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Filed Electronically

Ms. Elizabeth M. Murphy, Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Re: *Temporary Rule Regarding Principal Trades With Certain Advisory Clients; File No. S7-23-07*

Dear Ms. Murphy:

We submit these comments in response to the above-referenced proposal to extend, until December 31, 2012, temporary rule 206(3)-3T which provides an alternative means for certain dually registered broker-dealer/investment advisers to meet the principal trade requirements of the Investment Advisers Act of 1940 ("Advisers Act").[1] While we support the proposed extension, we believe that many of the compliance issues described in the Proposing Release derive from the unnecessarily complex conditions the temporary rule imposes. We therefore urge the Commission to explore ways to simplify compliance with the Advisers Act's principal trade restrictions. In particular, we ask the Commission to update its guidance on the use of electronic media, so that firms can more easily comply with the statutory restrictions on principal trades without having to resort to the temporary rule. We also ask the Commission to consider more extensive exemptive rulemaking in this area.

Background

Section 206(3) of the Advisers Act forbids investment advisers and their affiliates to knowingly sell any security to or purchase any security from an advisory client on a principal basis, without disclosing this capacity to the client in writing before the completion of the transaction and obtaining the client's consent. As noted in the Proposing Release, one of the primary purposes of this restriction is to prevent advisers from dumping unwanted securities into client accounts.

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[1] Investment Advisers Act Rel. No. 3118 (December 1, 2010), 75 Fed. Reg. 75650 (December 6, 2010) ("Proposing Release"). Pickard and Djinis LLP specializes in securities regulatory matters, with a particular focus on investment adviser and broker-dealer issues. We represent a number of clients who are subject to the Advisers Act's principal trading restrictions.

By its terms, Section 206(3) is transaction-specific; its restrictions do not apply unless the executing broker-dealer or its affiliate is also acting as an investment adviser to the client *with regard to that transaction.*[2] Where the provision does apply, written disclosure relating to principal trades must be given, and oral or written client consent must be obtained on a case-by-case basis at or before the time the transaction settles.[3] The content of the required disclosure depends on facts and circumstances, including the degree of the client's trust and confidence in and reliance on the investment adviser with respect to the transaction.[4]

As noted in the Proposing Release, the Commission adopted temporary rule 206(3)-3T in 2007, in the wake of a court decision that effectively subjected a new class of broker-dealers to the Advisers Act.[5] The purpose of the rule was to make it easier for these broker-dealers to comply with the principal trade restrictions, while protecting clients from conflicts of interest that can arise from such principal trades. The relief provided by rule 206(3)-3T is very modest; it simply allows the broker-dealer to give clients the required case-by-case notice orally instead of in writing. And even this modest relief is subject to a host of limitations and conditions.

First of all, the relief is available only for non-discretionary accounts. Second, only dually registered broker-dealer/investment advisers may use the rule, even though section 206(3) applies to principal trades an adviser effects either directly or indirectly through an affiliate. Moreover, with certain exceptions, the relief is not available where the adviser or any of its affiliates is the issuer or an underwriter of the subject security.

Once these hurdles are cleared, the party relying on the temporary rule must give the client multiple disclosures about the principal trades and must obtain multiple client consents. For example, the broker-dealer/adviser must give the client prospective written disclosure of the circumstances under which the firm may directly or indirectly engage in principal transactions; the nature and significance of conflicts of interest resulting from such transactions; and how such conflicts are addressed. After giving this disclosure, the broker-dealer/adviser must obtain a written, revocable consent from the client prospectively authorizing the principal transactions.

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[2] By virtue of Advisers Act Rule 206(3)-1, the principal trading restrictions do not apply in connection with any transaction as to which the broker-dealer or its affiliate is acting as an investment adviser only in certain restricted ways. Furthermore, the Commission staff has granted no-action relief from Section 206(3) for certain practices that do not present the types of abuses the law was designed to address. *See e.g., Morgan, Lewis & Bockius LLP*, 1997 SEC No-Act. LEXIS 529 (April 16, 1997).

[3] Investment Advisers Act Rel. No. 1732 (July 17, 1998), 63 Fed. Reg. 39505 (July 23, 1998). An adviser who executes a transaction before obtaining client consent must ensure that the client understands that his or her consent to the transaction is not mandatory.

[4] IA Release No. 557 (December 2, 1976), 41 Fed. Reg. 53808; IA Release No. 470 (August 20, 1975), 40 Fed. Reg. 38158.

[5] *See* Proposing Release at notes 2 and 4 and accompanying text.

In addition to requiring prospective notice and consent, rule 206(3)-3T also requires the broker-dealer/adviser to make certain disclosures, either orally or in writing,[6] and to obtain the client's consent before each principal trade is *executed.*[7] The firm also must send each client a trade confirmation that, in addition to the standard confirmation information, states that the firm sold the security to or bought the security from the client for its own account, and states that the firm disclosed that it might act as principal and obtained the client's consent prior to the execution of the transaction. Finally, the broker-dealer/adviser must send the client at least annually, a written report itemizing the principal trades effected in the client's account pursuant to the rule during the reporting period, along with the date and price of such transactions.

Each written disclosure required by rule 206(3)-3T must include a conspicuous statement that the client may revoke its prospective consent at any time, without penalty, upon written notice to the adviser.

The Temporary Rule in Practice

According to the Proposing Release, the Commission's Office of Compliance Inspections and Examinations has examined industry compliance with rule 206(3)-T. The most notable aspect of these examinations is that the staff did not find any evidence that broker-dealer/advisers have dumped unwanted securities in client accounts.[8] In other words, there is no evidence that the principal trades examined by the staff caused the type of harm that section 206(3) was designed to address.

On the other hand, the staff reportedly did find evidence suggesting that some firms have not complied with the specific conditions and limitations imposed by the temporary rule. Among other things, the staff reportedly observed instances in which firms: (a) relied on the rule for securities that were not eligible for trading under the rule; (b) failed to implement special compliance procedures related to the rule; (c) sent confusing, misleading or incomplete prospective written disclosures to clients; (d) sent incomplete annual summary reports to clients or failed to send such reports at all; or (e) issued confirmations that omitted the special disclosure required by the rule.[9]

The absence of any evidence that unwanted securities were dumped in client accounts despite numerous alleged technical violations of the rule raises legitimate concerns about whether

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[6] Of course, if the transaction-based disclosures are made in writing, there is no need for the temporary rule's relief, and the rule's limitations and conditions do not apply.

[7] As noted above, section 206(3) permits notice and consent to occur at any time before the *completion* (*i.e.* settlement) of the trade. In its 1998 interpretive guidance on this provision, the Commission discussed the practical concerns arising from interpreting the statutory phrase the "completion of such transaction" to mean execution rather than settlement. Investment Advisers Act Rel. No. 1732, *supra,* note 3.

[8] Proposing Release at 7, 9, 75 Fed. Reg. at 75651 - 75652.

[9] *Id.* at 7-8, 75 Fed. Reg. at 75652.

the conditions and limitations in 206(3)-3T are really necessary. This situation also reveals the need for advisers to find a way to comply with the Advisers Act's principal trade restrictions without resorting to the cumbersome rule in the first place.

Alternative Means of Complying With Section 206(3)

Perhaps the simplest and most effective way for an adviser to comply with section 206(3) is to rely on the types of electronic communications that have become the mainstay of modern life. An e-mail or a text message sent to a client before the settlement of a principal trade can satisfy the requirement to disclose the capacity in which the adviser or its affiliate is acting. A client's electronic response can be used to satisfy the requirement to obtain the client's consent. A follow-up phone call can do the same thing, since the statute does not require consent to be in writing.

Satisfying the principal trade restrictions in this way reduces advisers' compliance costs, conserves the resources of the Commission's staff[10] and avoids bombarding investors with duplicative disclosures.[11] Unfortunately, the current standards governing advisers' use of electronic media to deliver most kinds of regulatory disclosure are based on outdated interpretive releases.[12] We urge the Commission to update this guidance so that investment advisers and broker-dealers can satisfy their regulatory obligations in the most efficient and effective manner possible. At a minimum, this would entail liberalizing registrants' ability to communicate through widely available electronic media without obtaining specific client consent.[13]

We also urge the Commission, in connection with the study it is conducting pursuant to section 913 of the Dodd-Frank Act and subsequent rulemaking, to seriously consider whether it is time to relieve advisers of the burden of case-by-case notice and consent for principal trades. The world has changed dramatically since section 206(3) was enacted. Principal markets are more transparent; the securities industry is more consolidated; and investment advisers are now subject to a comprehensive compliance regime. In light of these changes, the current principal trade limitations appear counterproductive.

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[10] If advisers comply with the statute directly, there is no need for the staff to examine or enforce compliance with rule 206(3)-3T's host of additional technical requirements.

[11] As the Commission has recognized in the mutual fund context, too much disclosure leads to *less*-informed investors, since they eventually fail to read anything they're given.

[12] Securities Act Rel. No. 7233 (October 6, 1995); Investment Advisers Act Rel. No. 1562 (May 9, 1996); and Exchange Act Rel. No. 42728 (April 28, 2000).

[13] The Commission has already adopted a "notice and access" approach to mutual fund prospectus delivery, Investment Company Act Rel. No. 28584 (January 13, 2009), 74 Fed. Reg. 4545 (January 26, 2009); and the delivery of proxy materials to shareholders, Exchange Act Rel. No. 56135 (July 26, 2007), 72 Fed. Reg. 42221 (August 1, 2007).

We appreciate the opportunity to comment on this important matter. We would be happy to supply further information to the Commission or the staff if you so desire.

Very truly yours,

Mari-Anne Pisarri

cc: Hon. Mary L. Schapiro
Hon. Kathleen L. Casey
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