

# Client Alert.

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## SEC Extends Temporary Rule for Adviser Principal Trades

By Jay G. Baris

The Securities and Exchange Commission has proposed to extend by two years a temporary rule that establishes an alternative means for registered investment advisers that are also registered as broker-dealers to meet the requirements of Section 206(3) of the Investment Advisers Act of 1940 (the “Advisers Act”) when they act in a principal capacity in transactions with certain of their advisory clients. Absent SEC action, Rule 206(3)-3T will sunset on December 31, 2012.

The SEC adopted Rule 206(3)-3(T) as a temporary rule in September 2007, as a consequence of the *Financial Planning Association v. SEC* decision (the “FPA Decision”). In the FPA Decision, the Court of Appeals for the D.C. Circuit threw out Rule 202(a)(11)-1 under the Advisers Act, which provided, among other things, that fee-based brokerage accounts were not advisory accounts and were thus not subject to the Advisers Act. The FPA Decision meant that investment advisers to fee-based brokerage accounts (such as “wrap” accounts) had to register with the SEC as investment advisers, and thus were subject to limitations on principal transactions with their clients and other fiduciary responsibilities.

Section 206(3) of the Advisers Act prohibits registered investment advisers from engaging in principal transactions with their clients unless they obtain *written* consents for each individual principal transaction. Without an alternative means of compliance with this restriction, many advisers refrained from engaging in principal trades with their clients, including those in fee-based advisory accounts (which, in light of the FPA decision, were now subject to the Advisers Act), due to the impracticality of promptly obtaining written consents before market action changed the appropriate trading price. A practical consequence of this ruling was that wrap fee clients could not access securities held in the principal accounts of their advisory firms. To access these securities, clients would have to open a traditional commission-based brokerage account, instead of trading through an advisory account with an asset-based fee.

Rule 206(3)-3T provided an alternative means for investment advisers to comply with the limitations of Section 206(3). Among other things, the adviser must make certain disclosures to clients about conflicts of interest, and obtain written, revocable consents that prospectively authorize principal transactions. Under these circumstances, the Rule then permits the investment adviser to obtain either *written or oral* consent from the client with respect to each individual principal transaction. The availability of oral consent facilitates prompt decisions before there are changes in the market price of the security.

The SEC proposed the amendments to Rule 206(3)-3T on October 9, 2012. The comment period ends 30 days after the publication of the notice in the Federal Register.

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