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The Honorable Christopher Cox
Chairman
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: Temporary Rule Regarding Principal Trades with Certain Advisory Clients

Dear Chairman Cox:

We are writing in connection with the Securities and Exchange Commission's ("SEC" or "Commission") Temporary Rule Regarding Principal Trades with Certain Advisory Clients" (the "temporary rule").[1] As we approach the one-year mark since the temporary rule became effective, the Financial Planning Association® ("FPA®") wishes to draw your attention to issues raised in our original comment letter.[2] We hope our comments will be beneficial as the Commission evaluates the impact of the temporary rule on investor protection and considers the temporary rule's expiration on Dec. 31, 2009.

The temporary rule was adopted following a decision[3] of the Court of Appeals for the D.C. Circuit to vacate Rule 202-(a)(11)-1 (the "Rule 202") of the Investment Advisers Act of 1940 ("Advisers Act").[4] The rule provided that fee-based brokerage accounts were not advisory accounts or subject to the Advisers Act. One of the primary benefits to broker-dealers of Rule 202 was the ability to engage in principal transactions with clients without having to comply with the strict notice and consent requirements of Section 206(3) of the Advisers Act.[5] The temporary rule mitigated the effect of the court's decision by establishing a streamlined mechanism for principal trading in advisory accounts by broker-dealers dually registered with the SEC as investment advisers.

[1] 17 C.F.R. 275.206(3)-3T.

[2] http://www.sec.gov/comments/s7-23-07/s72307-17.pdf

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

[4] 15 U.S.C 80b.

[5] 15 U.S.C. 80b-6(3).

Recognizing the need to allow for an orderly conversion of 1 million fee-based brokerage accounts, FPA did not oppose the Commission's motion to delay the effective date of the court decision in order to develop transitional guidance, nor did FPA object to the temporary rule itself. At the time, however, we noted the inherent and longstanding conflicts of interest and risks involved in principal trades. We cautioned that any rule easing the principal trading restrictions should be very limited in duration and scope, and must be consistent with the principal intent of the Advisers Act, namely investor protection. As the Commission noted in the adopting release for the temporary rule:

> "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. 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…. 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."[6] [Footnotes omitted]

In commenting on the temporary rule, FPA noted that the alternative method of compliance with the principal trading restrictions of the Advisers Act was wholly untested. FPA encouraged the SEC to obtain as much empirical data as possible to help assess the costs, benefits, and risks of principal trading under the temporary rule. Such information is imperative to making an informed decision on a rule that directly implicates investor protection. If the Commission has been gathering data, we encourage you to share it with the public to the extent possible.

Broker-dealers offering the fee-based programs have now had more than a year since the court decision to conform these programs to the Advisers Act. With little more than one year remaining until it expires, the Commission is, or will soon be evaluating the effects of the temporary rule and considering whether to make the rule permanent in its current or an amended form, extending it, or allowing the rule to expire. We therefore urge the Commission to allow the rule to expire, or at most, extend the temporary rule for an additional year while it conducts a study that either substantiates a clear basis for adopting a permanent exemption under Sec. 206(3), or disproves the rhetoric of firms that it affords unique benefits to the public.

We suggest two primary avenues of inquiry. First, the SEC should assess firms' compliance with the letter, as well as the spirit, of the temporary rule with the Advisers Act. Second, the SEC should examine the risks and benefits to investors of principal trading under the temporary rule, including the extent to which the trading has been executed with actual, informed consent from the investor on a trade-by-trade basis,[7] and any unusual trading patterns that might indicate the "dumping" of unwanted

[6] Release No. IA-2653; File No. S7-23-07 at 13.

[7] We note that under the temporary rule, once an investor initially consents to principal trading in his account, trade-by-trade approval may be obtained by informing the investor that the trade *may* be a principal transaction. The SEC should examine whether such a disclosure is adequate to obtain the truly informed consent of the investor.

securities. As you are probably aware, the brokerage community urged adoption of the temporary rule arguing primarily that it was for the benefit and convenience of their clients.[8] The rule should not be extended or made permanent without some showing of a benefit to investors.

As the Commission considers its options with regard to the temporary rule, we wish to reemphasize some issues raised in our previous letter:

- We supported the Commission's decision to reject calls for a blanket exclusion from the principal trading restrictions of the Advisers Act for broker-dealers. Such an exclusion would be contrary to the intent of the Advisers Act and would create dual standards for compliance with principal trading disclosure. We would strongly oppose a broader exclusion for broker-dealers.

- We supported limiting the temporary rule's application to non-discretionary accounts, or accounts where discretion is temporary or limited. Discretionary accounts would be far more susceptible to the abuses that Congress sought to protect against with Section 206(3) of the Advisers Act.

- We suggested that the Commission should limit blanket principal trading authorizations only to institutional clients or natural persons who are deemed to be "qualified clients" for purposes of Advisers Act Rule 205-3.

- We expressed concern that under the temporary rule an investor's written notice and consent to permit principal trading in the account could be assigned to a new account without appropriate notification and consent. Even if added as a noticeable addendum, its purpose may be undercut by including it as part of another document.

  We also noted that if the notice and consent are made part of a new account document, that the consent will effectively become a condition of opening an advisory account. This result would clearly be contrary the purpose Advisers Act and the temporary rule which contemplates a knowing consent to principal trading. If the Commission extends or make permanent the temporary rule we would again urge it to require that the notice and consent be contained in a separately delivered and executed document. Beyond merely authorizing principal transactions the client should represent that he or she understands the disclosures, including the potential conflicts.

For nearly seven decades, the principal trading restrictions in Section 206(3) and the Advisers Act have served the investing public well. In fact, with the exception of the Public Utility Holding Company Act of 1935, now repealed, the Advisers Act is the only

[8] Of course the overall market would not reflect a positive rate of return over the period that the temporary rule has been in effect. However, there are a variety of methodologies for determining consumer benefits based on comparative market performance. The SEC could, for example, compare rates of return for fee-based accounts where principal trading occurred versus other advisory accounts of dual registrants. Or it could examine basic investment performance of IPOs and other securities from the firm's inventory, including bonds that were moved into advisory accounts subject to the Temporary Rule, compared to similar securities or market indices.

one of the securities laws passed by Congress in the Great Depression that has seen little or no systemic fraud or scandal since its enactment. We see no need to hastily adopt a permanent rule that arguably poses one of the greatest challenges to an investment adviser's ability to manage conflicts without a compelling policy reason to do so.

Finally, we believe that any subsequent rulemaking should not be undertaken without considering the recent volatility of the capital markets and the feckless role that the proponents of the temporary rule played in contributing to the present crisis. To put it plainly, the Commission shouldn't reward aberrant behavior by Wall Street with a free regulatory pass in one area of the capital markets for damage inflicted in another. Absent empirical evidence demonstrating the clear benefits to investors of principal trading relief, the Commission should not accept the blandishments of these firms as the unvarnished truth. Where investment banks failed to identify systemic risks in the sale of collateralized debt obligations, the Commission should be wary of similar assurances with regard to the risks posed by principal trading.

In summary, FPA appreciates your consideration of our comments. We welcome an opportunity to meet with you or SEC staff to discuss these issues in greater detail. And we look forward to learning more about the Commission's assessment of the benefits any permanent rule would accrue to investors over the long-term.

Very truly yours,

Duane R. Thompson
Managing Director

Cc: The Honorable Luis A. Aguilar
The Honorable Kathleen L. Casey
The Honorable Troy A. Parades
The Honorable Elisse B. Walter
Andrew J. Donohue, Director, Division of Investment Management
Erik R. Sirri, Director, Division of Trading and Markets