

Investment Advisers Act of 1940
Section 206(4) and Rule 206(4)-3

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BY E-MAIL AND MESSENGER

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Associate Director and Chief Counsel
Division of Investment Management
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549

Re: In the Matter of Certain Specialist Trading
on Regional and Options Exchanges, File No. NY-7439

Dear Mr. Scheidt:

We submit this letter on behalf of our client Automated Trading Desk Specialists, LLC (“ATDS”), in connection with a settlement agreement (the “Settlement”) by ATDS arising out of the above referenced investigation by the Securities and Exchange Commission (the “Commission”). The Complaint filed by the Commission contained the following allegations, which neither admitted nor denied: ATDS failed to meet its obligations as a specialist to serve public customer orders over its own proprietary interests while executing trades on the Chicago Stock Exchange (“CHX”). More specifically, the Complaint alleged that ATDS engaged in improper trades for its own proprietary accounts by failing to match buy and sell agency orders and that it failed to make or keep current a blotter containing an itemized daily record of all purchases and sales of securities effected by ATDS for its proprietary accounts. The Complaint alleged that, as a result of its conduct, ATDS violated Section 17(a) of the Securities Exchange Act of 1934 and Rule 17a-3(a)(1) thereunder, CHX Article 9, Rule 17 (Personal Selling and Purchasing Prohibited), and CHX Article XXX, Rule 2 (Precedence to Orders in Book), before its repeal was effective.

ATDS seeks the assurance of the Staff of the Division of Investment Management (“Staff”) that it would not recommend any enforcement action to the Commission under Section 206(4) of the Investment Advisers Act of 1940 (“Advisers Act”), or Rule 206(4)-3 thereunder (the “Rule”), if an investment adviser pays ATDS a cash payment for the solicitation of advisory clients, notwithstanding the existence of the Judgment (as defined below) entered against ATDS. While the Judgment does not operate to prohibit or suspend ATDS or any associated person of ATDS from acting as, or being associated with, an investment adviser and does not relate to solicitation activities on behalf of any investment adviser, the Judgment may affect the ability of ATDS to receive such payments. The Staff in other instances has granted no-action relief under the Rule in similar circumstances.

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BACKGROUND

The Enforcement Staff of the Commission's New York Regional Office engaged in settlement discussions with ATDS in connection with the above-captioned investigation. The discussions resulted in the Settlement, and the Commission filed a complaint (the "Complaint") against ATDS in the United States District Court for the Southern District of New York (the "District Court") in a civil action captioned Securities and Exchange Commission v. Automated Trading Desk Specialists, LLC, Civil Action No. 1:09cv1977(S.D.N.Y. Mar. 4, 2009) (the "Action"). ATDS executed a Final Consent Judgment As To Automated Trading Desk Specialists, LLC (the "Consent"), in which ATDS neither admitted nor denied the allegations in the Complaint, except as to personal and subject matter jurisdiction, which it admitted, and in which it consented to the entry of a final judgment against it by the District Court (the "Judgment"). As negotiated by the parties, the Judgment, among other things, enjoined ATDS from violating Exchange Act Section 17(a)(1), Rule 17a-3 thereunder, and CHX Article 9, Rule 17. Additionally, the Judgment ordered ATDS to, among other things, pay disgorgement of \$4.2 million and a civil penalty of \$800,000. ATDS currently is not engaged in any cash solicitation activities that are subject to Advisers Act Rule 206(4)-3.

EFFECT OF RULE 206(4)-3

The Rule prohibits an investment adviser from paying a cash fee to any solicitor that has been temporarily or permanently enjoined by an order, judgment, or decree of a court of competent jurisdiction from engaging in or continuing any conduct or practice in connection with the purchase or sale of any security. Entry of the Judgment could cause ATDS to be disqualified under the Rule, and accordingly, absent no-action relief, ATDS may be unable to receive cash payments for the solicitation of advisory clients from advisers registered or required to be registered.

DISCUSSION

In the release adopting the Rule, the Commission stated that it "would entertain, and be prepared to grant in appropriate circumstances, requests for permission to engage as a solicitor a person subject to a statutory bar."¹ We respectfully submit that the circumstances present in this case are precisely the sort that warrant a grant of no-action relief.

The Rule's proposing and adopting releases explain the Commission's purpose in including the disqualification provisions in the Rule. The purpose was to prevent an investment adviser from hiring as a solicitor a person whom the adviser was not permitted to hire as an employee, thus

¹ See Requirements Governing Payments of Cash Referral Fees by Investment Advisers, Inv. Adv. Act Rel. No. 688 (July 12, 1979), 17 S.E.C. Docket (CCH) 1293, 1295, at note 10.

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doing indirectly what the adviser could not do directly. In the proposing release, the Commission stated that:

[b]ecause it would be inappropriate for an investment adviser to be permitted to employ indirectly, as a solicitor, someone whom it might not be able to hire as an employee, the Rule prohibits payment of a referral fee to someone who . . . has engaged in any of the conduct set forth in Section 203(e) of the [Advisers] Act . . . and therefore could be the subject of a Commission order barring or suspending the right of such person to be associated with an investment adviser.²

The Judgment expressly does not bar, suspend, or limit ATDS or any person currently associated with it from acting in any capacity under the federal securities laws.³ ATDS has not been sanctioned for activities relating to conduct as an investment adviser or relating to solicitation of advisory clients.⁴ ATDS's conduct addressed by the Judgment does not pertain to advisory activities. Accordingly, consistent with the

² See Requirements Governing Payments of Cash Referral Fees by Investment Advisers, Inv. Adv. Act Rel. No. 615 (Feb. 2, 1978), 14 S.E.C. Docket (CCH) 89, 91.

³ Under Section 9(a) of the Investment Company Act, ATDS and its affiliated persons will, as a result of the Judgment, be prohibited from serving or acting as, among other things, an investment adviser or depositor of any registered investment company or as principal underwriter for any registered open-end investment company or registered unit investment trust. As of the date of this letter, ATDS does not serve in any of the capacities listed in the Section 9(a) of the Investment Company Act with respect to registered investment companies. However, affiliated persons of ATDS do serve in such capacities, and they, along with ATDS, have filed an application under Section 9(c) of the Investment Company Act requesting the Commission to issue both temporary and permanent orders exempting them, and ATDS's future affiliated persons should any of them serve or act in any of the capacities set forth in Section 9(a) in the future, from the restrictions of Section 9(a). The applicants believe that they meet the standards for exemptive relief under Section 9(c), and they expect that the Commission will issue a temporary order prior to or simultaneously with entry of the Judgment, and a permanent order in due course thereafter. In no event will ATDS or any of its affiliated persons act in any capacity enumerated in Section 9(a) unless and until the Commission issues an order pursuant to Section 9(c) of the Investment Company Act, exempting them from the prohibitions of Section 9(a) of the Investment Company Act resulting from the Judgment.

⁴ ATDS additionally notes that it has not violated, or aided and abetted another person in violating, the cash solicitation rule.

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Commission's reasoning, there does not appear to be any reason to prohibit an adviser from paying ATDS for engaging in solicitation activities under the Rule.

In addition, the need for the relief is not theoretical or speculative but instead is concrete. It is possible at some point in the near future that ATDS would like to solicit clients for other investment advisers, both affiliated and unaffiliated with it.

The Staff previously has granted numerous requests for no-action relief from the disqualification provisions of the Rule to individuals and entities found by the Commission to have violated a wide range of federal securities laws and rules thereunder or permanently enjoined by courts of competent jurisdiction from engaging in or continuing any conduct or practice in connection with the purchase or sale of any security.⁵

⁵ See, e.g., *Millenium Partners, L.P., et al.*, SEC No-Action Letter (pub. avail. Mar. 9, 2006) (no-action request and relief encompassed natural persons); *American International Group, Inc.*, SEC No-Action Letter (pub. avail. Feb. 21, 2006); *CIBC Mellon Trust Company*, SEC No-Action Letter (pub. avail. Feb. 24, 2005); *Goldman, Sachs & Co.*, SEC No-Action Letter (pub. avail. Feb. 23, 2005); *Morgan Stanley & Co. Incorporated*, SEC No-Action Letter (pub. avail. Feb. 4, 2005); *American International Group, Inc.*, SEC No-Action Letter (pub. avail. Dec. 8, 2004); *James DeYoung*, SEC No-Action Letter (pub. avail. Oct. 24, 2003) (relief given to natural person); *Stephens Inc.*, SEC No-Action Letter (pub. avail. Dec. 27, 2001); *Prime Advisors, Inc.*, SEC No-Action Letter (pub. avail. Nov. 8, 2001); *Legg Mason Wood Walker, Inc.*, SEC No-Action Letter (pub. avail. June 11, 2001); *Dreyfus Corp.*, SEC No-Action Letter (pub. avail. March 9, 2001); *Prudential Securities Inc.*, SEC No-Action Letter (pub. avail. Feb. 7, 2001); *Tucker Anthony Inc.*, SEC No-Action Letter (pub. avail. Dec. 21, 2000); *J.B. Hanauer & Co.*, SEC No-Action Letter (pub. avail. Dec. 12, 2000); *Founders Asset Management LLC*, SEC No-Action Letter (pub. avail. Nov. 8, 2000); *Credit Suisse First Boston Corp.*, SEC No-Action Letter (pub. avail. Aug. 24, 2000); *Janney Montgomery Scott LLC*, SEC No-Action Letter (pub. avail. July 18, 2000); *Aeltus Investment Management, Inc.*, SEC No-Action Letter (pub. avail. July 17, 2000); *Paul Laude, CFP*, SEC No-Action Letter (pub. avail. June 22, 2000) (relief given to natural person); *William R. Hough & Co.*, SEC No-Action Letter (pub. avail. Apr. 13, 2000); *In the Matter of Certain Municipal Bond Refundings*, SEC No-Action Letter (pub. avail. Apr. 13, 2000); *In the Matter of Certain Market Making Activities on Nasdaq*, SEC No-Action Letter (pub. avail. Jan. 11, 1999); *Paine Webber, Inc.*, SEC No-Action Letter (pub. avail. Dec. 22, 1998); *NationsBanc Investments, Inc.*, SEC No-Action Letter (pub. avail. May 6, 1998); *Morgan Keegan & Co., Inc.*, SEC No-Action Letter (pub. avail. Jan. 9, 1998); *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, SEC No-Action Letter (pub. avail. Aug. 7, 1997); *Gruntal & Co.*, SEC No-Action Letter (pub. avail. July 17, 1996); *Salomon Brothers Inc.*, SEC No-Action Letter (pub. avail. Jan. 26, 1994); *BT Securities Corporation*, SEC No-Action Letter (pub. avail. Mar. 30, 1992); *Kidder Peabody & Co. Inc.*, SEC No-Action Letter (Oct. 11, 1990); *First City Capital Corp.*, SEC No-Action Letter (pub. avail. Feb. 9, 1990); *RNC Capital Management Co.*, SEC

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UNDERTAKINGS

In connection with this request, ATDS undertakes:

1. to conduct any cash solicitation arrangement entered into with any investment adviser registered or required to be registered under Section 203 of the Advisers Act in compliance with the terms of Rule 206(4)-3, except for the investment adviser's payment of cash solicitation fees to ATDS, which is subject to the Judgment;
2. to comply with the terms of the Judgment, including, but not limited to, to complying with the Court's orders to pay disgorgement and a civil penalty totaling \$5 million; and
3. that, for ten years from the date of the entry of the Judgment, ATDS or an investment adviser with whom it has a solicitation arrangement subject to Rule 206(4)-3, will disclose information about the Judgment in a written document that is delivered to each person whom ATDS solicits (a) not less than 48 hours before the person enters into a written or oral investment advisory contract with the investment adviser or (b) at the time the person enters into such a contract, if the person has the right to terminate such contract without penalty within 5 business days after entering into the contract.

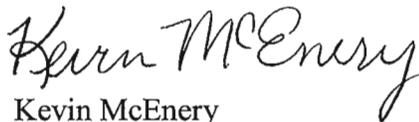
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CONCLUSION

We respectfully request the Staff to advise us that it will not recommend enforcement action to the Commission if an investment adviser that is registered or is required to be registered with the Commission pays ATDS a cash payment for the solicitation of advisory clients, notwithstanding the Judgment.

Please do not hesitate to call me at (202) 663-6596 regarding this request.

Very truly yours,


Kevin McEnery