

November 30, 2007

*Via Electronic Filing*

Nancy M. Morris  
Secretary  
Securities and Exchange Commission  
100 F Street, N.E.  
Washington, DC 20549-1090

**Re: Temporary Rule Regarding Principal Trades with Certain Advisory Clients,  
Rel. No. IA-2653, File No. S7-23-07**

Dear Ms. Morris:

The Investment Adviser Association<sup>1</sup> appreciates the opportunity to submit comments on temporary rule 206(3)-3T, which enables broker-dealers also registered as investment advisers to engage in certain principal transactions in non-discretionary accounts, subject to several conditions.<sup>2</sup> The interim rule establishes an alternative means for those broker-dealers to meet the requirements of Section 206(3) of the Investment Advisers Act of 1940.<sup>3</sup> As noted below, we believe the Commission has struck an appropriate balance, although we would strongly oppose expansion of the terms or conditions of the temporary rule.

Section 206(3) 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.” An adviser entering into a principal transaction with a client must satisfy these disclosure and consent requirements on a transaction-by-transaction basis. Section 206(3) was enacted to address concerns that an adviser might undertake principal transactions

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<sup>1</sup> The Investment Adviser Association (formerly the Investment Counsel Association of America) is a not-for-profit association that represents the interests of SEC-registered investment adviser firms. Founded in 1937, the Association’s current membership consists of more than 500 firms that collectively manage in excess of \$8 trillion in assets for a wide variety of individual and institutional clients. For more information, please visit our web site: [www.investmentadviser.org](http://www.investmentadviser.org).

<sup>2</sup> *Temporary Rule Regarding Principal Trades with Certain Advisory Clients*, SEC Rel. No. IA-2653 (Sept. 24, 2007) (“Temporary Rule Release”).

<sup>3</sup> The interim rule was adopted in response to the decision by the D.C. Circuit Court of Appeals earlier this year that invalidated the SEC’s rule providing that fee-based brokerage accounts were not advisory accounts and were not subject to the Advisers Act. *See Financial Planning Association v. S.E.C.*, 2007 WL 935733, C.A.D.C. (Mar. 30, 2007) (vacating Advisers Act rule 202(a)(11)-1 adopted in *Certain Broker-Dealers Deemed Not To Be Investment Advisers*, SEC Rel. Nos. IA-2376; 34-51523; File No. S7-25-99 (Apr. 12, 2005)).

with clients in order to engage in self-dealing or to dump unmarketable securities or securities that are declining in value.<sup>4</sup>

The IAA commends the Commission for narrowly tailoring the interim rule so that it solely provides limited relief with respect to investors in certain non-discretionary accounts.<sup>5</sup> Because of the risks associated with principal transactions, an expansive exception to the principal trading restrictions would be unwarranted. Congress's concerns regarding the risks inherent in principal transactions were and continue to be significant.<sup>6</sup> As noted by the Commission in the Temporary Rule Release, "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."<sup>7</sup>

The IAA also commends the Commission for adopting the interim rule on a temporary basis.<sup>8</sup> The temporary nature of the rule will enable the Commission to carefully consider and respond to comments and assess the operation of the rule.<sup>9</sup> In light of the sunset provision, we expect the staff to conduct a thorough analysis of whether the rule is working, including monitoring both how firms comply with their disclosure obligations and whether firms that conduct principal trades with their clients serve the best interests of their clients.<sup>10</sup> Such review and evaluation of the temporary rule is essential. We respectfully urge the Commission to dedicate adequate resources to ensure that the rule is properly implemented and to ensure that dual registrants comply fully with its requirements. The Commission's review is needed in order to guarantee compliance with the rule on a temporary basis, to protect clients, and to fully inform the Commission as to any future rulemaking decisions.<sup>11</sup>

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<sup>4</sup> Temporary Rule Release at 13.

<sup>5</sup> The requirements set forth in the interim rule include: providing advanced written disclosure of conflicts, obtaining written revocable consent from the client, providing certain disclosures and obtaining consent before each principal trade, sending client confirmation statements, and delivering an annual report itemizing the principal trades. *Id.*, at 14-15.

<sup>6</sup> *Id.*, at 14.

<sup>7</sup> *Id.*

<sup>8</sup> Absent further action by the SEC, the temporary rule will expire on December 31, 2009. *Id.*, at 1.

<sup>9</sup> *Id.*, at 38-39.

<sup>10</sup> See Andrew J. Donohue, "Keynote Address at the 2007 Managed Account Solutions Conference" (Oct. 19, 2007) available at <http://sec.gov/news/speech/2007/spch101907ajd.htm> ("[The sunset provision] gives the Commission and the staff 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 serve their clients' best interests."). See also Temporary Rule Release at 13 and 31.

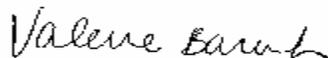
<sup>11</sup> The results of the RAND study of the marketing, sale and delivery of financial products and services to investors are expected to be part of that evaluation. See Press Release, "Commission Seeks Time for Investors and Brokers to Respond to Court Decision on Fee-Based Accounts," Rel. No. 2007-95 (May 14, 2007) ("The results of the study are expected to provide an important empirical foundation for considering improvements in [this regulatory area]").

Furthermore, the Commission should carefully evaluate the interim rule by taking into account the purpose and intent of Section 206(3). Any further exemption from the provisions of the Advisers Act could lead to a “slippery slope,” whereby the principal trading protections set forth in the Advisers Act eventually are completely eroded. In addition, evaluation of the interim rule should take into consideration long-established, core legal and regulatory distinctions between investment advisers and broker-dealers to ensure that the statutory distinctions between brokerage activities and investment advisory services remain intact.<sup>12</sup>

Finally, we also encourage the Commission to use this opportunity to play a proactive and prominent role in educating investors and consumers about the fundamental issues involved in this and related rulemakings. As we have stated in prior correspondence, we recommend that the Commission actively provide notice and information to investors about the differences between broker-dealers and investment advisers, and the laws and activities governing each.<sup>13</sup> Such information should include educational materials regarding principal trades, including the interim rule. We continue to strongly believe that the Commission must play a central role in educating the investing public about these critical issues.

We welcome the opportunity to work with you and continue our discussions regarding these matters.

Sincerely,



Valerie Baruch  
Assistant General Counsel

cc: Hon. Christopher Cox  
Hon. Paul S. Atkins  
Hon. Annette L. Nazareth  
Hon. Kathleen L. Casey

Andrew J. Donohue, Director, Division of Investment Management  
Robert E. Plaze, Associate Director, Division of Investment Management

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<sup>12</sup> See, e.g., Letter from David G. Tittsworth, Investment Counsel Association of America, to Jonathan G. Katz, Secretary, SEC (Jan. 12, 2000).

<sup>13</sup> See, e.g., Letter from David G. Tittsworth, Investment Adviser Association, to the Honorable William H. Donaldson, Chairman, SEC (June 22, 2005). See also, Letter from Karen Barr, Investment Adviser Association, to Nancy Morris, Secretary, SEC (Nov. 2, 2007). In 2006, the North American Securities Administrators Association, Consumer Federation of America, IAA, CFA Institute, and Financial Planning Association published a brochure, entitled “Cutting Through the Confusion,” that provides helpful information to consumers about the differences between various investment services providers. In October 2006, the SEC established various links to the brochure as part of its Investor Education information (via NASAA’s web site). Earlier this year, however, the SEC removed the links to the consumer brochure. Restoration of such links on the SEC web site would be a small, but positive, step toward enhanced investor education.