The New Merrill Lynch Guidelines

In last issue's Compliance column, we talked about the recision of Merrill Lynch rule, which had allowed brokers and other financial professionals to call themselves financial advisors without taking on a fiduciary role. As part of the fallout of this decision, the SEC voted in September to adopt a "Temporary Rule on Principal Trades with Certain Advisory Clients" (technically referred to as Temporary Rule 206(3)-3T).

The purpose of Rule 206(3)-3T is to establish on an interim-final basis an alternative means for investment advisors to meet the requirements of Section 206(3) of the Advisers Act when acting in a principal capacity in transactions with certain advisory clients. The Section effectively prohibits investment advisors from doing this without first obtaining the client's consent.

The Temporary Rule requires investment advisors to:

- Provide full written disclosure to each affected client that the investment advisor will act as a principal in transactions with the client.
- Specify the circumstances in which the investment advisor will do so; explain the conflicts of interest that such transactions will produce; and explain the measures the investment advisor will take to address those conflicts.
- Additionally, the investment advisor will need to obtain each affected client's prospective consent to such transactions.
- Obtain the client's advance oral or written consent to each actual transaction, after having orally or verbally disclosed the investment advisor's capacity in the transaction to the client.
- Provide a transaction report to the client for each transaction, either at the time of the transaction or prior to it, which must summarize the transaction and explain that the client consented to the transaction after the investment advisor disclosed its capacity in the transaction.
- Deliver the client an annual report itemizing the principal transactions.
- Include a conspicuous statement in each written disclosure that the client may revoke their prospective consent at any time without incurring a penalty.
- Be registered as a broker–dealer at all times, comply with the rules of the self-regulatory body with which they are registered and only enter into such transactions in respect of brokerage accounts.

Keep in mind that Rule 206(3)-3T is set to expire in December, 2009.

Broker-dealers who are not registered as investment advisors are faced with a pressing choice: to either restructure fee-based accounts so as to avoid fiduciary obligations under the Advisers Act or register as advisors with the SEC and subject the firm to those increased obligations. While the aforementioned is just that — proposals — if adopted the proposed rules would arguably provide some much needed clarity and guidance to broker-dealers in the aftermath of the Financial Planning Association decision. As the issues unfold, we will be discussing the Merrill Lynch rule's applicability in upcoming columns in *Bank Advisor.*

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