment adviser must deliver to each client, no less frequently than annually, written disclosure containing a list of all transactions that were executed in the account in reliance upon the rule, and the date and price of such transactions. This report will require a collection of information that should already be available to the adviser or its broker-dealer affiliate executing the client's transactions. Pursuant to paragraph (a)(8) of the rule, each principal transactions report must include a conspicuous, plain English statement that the written, prospective consent described above may be revoked without penalty at any time by written notice to the investment adviser from the client. This collection of information is necessary to ensure that clients receive a periodic record of the principal trading activity in their accounts and are afforded an opportunity to assess the frequency with which their adviser engages in such trades.

We estimate that other than the actual aggregation and delivery of this statement, the burden of this collection will not be substantial because the information required to be contained in the statement is already maintained by investment advisers and/or broker-dealers executing trades for their clients. Advisers and broker-dealers already send periodic or annual statements to clients.[93] Thus, to comply, advisers will need to add information they already maintain to documents they already prepare and send. We expect that there will be a one-time burden associated with this requirement relating to programming computer systems to generate the report, aggregating information that is already available and maintained by advisers or their broker-dealer affiliates. We estimate this burden to be on average approximately 5 hours per eligible firm for a total of 1,900 hours.[94] We also estimate that in addition to the hour burden, firms may have costs associated with retaining outside professionals to assist in programming. We estimate these costs to average $10,000 per adviser for a total upfront cost of $3,800,000.[95] Once

[90] These assumptions may result in the estimated paperwork burdens and costs of proposed rule 206(3)–3T being overstated.

[91] 50 trades per account per year × 716,580 accountholders that will provide prospective consent and therefore enable their advisers to rely on the rule with respect to them × 0.0083 hours (approximately 30 seconds) per trade for disclosure = a burden of 297,381 hours per year.

[92] $20,000 to program system generating confirmations per adviser × 380 eligible advisers that will rely on the rule = $7,600,000 total programming costs for confirmations. Our estimate for the cost to program the confirmation system was derived from discussions with broker-dealers.

[93] For example, investment advisers that are qualified custodians for purposes of rule 206(4)–2 under the Advisers Act and that maintain custody of their advisory clients' assets must, at a minimum, send quarterly account statements to their clients pursuant to rule 206(4)–2(a)(3).

[94] 5 hours per eligible adviser for programming relating to the principal trade report × 380 advisers = a total programming burden relating to the principal trade report of 1,900 hours. Advisers that use proprietary systems will likely devote considerably more time to programming reports. However, these advisers are also likely to have already programmed systems to meet the requirements of rule 206(3)–2(a)(3), which contains a similar annual report requirement with respect to agency cross transactions. Other advisers may be using commercial software to track and report trades in accounts. These software packages should take little time for an adviser to implement, and consequently should impose significantly less than a 5 hour burden.

[95] $10,000 for retaining outside professionals to assist in programming in connection with the principal transactions report per adviser × 380 advisers = $3,800,000 in outside programming costs in connection with the principal transactions report. We based our outside programming cost estimate on a rate of $250 per hour for 40 hours of programming consultant time. We anticipate that the advisers that rely on commercial software solutions, many of which will be components to trading software they already have acquired, will not have to retain outside programming consultants.

computer systems enable these reports to be generated electronically, we estimate that the average ongoing burden of generating the reports and delivering them to clients will be 0.05 hours (three minutes) per eligible non-discretionary advisory account, or a total of 35,829 hours per year.[96]

C. Summary of Estimated Paperwork Burden

For purposes of the Paperwork Reduction Act, we estimate an annual incremental increase in the burden for investment advisers and their affiliated broker-dealers to comply with the alternative means for compliance with section 206(3) of the Advisers Act contained in rule 206(3)–3T. As discussed above, our estimates reflect the fact that the alternative means of compliance is similar to the approach advisers currently employ to comply with the disclosure and consent obligations of section 206(3) of the Advisers Act and also is similar to the approach broker-dealers employ to comply with certain of the requirements of rule 10b–10 under the Exchange Act.

Some amount of training of personnel on compliance with the rule and developing, acquiring, installing, and using technology and systems for the purpose of collecting, validating and verifying information may be necessary. In addition, as discussed above, some amount of time, effort and expense may be required in connection with processing and maintaining information. We estimate that the total amount of costs, including capital and start-up costs, for compliance with the rule is approximately $13,050,300.[97] We estimate that the hour burden will be 494,440 hours.[98]

D. Request for Comment

We invite comment on each of these estimates and the underlying assumptions. Pursuant to 44 U.S.C. 3506(c)(2)(B), we request comment with respect to the collections described in this section of this Release in order to: (i) Evaluate whether the collections of information are necessary for the proper performance of our functions, including whether the information will have practical utility; (ii) evaluate the accuracy of our estimate of the burden of the collections of information; (iii) determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected; and (iv) evaluate whether there are ways to minimize the burden of the collections of information on those who respond, including through the use of automated collection techniques or other forms of information technology.[99]

Persons submitting comments on the collection of information requirements should direct the comments to the Office of Management and Budget, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and should send a copy to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549–1090, with reference to File No. S7–23–07. Requests for materials submitted to OMB by the Commission with regard to these collections of information should be in writing, refer to File No. S7–23–07, and be submitted to the Securities and Exchange Commission, Records Management, Office of Filings and Information Services, Washington, DC 20549. The OMB is required to make a decision concerning the collection of information between 30 and 60 days after publication of this release. Consequently, a comment to OMB is assured of having its full effect if OMB receives it within 30 days of publication.

VI. Cost-Benefit Analysis

A. Background

We are adopting, as an interim final temporary rule, rule 206(3)–3T under the Advisers Act, which provides an alternative means for investment advisers that are registered with us as broker-dealers to meet the requirements of section 206(3) when they act in a principal capacity with respect to transactions with certain of their advisory clients. We are adopting this rule as part of our response to a recent court decision invalidating rule 202(a)(11)–1, which provided that fee-based brokerage accounts were not advisory accounts and were thus not subject to the Advisers Act. As a result of the court's decision, these fee-based accounts are advisory accounts subject to the fiduciary duty and other requirements of the Advisers Act, unless converted to commission-based brokerage accounts. To maintain investor choice and protect the interests of investors holding an estimated $300 billion in approximately one million fee-based brokerage accounts, we are adopting rule 206(3)–3T.

B. Summary of Temporary Rule

Rule 206(3)–3T permits an adviser, with respect to a non-discretionary advisory account, to comply with section 206(3) by: (i) Making certain written disclosures; (ii) obtaining written, revocable consent from the client prospectively authorizing the adviser to enter into principal trades; (iii) making oral or written disclosure of the capacity in which the adviser may act and obtaining the client's consent orally or in writing prior to the execution of each principal transaction; (iv) sending to the client confirmation statements disclosing the capacity in which the adviser has acted and indicating that the adviser disclosed to the client that it may act in a principal capacity and that the client authorized the transaction; and (v) delivering to the client an annual report itemizing the principal transactions. These conditions are designed to require an adviser to fully apprise the client of the conflicts of interest involved in these transactions, inform the client of the circumstances in which the adviser may effect a trade on a principal basis, and provide the client with meaningful opportunities to revoke prospective consent or refuse to authorize a particular transaction.

To avoid disruption that would otherwise occur to customers who currently hold fee-based brokerage accounts, we are adopting rule 206(3)–3T on an interim final basis so that it will be available when the Court's decision takes effect on October 1, 2007.[100] For reasons explained below, we are adopting the rule on a temporary basis so that it will expire on December 31, 2009.

[96] 0.05 hours (three minutes) per eligible accountholder to generate and deliver reports × 716,580 eligible accountholder = 35,829 hours total burden for generating and delivering reports to accountholders. Because, as we note above, the information required by the rule will be added to documents advisers already send to clients, we estimate that there is no added cost associated with delivering the reports to clients (*e.g.*, postage costs).

[97] $456,000 for outside professional fees associated with preparation of the prospective disclosure + $1,194,300 for printing and physical distribution costs associated with the prospective disclosure + $7,600,000 for programming costs for outside professionals for rendering trade confirmations compliant with the rule + $3,800,000 for programming costs for outside professionals to create principal trading reports = a total of $13,050,300.

[98] 1,900 hours for drafting prospective disclosure + 79,620 hours for administering distribution of prospective disclosure to accountholders + 39,810 hours for review by accountholders of the consent solicitation and returning consents + 38,000 hours for advisers maintaining and updating consent information + 297,381 hours for preparation and communication of trade-by-trade disclosure and consent + 1,900 hours for programming to create principal trading reports + 35,829 hours for ongoing generation of principal trading reports = a total of 494,440 hours.

[99] Comments are requested pursuant to 44 U.S.C. 3506(c)(2)(B).

[100] *See supra* note 5 and accompanying text.

C. Benefits

As discussed above, the principal benefit of rule 206(3)–3T is that it maintains investor choice and protects the interests of investors holding an estimated $300 billion in one million fee-based brokerage accounts. It is our understanding that investors favor having the choice of advisory accounts with access to the inventory of a diversified broker-dealer but that meeting the requirements set out in section 206(3) is not feasible for advisers affiliated with broker-dealers or advisers that also are registered as broker-dealers. By complying with what we believe to be relatively straightforward procedural requirements, investment advisers can avoid what they have indicated to us is a critical impediment to their providing access to certain securities which they hold in their own accounts—namely, written trade-by-trade disclosure. These advisers have communicated to us that the trade-by-trade written disclosure requirement is so impracticable in today's markets that it effectively stands in the way of their being able to give clients access to certain securities that might most cheaply or quickly be traded with a client on a principal basis. In fact, with respect to some securities, for which the risks might be relatively low (such as investment-grade debt securities), absent principal trading, clients may not have access to them at all. For other securities, execution may be improved where the adviser or affiliated broker-dealer can provide the best execution of the transaction.

A resulting second benefit of the rule is that non-discretionary advisory clients of dually registered firms will have easier access to a wider range of securities. This in turn will likely increase liquidity in the markets for these securities and promote capital formation in these areas.

A third benefit of the rule is that it provides the protections of the sales practice rules of the Exchange Act and the relevant self-regulatory organizations because an adviser relying on the rule must also be a registered broker-dealer. As a result, clients will have the benefit of the fiduciary duties imposed on the investment adviser by the Advisers Act and of the Commission's rules and regulations under the Exchange Act as well as those of the SROs.

Another benefit of Rule 206(3)–3T is that it provides a lower cost alternative for an adviser to engage in principal transactions. As discussed above, in the absence of this rule our view has been that an adviser must provide written disclosure and obtain consent for each specific principal transaction. Rule 206(3)–3T permits an adviser to comply with section 206(3) by, among other things, providing oral disclosure prior to the execution of each principal transaction. As discussed above, we understand traditional compliance is difficult and costly. This alternative means of compliance should be, consistent with the protection of investors, less costly and less burdensome.

D. Costs

Prospective Disclosure and Consent: Pursuant to paragraph (a)(3) of the rule, an investment adviser must provide written, prospective disclosure to the client explaining: (i) The circumstances under which the investment adviser directly or indirectly may engage in principal transactions; (ii) the nature and significance of conflicts with its client's interests as a result of the transactions; and (iii) how the investment adviser addresses those conflicts. Pursuant to paragraph (a)(8) of the rule, the written, prospective disclosure must include a conspicuous, plain English statement that a client's written, prospective consent may be revoked without penalty at any time by written notice to the investment adviser from the client. And, for the adviser to be able to rely on rule 206(3)–3T with respect to an account, the client must have executed a written, revocable consent after receiving such written, prospective disclosure. The principal costs associated with this requirement include: (i) Preparation of the prospective disclosure and consent solicitation; (ii) distribution of the disclosure and consent solicitation to clients; and (iii) ongoing management of information, including revocations of consent and grants of consent that occur subsequent to the account opening process.

We estimate that the costs of preparing the prospective disclosure and consent solicitation will be borne upfront. Once these items have been generated by eligible advisers, such advisers will be able to include them in other materials already required to be delivered to clients. For purposes of the Paperwork Reduction Act, we have estimated the number of hours and costs the average adviser would spend in the initial preparation of their prospective disclosure and consent solicitation.[101] Based on those estimates, we estimate that advisers would incur costs of approximately $1,480 on average per adviser, including a conflicts review process, drafting efforts and consultation with clients, and legal consultation.[102] Assuming there are 380 eligible advisers (*i.e.*, advisers that also are registered broker-dealers) that will prepare the prospective disclosure and consent solicitation, we estimate that the total costs will be $562,400.[103]

For purposes of the Paperwork Reduction Act, we have estimated the number of hours and costs the average adviser would spend on the distribution of their prospective disclosure and consent solicitation as 210 hours and $3,143.[104] We expect that the costs of distribution of the prospective disclosure and solicitation consent to existing non-discretionary advisory clients and fee-based brokerage accountholders converting their accounts to non-discretionary advisory accounts will include duplication charges, postage and other mailing related expenses. We estimate that these costs will be approximately $5.60 on average per client, for a total of $4,458,720.[105]

[101] *See* section V.B of this Release. We estimate the following burdens and/or costs: (i) For drafting the required prospective disclosure, approximately 5 hours on average per eligible adviser, of which we estimate there are 380, for a total of 1,900 hours; and (ii) for utilizing outside legal professionals in the preparation of the prospective disclosure, approximately $1,200 on average per eligible adviser, for a total of $456,000.

[102] We expect that the internal preparation function will most likely be performed by compliance professionals. Data from the SIFMA's *Report on Office Salaries in the Securities Industry 2006* (''Industry's Salary Report''), modified to account for an 1,800-hour work-year and multiplied by 2.93 to account for bonuses, firm size, employee benefits and overhead, suggest that the cost for a Compliance Clerk is approximately $56 per hour. $56 per hour × 5 hours on average per adviser = $280 on average per adviser of internal costs for preparation of the prospective disclosure. $280 on average per adviser of internal costs + $1,200 on average per adviser of costs for external consultants = $1,480 on average per adviser.

[103] $1,480 on average per adviser in costs for preparation of the prospective disclosure × 380 advisers = $562,400 in total costs for preparation of the prospective disclosure.

[104] *See* section V.B of this Release. We estimate the following burdens and/or costs: (i) For printing the prospective disclosure (including a disclosure and consent form and, if necessary, a revised Form ADV brochure and account agreement), approximately $1.50 on average per eligible account, of which we estimate there are approximately 796,200, for a total of $1,194,300 (which, if divided by the estimated 380 eligible advisers, equals a total cost for printing of approximately $3,143 on average per adviser); (ii) for distributing the prospective disclosure, approximately 0.1 hours on average per eligible account, for a total of 79,620 hours (which, if divided by the estimated 380 eligible advisers, equals a total burden of 210 hours on average per adviser).

[105] We expect that the distribution function for the prospective written disclosure and consent solicitation will most likely be performed by a general clerk. Data from the Industry's Salary Report, modified to account for an 1,800-hour work-year and multiplied by 2.93 to account for bonuses,

Continued

For purposes of the Paperwork Reduction Act, we have estimated the number of hours the average accountholder would spend on reviewing the written disclosure document and, if it wishes, returning an executed consent.[106] We estimate that the costs corresponding to this hour burden will be approximately $0.50 on average per eligible accountholder. Assuming that there are 796,200 eligible accountholders who will receive the written disclosure document and 716,580 that will provide consent during the transitional solicitation, we estimate that the total cost to clients will be $398,100.[107]

For purposes of the Paperwork Reduction Act, we have estimated the number of hours the average adviser would spend in ongoing maintenance of prospective disclosure and consent solicitation efforts.[108] Based on those estimates, we estimate that the average cost of updating the written prospective disclosure, maintaining records on prospective consents provided, and processing consent revocations and consents granted subsequent to the initial solicitation will be approximately $5,600 on average per eligible adviser per year.[109] We estimate that the annual cost for all eligible advisers to keep consent information up to date will be $2,128,000.[110]

Based on the discussion above, we estimate the costs relating to paragraph (a)(3) of rule 206(3)–3T to be on average approximately: (i) $13,213 per adviser in one-time costs;[111] (ii) $5,600 per adviser in ongoing costs; and (iii) $0.50 per client account in costs. As such, we estimate the total costs associated with the prospective written disclosure and consent requirement of the rule to be $7,547,040.[112]

Trade-by-Trade Disclosure and Consent: Pursuant to paragraph (a)(4) of the rule, an investment adviser, prior to the execution of each principal transaction, must inform the advisory client, orally or in writing, of the capacity in which it may act with respect to such transaction. Also pursuant to paragraph (a)(4) of the rule, an investment adviser, prior to the execution of each principal transaction, must obtain oral or written consent from the advisory client to act as principal for its own account with respect to such transaction. Further, investment advisers likely will want to document for their own evidentiary purposes the receipt of trade-by-trade consent by their representatives.

As noted in our Paperwork Reduction Act analysis, section 206(3) of the Advisers Act already requires written trade-by-trade disclosure in connection with principal trades. We believe that complying with this requirement of rule 206(3)–3T provides an alternative method of compliance that is likely to be less costly than compliance with section 206(3). To the extent that advisers are not currently engaging in principal trades with non-discretionary advisory accountholders (and thus are not preparing and providing written disclosure regarding conflicts of interest associated with principal trading in particular securities), advisers electing to rely on the rule will need to begin to prepare such tailored disclosure and communicate it to clients.

We estimate that the costs of preparing and communicating trade-by-trade disclosures to clients and obtaining their consents could include: (i) Preparing disclosure relating to the conflicts associated with executing that transaction on a principal basis; and (ii) communicating that disclosure to clients. For purposes of the Paperwork Reduction Act, we have estimated the number of hours advisers would spend on providing trade-by-trade disclosure and consent solicitation.[113] Based on those estimates, we estimate that the cost of preparing each trade-by-trade disclosure will be approximately $0.47 on average.[114] For purposes of the Paperwork Reduction Act analysis, we have estimated that eligible clients engage in an average of approximately 50 trades per year, all of which we have conservatively assumed are principal trades. We further estimate that communicating the disclosure to clients orally will be at most a minimal cost (note that system programming costs are discussed separately under the subsection entitled ''Related Costs'' below). As such, we estimate the total annual cost for compliance with paragraph (a)(4) of rule 206(3)–3T to be approximately $16,662,240.[115]

Trade-by-Trade Confirmations: Pursuant to paragraph (a)(5) of the rule, an investment adviser must deliver to its client a written confirmation at or before completion of each principal transaction that includes, in addition to the information required by rule 10b–10 under the Exchange Act [17 CFR 240.10b–10], a conspicuous, plain English statement that the investment adviser: (i) Informed the advisory client that it may be acting in a principal capacity in connection with the

firm size, employee benefits and overhead, suggest that cost for a General Clerk is approximately $41 per hour. $41 per hour × 0.1 hours on average for distribution per account = approximately $4.10 on average per account for distribution. $1.50 on average printing cost per account + $4.10 on average distribution cost per account = $5.60 on average per account. $5.60 on average per account × 796,200 accounts to which we expect the disclosure to be distributed = a total printing and distribution cost for the prospective disclosure and consent solicitation of $4,458,720 (which, if divided by the estimated 380 eligible advisers, equals a total cost for distribution of approximately $11,733 on average per eligible adviser).

[106] *See* section V.B of this Release. We estimate that the burden per client account that will return an executed consent (eligible accountholder), of which we estimate that there will be approximately 716,580, will be 0.05 hours (3 minutes) on average, for a total burden of 35,829 hours. We do not believe there will be a significant difference in burden between those clients that consent and those that do not.

[107] $0.50 on average for each accountholder who receives a written prospective disclosure document × 796,200 eligible accountholders = $398,100. We do not believe there will be a significant difference in burden between those accountholders that consent and those that do not.

[108] *See* section V.B of this Release. We estimate that the burden per eligible adviser of ongoing maintenance of the prospective disclosure and consent solicitation efforts will be approximately 100 hours on average per year, for a total of 38,000 hours.

[109] We expect that this function will most likely be performed by compliance professionals at $56 per hour. *See* Industry's Salary Report. 100 hours on average per adviser per year × $56 per hour = $5,600 on average per adviser per year.

[110] $5,600 on average per adviser per year × 380 eligible advisers = $2,128,000.

[111] $1,480 on average per adviser in costs for preparation of the prospective disclosure and consent solicitation + $11,733 on average per adviser in costs for printing and distributing the prospective disclosure and consent solicitation = total one-time costs for preparation, printing and distribution of the prospective disclosure and consent solicitation of $13,213 on average per adviser.

[112] ($13,213 average one time cost per adviser × 380 eligible advisers) + ($5,600 average ongoing costs per adviser × 380 eligible advisers) + ($0.50 average costs per accountholder × 796,200 accountholders who will review the written disclosure) = $5,020,940 + $2,128,000 + $398,100 = $7,547,040 total cost of compliance with paragraph (a)(3) of rule 206(3)–3T.

[113] *See* section V.B of this Release. We estimate that based on discussions with industry representatives that there will be approximately 50 trades (which we conservatively assume will be principal trades) on average made per year per eligible account. We estimate a burden of 0.0083 hours (30 seconds) on average per trade for communication of the requisite disclosure to an eligible accountholder, of which we estimate there will be 716,580, for an estimated total burden of approximately 297,381 hours per year. The burden for the average adviser would thus be 297,381 total hours per year ÷ 380 eligible advisers = approximately 783 hours on average per adviser per year.

[114] We expect that this function will most likely be performed by compliance professionals at $56 per hour (*see* Industry's Salary Report) and that the preparation and communication of trade-by-trade disclosure will comprise an average burden of approximately 0.0083 hours (30 seconds) per trade. 0.0083 hours on average per trade × $56 per hour = approximately $0.47 on average per trade.

[115] 783 hours on average per adviser per year × $56 per hour = $43,848 on average per adviser per year. $43,848 on average per eligible adviser per year × 380 eligible advisers = $16,662,240 total costs per year.

transaction and the client authorized the transaction; and (ii) owned the security sold to the advisory client (or bought the security from the client for its own account). As noted above in the Paperwork Reduction Act section of this Release, the majority of the information that this provision requires to be delivered to clients is already required to be assembled and communicated to clients pursuant to requirements under the Exchange Act. We expect that the costs associated with conforming trade confirmations to the requirements of paragraph (a)(5) of rule 206(3)–3T will stem principally from programming computer systems that generate confirmations to ensure that all the required information is contained in the confirmations. Costs associated with programming are described under the subsection entitled ''Related Costs'' below.

Principal Transactions Report: Pursuant to paragraph (a)(6) of the rule, the investment adviser must deliver to each client, no less frequently than annually, written disclosure containing a list of all transactions that were executed in the account in reliance upon the rule, and the date and price of such transactions. This report will require advisers to aggregate and distribute information that should already be available to the adviser or its broker-dealer affiliate executing the client's transactions.

As noted in the Paperwork Reduction Act section of this Release, we estimate that other than the actual aggregation and delivery of this statement, the burden of this collection will not be substantial because the information required to be contained in the statement is already collected and maintained by investment advisers and/or broker-dealers executing trades for their clients. Advisers and broker-dealers already send periodic or annual statements to clients. Thus, to comply, advisers will need to add information they already maintain to documents they already prepare and send. We expect that there will be a one-time cost associated with this requirement relating to programming computer systems to generate the report, aggregating information that is already available and maintained by advisers or their broker-dealer affiliates. Costs associated with programming are described under the subsection entitled ''Related Costs'' below.

Related Costs: We expect that the bulk of the costs of compliance with rule 206(3)–3T relate to: (i) The initial distribution of prospective disclosure and collection of consents (described above); (ii) systems programming costs to ensure that trade confirmations contain all of the information required by paragraph (a)(4) of the rule; and (iii) systems programming costs to aggregate already-collected information to generate compliant principal transactions reports. For purposes of the Paperwork Reduction Act, we have estimated the cost an average adviser would incur on programming their computer systems, regardless of the size of their non-discretionary advisory account programs, to prepare compliant confirmations and principal transaction reports and to be able to track both prospective and trade-by-trade consents. For purposes of the Paperwork Reduction Act analysis, we have estimated the number of hours the average adviser would spend on programming computer systems to facilitate compliance with the rule.[116] Based on those estimates, we estimate the costs of programming, generating and delivering compliant confirmations and principal trade reports to be approximately $34,201 on average per eligible adviser,[117] for a total of $12,996,289.[118]

For those advisers that are converting fee-based brokerage accounts to non-discretionary advisory accounts, we are providing transition relief, described in section IV of this Release, that is designed, among other things, to avoid disruptions to clients and minimize costs to advisers.

Total Costs: The total overall costs, including estimated costs for all eligible advisers and eligible accounts, relating to compliance with rule 206(3)–3T are $37,205,569.[119]

E. Request for Comment

- We solicit quantitative data to assist with our assessment of the benefits and costs of rule 206(3)–3T.
- What, if any, additional costs are involved in complying with the rule? What are the types of costs, and what are the amounts? Should the rule be modified in any way to mitigate costs? If so, how?
- Does the rule's requirement that a report be provided to each client, at

[116] *See* section V.B of this Release. We estimate the following burdens and costs: (i) For programming computer systems to generate trade confirmations compliant with rule 206(3)–3T, approximately $20,000 on average per eligible adviser, of which we estimate there are approximately 380, for a total of $7,600,000; (ii) for the internal burden associated with programming computer systems relating to principal trade reports compliant with rule 206(3)–3T, approximately five hours on average per eligible adviser, for a total of 1,900 hours; (iii) for assistance of outside professionals to assist in programming computer systems to generate principal trade reports, approximately $10,000 on average per eligible adviser, for a total of $3,800,000; and (iv) for generation and delivery of annual principal trade reports each year, approximately 0.05 hours (three minutes) on average per eligible account, of which we estimate there are approximately 716,580, for a total of 35,829 hours total per year.

[117] We expect that the internal programming function most likely will be performed by computer programmers. Data from the Industry's Salary Report, modified to account for an 1,800-hour work-year and multiplied by 2.93 to account for bonuses, firm size, employee benefits and overhead, suggest that cost for a Sr. Computer Operator is approximately $67 per hour. Five hours on average per adviser × $67 per hour = $335 on average per adviser (or, across all 380 eligible advisers, $127,300). We expect that the generation and delivery of annual principal trade reports will most likely be performed by general clerks at $41 per hour. $41 per hour × 35,829 total hours per year = $1,468,989 (or, if divided among all 380 eligible advisers, approximately $3,866 on average per adviser per year). $20,000 on average per adviser for programming to generate compliant trade confirmations + $335 on average per adviser for internal programming costs in connection with developing an annual principal trades report + $10,000 on average per adviser for outside computing assistance in developing the annual principal trade report + $3,866 on average per adviser for generation and delivery of annual principal trade reports per year = approximately $34,201 on average per adviser in connection with compliance with the confirmation and principal trade report requirements.

[118] $7,600,000 for programming to generate compliant trade confirmations + $127,300 for internal programming costs in connection with developing an annual principal trades report + $3,800,000 for outside computing assistance in developing the annual principal trade report + $1,468,989 for generation and delivery of annual principal trade reports per year = $12,996,289 total costs in connection with compliance with the confirmation and principal trade report requirements.

[119] $7,547,040 total costs in connection with compliance with the prospective disclosure and consent requirements of the rule + $16,662,240 total costs in connection with compliance with the trade-by-trade disclosure and consent requirements of the rule + $12,996,289 total costs in connection with compliance with the confirmation and principal trade report requirements of the rule = $37,205,569 total costs in connection with compliance with the rule.

least annually, of the transactions undertaken with the client in reliance on the rule result in a meaningful identification of an adviser's trading patterns with its clients that will enable the client to evaluate more effectively than it would simply with prospective disclosure and trade-by-trade disclosure prior to the execution of a principal transaction whether it should continue to consent, or revoke its consent, to principal trading in reliance on the rule?

○ What will the effect of the rule be on the availability of account services and securities to clients who do not consent to principal transactions?

○ Have we accurately estimated the costs of compliance with the rule?

○ We assumed that firms already collect much of the information that the rule would require for the principal trading reports. Are we correct? We solicit comments on the extent to which firms already aggregate the information that the rule will require to be disclosed in the principal trading reports.

VII. Promotion of Efficiency, Competition and Capital Formation

Section 202(c) of the Advisers Act mandates that the Commission, when engaging in rulemaking that requires it to consider or determine whether an action is necessary or appropriate in the public interest, consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.[120]

Rule 206(3)–3T permits an investment adviser, with respect to a non-discretionary advisory account, to comply with section 206(3) by: (i) Making certain written disclosures; (ii) obtaining written, revocable consent from the client prospectively authorizing the adviser to enter into principal trades; (iii) making oral or written disclosure and obtaining the client's consent orally or in writing prior to the execution of each principal transaction; (iv) sending to the client confirmation statements for each principal trade that disclose the capacity in which the adviser has acted and indicating that the client consented to the transaction; and (v) delivering to the client an annual report itemizing the principal transactions.

Rule 206(3)–3T may increase efficiency by providing an alternative means of compliance with section 206(3) of the Advisers Act that we believe will be less costly and less burdensome. As discussed above, by permitting oral trade-by-trade disclosure, advisers may be more willing to engage in principal trades with advisory clients. As a result, advisers may provide access to certain securities the adviser or its affiliate has in inventory. Clients might want access to securities an adviser, or an affiliated broker-dealer, has in inventory, despite the conflicts inherent in principal trading, if those securities are scarce or hard to acquire. Firms have argued that purchasing such securities from, or selling them to, an adviser could lead to faster or less expensive execution, advantages a client may deem to outweigh the risks presented by principal trading with an adviser.[121]

We expect that rule 206(3)–3T will promote competition because it preserves investor choice for different types of advisory accounts. As a practical matter, advisers did not frequently engage in principal trades. By relying on the rule, advisers that are also registered broker-dealers will be able to offer advisory clients access to their (and their affiliates') inventory. Advisers that are not also registered as broker-dealers may seek to market their services without principal trades and their associated costs and benefits. We are not able to predict with certainty the effect of the rule on them, but it is possible that some advisers may elect to register as broker-dealers in order to rely on rule 206(3)–3T.

We believe that if rule 206(3)–3T has any effect on capital formation it is likely to be positive, although indirect. We understand that most investment advisers will not trade with non-discretionary advisory client accounts on a principal basis so long as they must provide trade-by-trade written disclosure. Providing an alternative to the traditional requirements of trade-by-trade written disclosure might serve to broaden the potential universe of purchasers of securities, in particular investment grade debt securities for the reasons described above, opening the door to greater investor participation in the securities markets with a potential positive effect on capital formation.

The Commission requests comment on whether the proposed amendments are likely to promote efficiency, competition, and capital formation.

VIII. Final Regulatory Flexibility Analysis

This Final Regulatory Flexibility Analysis (''FRFA'') has been prepared in accordance with 5 U.S.C. 604. It relates to rule 206(3)–3T, which we are adopting in this Release.[122]

A. Need for and Objectives of the Rule

Sections I and II of this Release describe the reasons for and objectives of rule 206(3)–3T. As we discuss in detail above, our reasons include the need to facilitate the transition of customers in fee-based brokerage accounts in the wake of the *FPA* decision and to address the stated inability of the sponsors of those accounts to offer clients some of the services the clients desire in the non-discretionary advisory accounts to which they will be transitioned.

B. Small Entities Affected by the Rule

Rule 206(3)–3T is an alternative method of complying with Advisers Act section 206(3) and is available to all investment advisers that: (i) Are registered as broker-dealers under the Exchange Act; and (ii) effect trades with clients directly or indirectly through a broker-dealer controlling, controlled by or under common control with the investment adviser, including small entities. Under Advisers Act rule 0–7, for purposes of the Regulatory Flexibility Act an investment adviser generally is a small entity if it: (i) Has assets under management having a total value of less than $25 million; (ii) did not have total assets of $5 million or more on the last day of its most recent fiscal year; and (iii) does not control, is not controlled by, and is not under common control with another investment adviser that has assets under management of $25 million or more, or any person (other than a natural person) that had $5 million or more on the last day of its most recent fiscal year.[123]

We have opted not to make the relief available to all investment advisers, but have instead restricted it to investment advisers that are dually registered as broker-dealers under the Exchange Act. We have taken this approach because, as more fully discussed above, in the context of principal trades which implicate potentially significant conflicts of interest, and which are executed through broker-dealers, we believe it is important that the protections of both the Advisers Act and the Exchange Act, which includes well developed sales practice rules, apply to advisers entering into principal transactions with clients.

The Commission estimates that as of August 1, 2007, 597 investment advisers were small entities.[124] The Commission

[120] 15 U.S.C. 80b–2(c).

[121] *See, e.g.*, SIFMA Letter.

[122] Although the requirements of the Regulatory Flexibility Act are not applicable to rules adopted under the Administrative Procedure Act's ''good cause'' exception, see 5 U.S.C. 601(2) (defining ''rule'' and notice requirements under the Administrative Procedures Act), we nevertheless prepared a FRFA.

[123] *See* 17 CFR 275.0–7.

[124] IARD Data as of August 1, 2007.

assumes for purposes of this FRFA that 29 of these small entities (those that are both as investment advisers and broker-dealers) could rely on rule 206(3)–3T, and that all of these small entities would rely on the new rule.[125] We welcome comment on the availability of the rule to small entities. Do small investment advisers believe an alternative means of compliance with section 206(3) of the Advisers Act should be available to more of them? Do they believe that the dual registration requirement of the rule is too onerous for small advisers despite the discussion in subsection F below? If so, how do they propose replicating the additional protections afforded to clients by the broker-dealer regulations?

C. Projected Reporting, Recordkeeping, and Other Compliance Requirements

The provisions of rule 206(3)–3T would impose certain new reporting or recordkeeping requirements, but are not expected to materially alter the time required for investment advisers that also are registered as broker-dealers to engage in transactions with their clients on a principal basis. Rule 206(3)–3T is designed to provide an alternative means of compliance with the requirements of section 206(3) of the Advisers Act. Investment advisers taking advantage of the rule with respect to non-discretionary advisory accounts would be required to make certain disclosures to clients on a prospective, trade-by-trade and annual basis. Specifically, rule 206(3)–3T permits an adviser, with respect to a non-discretionary advisory account, to comply with section 206(3) of the Advisers Act by, among other things: (i) Making certain written disclosures; (ii) obtaining written, revocable consent from the client prospectively authorizing the adviser to enter into principal trades; (iii) making oral or written disclosure and obtaining the client's consent orally or in writing prior to the execution of each principal transaction; (iv) sending to the client confirmation statements for each principal trade that disclose the capacity in which the adviser has acted and indicating that the client consented to the transaction; and (v) delivering to the client an annual report itemizing the principal transactions. Advisers are already required to communicate the content of many of the disclosures pursuant to their fiduciary obligations to clients. Other disclosures are already required by rules applicable to broker-dealers.

D. Agency Action To Minimize Effect on Small Entities

Small entities registered with the Commission as investment advisers seeking to rely on the rule would be subject to the same disclosure requirements as larger entities. In each case, however, an investment adviser, whether large or small, would only be able to rely on the rule if it also is registered with us as a broker-dealer. As noted above, we estimate that 25 small entities are registered as both advisers and broker-dealers and therefore those small entities are eligible to rely on the rule. In developing the requirements of the rule, we considered the extent to which they would have a significant impact on a substantial number of small entities, and included flexibility where possible, calling for disclosures that are already generated by the relevant firms in one form or another wherever possible in light of the objectives of the rule, to reduce the corresponding burdens imposed.

E. Duplicative, Overlapping, or Conflicting Federal Rules

The Commission believes that there are no rules that duplicate or conflict with rule 206(3)–3T, which presents an alternative means of compliance with the procedural requirements of section 206(3) of the Advisers Act that relate to principal transactions.

The Commission notes, however, that rule 10b–10 under the Exchange Act is a separate confirmation rule that requires broker-dealers to provide certain information to their customers regarding the transactions they effect. Furthermore, FINRA Rule 2230 requires broker-dealers that are members of FINRA to deliver a written notification containing certain information, including whether the member is acting as a broker for the customer or is working as a dealer for its own account. Brokers and dealers typically deliver this information in confirmations that fulfill the requirements of rule 10b–10 under the Exchange Act. Rule G–15 of the Municipal Securities Rulemaking Board also contains a separate confirmation rule that governs member transactions in municipal securities, including municipal fund securities. In addition, investment advisers that are qualified custodians for purposes of rule 206(4)–2 under the Advisers Act and that maintain custody of their advisory clients' assets must send quarterly account statements to their clients pursuant to rule 206(4)–2(a)(3) under the Advisers Act.

These rules overlap with certain elements of rule 206(3)–3T, but the Commission has designed the temporary rule to work efficiently together with existing rules by permitting firms to incorporate the required disclosure into one confirmation statement.

F. Significant Alternatives

The Regulatory Flexibility Act directs us to consider significant alternatives that would accomplish our stated objective, while minimizing any significant adverse impact on small entities.[126] Alternatives in this category would include: (i) Establishing different compliance or reporting standards or timetables that take into account the resources available to small entities; (ii) clarifying, consolidating, or simplifying compliance requirements under the rule for small entities; (iii) using performance rather than design standards; and (iv) exempting small entities from coverage of the rule, or any part of the rule.

The Commission believes that special compliance or reporting requirements or timetables for small entities, or an exemption from coverage for small entities, may create the risk that the investors who are advised by and effect securities transactions through such small entities would not receive adequate disclosure. Moreover, different disclosure requirements could create investor confusion if it creates the impression that small investment advisers have different conflicts of interest with their advisory clients in connection with principal trading than larger investment advisers. We believe, therefore, that it is important for the disclosure protections required by the rule to be provided to advisory clients by all advisers, not just those that are not considered small entities. Further consolidation or simplification of the proposals for investment advisers that are small entities would be inconsistent with the Commission's goals of fostering investor protection.

We have endeavored through rule 206(3)–3T to minimize the regulatory burden on all investment advisers eligible to rely on the rule, including small entities, while meeting our regulatory objectives. It was our goal to ensure that eligible small entities may benefit from the Commission's approach to the new rule to the same degree as other eligible advisers. The condition that advisers seeking to rely on the rule must also be registered as broker-dealers and that each account with respect to which a dually-registered adviser seeks to rely on the rule must be a brokerage account subject to the Exchange Act, and the rules thereunder, and the rules

[125] *Id.*

[126] *See* 5 U.S.C. 603(c).

of the self-regulatory organization(s) of which it is a member, reflect what we believe is an important element of our balancing between easing regulatory burdens (by affording advisers an alternative means of compliance with section 206(3) of the Act) and meeting our investor protection objectives.[127] Finally, we do not consider using performance rather than design standards to be consistent with our statutory mandate of investor protection in the present context.

G. General Request for Comments

We solicit written comments regarding our analysis. We request comment on whether the rule will have any effects that we have not discussed. We request that commenters describe the nature of any impact on small entities and provide empirical data to support the extent of the impact.

IX. Statutory Authority

The Commission is adopting Rule 206(3)–3T pursuant to sections 206A and 211(a) of the Advisers Act.

Text of Rule

List of Subjects in 17 CFR Part 275

Investment advisers, Reporting and recordkeeping requirements.

■ For the reasons set out in the preamble, Title 17, Chapter II of the Code of Federal Regulations is amended as follows:

PART 275—RULES AND REGULATIONS, INVESTMENT ADVISERS ACT OF 1940

■ 1. The general authority citation for Part 275 is revised to read as follows:

Authority: 15 U.S.C. 80b–2(a)(11)(G), 80b–2(a)(17), 80b–3, 80b–4, 80b–4a, 80b–6(4), 80b–6a, and 80b–11, unless otherwise noted.

* * * * *

■ 2. Section 275.206(3)–3T is added to read as follows:

§ 275.206(3)–3T Temporary rule for principal trades with certain advisory clients.

(a) An investment adviser shall be deemed in compliance with the provisions of section 206(3) of the Advisers Act (15 U.S.C. 80b–6(3)) when the adviser directly or indirectly, acting as principal for its own account, sells to or purchases from an advisory client any security if:

(1) The investment adviser exercises no ''investment discretion'' (as such term is defined in section 3(a)(35) of the Securities Exchange Act of 1934 (''Exchange Act'') (15 U.S.C. 78c(a)(35))), except investment discretion granted by the advisory client on a temporary or limited basis, with respect to the client's account;

(2) Neither the investment adviser nor any person controlling, controlled by, or under common control with the investment adviser is the issuer of, or, at the time of the sale, an underwriter (as defined in section 202(a)(20) of the Advisers Act (15 U.S.C. 80b–2(a)(20))) of, the security; *except that* the investment adviser or a person controlling, controlled by, or under common control with the investment adviser may be an underwriter of an investment grade debt security (as defined in paragraph (c) of this section);

(3) The advisory client has executed a written, revocable consent prospectively authorizing the investment adviser directly or indirectly to act as principal for its own account in selling any security to or purchasing any security from the advisory client, so long as such written consent is obtained after written disclosure to the advisory client explaining:

(i) The circumstances under which the investment adviser directly or indirectly may engage in principal transactions;

(ii) The nature and significance of conflicts with its client's interests as a result of the transactions; and

(iii) How the investment adviser addresses those conflicts;

(4) The investment adviser, prior to the execution of each principal transaction:

(i) Informs the advisory client, orally or in writing, of the capacity in which it may act with respect to such transaction; and

(ii) Obtains consent from the advisory client, orally or in writing, to act as principal for its own account with respect to such transaction;

(5) The investment adviser sends a written confirmation at or before completion of each such transaction that includes, in addition to the information required by 17 CFR 240.10b–10, a conspicuous, plain English statement informing the advisory client that the investment adviser:

(i) Disclosed to the client prior to the execution of the transaction that the adviser may be acting in a principal capacity in connection with the transaction and the client authorized the transaction; and

(ii) Sold the security to, or bought the security from, the client for its own account;

(6) The investment adviser sends to the client, no less frequently than annually, written disclosure containing a list of all transactions that were executed in the client's account in reliance upon this section, and the date and price of such transactions;

(7) The investment adviser is a broker-dealer registered under section 15 of the Exchange Act (15 U.S.C. 78o) and each account for which the investment adviser relies on this section is a brokerage account subject to the Exchange Act, and the rules thereunder, and the rules of the self-regulatory organization(s) of which it is a member; and

(8) Each written disclosure required by this section includes a conspicuous, plain English statement that the client may revoke the written consent referred to in paragraph (a)(3) of this section without penalty at any time by written notice to the investment adviser.

(b) This section shall not be construed as relieving in any way an investment adviser from acting in the best interests of an advisory client, including fulfilling the duty with respect to the best price and execution for the particular transaction for the advisory client; nor shall it relieve such person or persons from any obligation that may be imposed by sections 206(1) or (2) of the Advisers Act or by other applicable provisions of the federal securities laws.

(c) For purposes of paragraph (a)(2) of this section, an *investment grade debt security* means a non-convertible debt security that, at the time of sale, is rated in one of the four highest rating categories of at least two nationally recognized statistical rating organizations (as defined in section 3(a)(62) of the Exchange Act (15 U.S.C. 78c(a)(62))).

(d) This section will expire and no longer be effective on December 31, 2009.

By the Commission.

September 24, 2007.

Nancy M. Morris,

Secretary.

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[127] *See* Section II.B.7 of this Release.