



New SEC Rule: Large Trader Reporting System

On July 27, 2011, the U.S. Securities and Exchange Commission (“SEC” or “Commission”) issued a release adopting new Rule 13h-1 and Form 13H under Section 13(h) of the Securities Exchange Act of 1934 (“Exchange Act”) to assist the Commission in both identifying and obtaining trading information on market participants that conduct a substantial amount of trading activity, as measured by volume or market value, in the U.S. securities markets.¹ The new rule will impose new filing requirements on “Large Traders,” and new recordkeeping, reporting and monitoring requirements on broker-dealers. Rule 13h-1 requires a Large Trader, as defined in Rule 13h-1, to identify itself to the Commission and make certain disclosures on Form 13H. Upon receipt of the Form 13H, the Commission will assign to each Large Trader a unique identification number, which the Large Trader must then provide to its registered broker-dealers effecting transactions on its behalf. Such registered broker-dealers will then be required to maintain records of two additional data elements in connection with transactions effected through accounts of such Large Traders (the Large Trader identification number and the time transactions in the account are executed). The SEC is also requiring that such broker-dealers report Large Trader transaction information upon request through the Electronic Blue Sheet (“EBS”) system currently used by broker-dealers for reporting trade information. Additionally, certain registered broker-dealers will be required to perform limited monitoring of their customers’ accounts for activity that may trigger the Large Trader identification requirements of Rule 13h-1.

The deadline for Large Traders to comply with the self-identification requirements of Rule 13h-1(b) is December 1, 2011. The deadline for broker-dealers to maintain records, report, and monitor for Large Trader activity pursuant to Rules 13h-1(d), (e), and (f) is April 30, 2012.

Who is a Large Trader?

Rule 13h-1 defines a Large Trader as “any person that: (i) directly or indirectly, including through other persons controlled² by such person, exercises investment discretion over one or more accounts and effects transactions for the

¹ See Exchange Act Release No. 64976 (July 27, 2011) (the “Adopting Release”).

² Rule 13h-1(a) defines the term “control” to mean “the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of securities, by contract, or otherwise. For purposes of this rule only, any person that directly or indirectly has the right to vote or direct the vote of 25% or more of a class of voting securities of an entity or has the power to sell or direct the sale of 25% or more of a class of voting securities of such entity, or in the case of a partnership, has the right to receive, upon dissolution, or has contributed, 25% or more of the capital, is presumed to control that entity.”

purchase or sale of any NMS security³ for or on behalf of such accounts, by or through one or more registered broker-dealers, in an aggregate amount equal to or greater than the identifying activity level; or (ii) voluntarily registers as a Large Trader by filing electronically with the Commission on Form 13H.”

Focus on Parent/Control Entities

According to the Commission, the definition of the term Large Trader is designed to focus on the ultimate parent company of an entity or entities that employ or otherwise control individuals that exercise investment discretion. Rule 13h-1(a)(4) provides that the term “investment discretion” for purposes of Rule 13h-1 has the “same meaning as in Section 3(a)(35)” of the Exchange Act, *i.e.*, encompasses a person who is “authorized to determine what securities or other property shall be purchased or sold for the account” as well as a person who “makes decisions as to what securities or other property shall be purchased or sold by or for the account even though some other person may have responsibility for such investment decisions...” Rule 13h-1(a)(4) also specifies that a “person’s employees who exercise investment discretion within the scope of their employment are deemed to do so on behalf of that person.” In this regard, to the extent an entity employs a natural person that individually, or collectively with others, meets the definition of a Large Trader, then, for purposes of Rule 13h-1, the entity that controls that person or those persons would be the Large Trader, and not the employees thereof who exercise investment discretion.

To determine whether a parent company is a Large Trader, the aggregate trading activity of all entities controlled by the parent company must be collected. According to the SEC, the controlled entities only need to produce aggregated statistics in summary form, which would be added together at the parent level to determine whether the identifying activity level has been met.⁴ If such level is met, the parent company is a Large Trader and would be required to provide information about itself and its affiliates, unless each of its affiliates comply on its behalf under Rule 13h-1. In connection with the collection of such information by a parent entity, the SEC states that to the extent a parent company is unaware of its subsidiaries’ aggregate transaction level and other basic identifying information, that implementing control systems to capture such information will be consistent with appropriate risk management considerations.

Identifying Activity Level

Rule 13h-1(a)(7) defines the term “identifying activity level” as “aggregate transactions in NMS securities that are equal to or greater than: (1) during a calendar day, either two million shares or shares with a fair market value of \$20 million; or (2) during a calendar month, either twenty million shares or shares with a fair market value of \$200 million.” The term “transactions” is defined to mean “all transactions in NMS securities, excluding exercises or assignments of option contracts,” except for a list of certain specifically enumerated transactions that the SEC explained “are not effected with an intent that is commonly associated with an arm’s length purchase or sale of securities in the secondary market.” In response to a Commission request for data, however, a broker-dealer must report all transactions that it effected through accounts of a Large Trader without excluding any of these enumerated transactions. In connection with options, for purposes of identifying the activity level, only purchases and sales of the options themselves, and not transactions in the underlying securities pursuant to exercises or assignments of such options, are required to be counted. In connection with options that qualify as NMS securities, for purposes of identifying the activity level, the

³ Rule 600 of Regulation NMS defines the term “NMS Security” to mean “any security or class of securities for which transaction reports are collected, processed, and made available pursuant to an effective transaction reporting plan, or an effective national market system plan for reporting transactions in listed options.”

⁴ In connection with the information the parent is required to obtain, Rule 13h-1 requires that a parent company aggregate and consider daily and monthly share volume and dollar value of certain transactions in NMS Securities effected by the persons it controls. Rule 13h-1 does not require the disclosure of any particular information (*e.g.*, the identity of or additional information on securities bought or sold); rather, under Rule 13h-1, persons need only produce a total figure of the relevant transactions for which they exercised investment discretion. The parent company would then aggregate those figures when measuring its overall activity to see if the trading activity threshold is met.

value and volume of options purchased and sold would be determined by reference to the underlying securities other than with respect to exercises or assignments of options.⁵

Voluntary Registration

The SEC provided the ability for a person to register voluntarily as a Large Trader as that person nears the applicable trading activity threshold in order to reduce the person's need to actively monitor its trading levels. Any person who voluntarily files a Form 13H will be treated as a Large Trader for purposes of Rule 13h-1, and will be subject to all of the obligations of a Large Trader under Rule 13h-1.

Form 13H

Filing Form 13H

Rule 13h-1 requires a Large Trader to self-identify by filing a Form 13H with the SEC. Upon receiving an initial Form 13H, the SEC will assign to the Large Trader a unique Large Trader identification number ("LTID"). Each Large Trader must disclose its unique LTID to the registered broker-dealers effecting transactions on its behalf and identify for them each account to which it applies. Additionally, upon request by the Commission, a Large Trader will be required promptly to provide additional information so as to allow the Commission to further identify the Large Trader and all accounts through which the Large Trader effects transactions.

Form 13H provides for six types of filings: (1) Initial Filing; (2) Annual Filing; (3) Amended Filing; (4) Inactive Status; (5) Termination Filing; and (6) Reactivated Status.

- **Initial Filing:** The Initial Filing of Form 13H must be made "promptly" after reaching the identifying activity level, with the Commission noting that, under normal circumstances, it would be appropriate for Initial Filings to be filed within 10 days after the Large Trader effects aggregate transactions equal to or greater than the identifying activity level.
- **Annual Filing:** All Large Traders must submit an Annual Filing within 45 days after the end of each full calendar year, except that Large Traders on Inactive Status are not required to file Form 13H while they are on Inactive Status.
- **Amended Filing:** If any of the information contained in a Form 13H filing becomes inaccurate for any reason, a Large Trader must file an Amended Filing no later than the end of the calendar quarter in which the information became stale. Additionally, although not required, a Large Trader may voluntarily file an Amended Filing more frequently than quarterly at its discretion.
- **Inactive Status:** A Large Trader on Inactive Status is not required to file any Amended Filings while it is on Inactive Status. Rule 13h-1 permits a Large Trader who has not effected aggregate transactions at any time during the previous calendar year in an amount equal to or greater than the identifying activity level to obtain inactive status by filing for Inactive Status through a Form 13H submission. Inactive Status would be effective upon such filing.
- **Reactivated Status:** A person on Inactive Status who effects aggregate transactions that are equal to or greater than the identifying activity threshold must file a Reactivated Status Form 13H promptly after effecting such transactions (similarly to Initial Filings, the SEC indicated that under normal circumstances, it would be

⁵ The SEC provided the example that 50,000 shares of XYZ stock and 500 XYZ call options would count as aggregate transactions of 100,000 shares in XYZ (*i.e.*, 50,000 + 500 x 100 = 100,000).

appropriate for Reactivated Status filing to be filed within 10 days after the Large Trader effects aggregate transactions equal to or greater than the identifying activity level).

- **Termination Filing:** Under certain narrow circumstances, a person may permanently end its Large Trader status by submitting a Termination Filing. Termination status is designed to indicate to the Commission not to expect future amended or annual Form 13H filings from the Large Trader, such as when a Large Trader dissolves, ceases doing business, or, in some cases, is acquired.

What Information is Required on Form 13H?

- **Item 1:** Item 1 of Form 13H requires the Large Trader to indicate the types of businesses in which it or any of its affiliates engage: (i) broker or dealer; (ii) bank holding company; (iii) non-bank holding company; (iv) government securities broker or dealer; (v) municipal securities broker or dealer; (vi) bank; (vii) pension trustee; (viii) non-pension trustee; (ix) investment adviser to one or more registered investment companies; (x) investment adviser to one or more hedge funds or other funds not registered under the Investment Company Act of 1940; (xi) insurance company; (xii) commodity pool operator; or (xiii) futures commission merchant. A Large Trader may also check “Other” and disclose other types of financial business engaged in by the Large Trader. Item 1 of Form 13H also requires the Large Trader to provide the following for itself and each of its Securities Affiliates: a description of the nature of its operations, including a general description of its trading strategies.⁶
- **Item 2:** Item 2 of Form 13H generally requires the Large Trader to indicate whether it or any of its Securities Affiliates files any other forms with the Commission and, if so, the identification of each filing entity, the form(s) filed, and the CIK number.
- **Item 3:** Item 3 of Form 13H generally requires a Large Trader to disclose whether it or any of its affiliates is registered with the Commodity Futures Trading Commission (“CFTC”) or regulated by a foreign regulator, and if so, the identity of each entity and the CFTC registration number or primary foreign regulator, as applicable.
- **Item 4:** Item 4 of Form 13H generally requires information on affiliates of the Large Trader that exercise investment over NMS securities (*i.e.*, Securities Affiliates), and also requires, among other things, that an organizational chart be attached to the Form 13H, depicting the Large Trader, its parent company (if applicable), all of its Securities Affiliates, and all entities identified in Item 3(a) of Form 13H.
- **Item 5:** Item 5 of the Form 13H generally requires information about the governance of the Large Trader. Specifically, Item 5(a) requires disclosure of one or more of the following statuses of the Large Trader: individual; partnership; limited liability partnership; limited partnership; corporation; trustee; or limited liability company. Additionally, Form 13H permits the Large Trader to check “Other” and specify a form of organization that is not comparable to any of the enumerated organization types. Item 5(b) requires the identification of each partner in the large trade partnership and partnership status, and Item 5(c) requires the identification of each executive officer, director, or trustee of a Large Trader corporation or trustee.
- **Item 6:** Item 6 of Form 13H requires Large Traders to identify broker-dealers at which the Large Trader has an account. Specifically Item 6 requires that Large Traders identify the registered broker-dealers at which the Large Trader or any of its Securities Affiliates has an account and disclose whether each such broker-dealer provides prime broker, executing broker, and/or clearing broker services.

⁶ As defined in the instructions to Form 13H, “Securities Affiliate” means an affiliate of the Large Trader that exercises investment discretion over NMS securities.

What are the Requirements for Broker-Dealers?

Rule 13h-1 imposes recordkeeping and reporting responsibilities on the following: (i) registered broker-dealers that are Large Traders; (ii) registered broker-dealers that, together with a Large Trader or Unidentified Large Trader,⁷ exercise investment discretion over an account; and (iii) registered broker-dealers that carry accounts for Large Traders or Unidentified Large Traders or, with respect to accounts carried by a non-broker-dealer, broker-dealers that execute transactions for Large Traders or Unidentified Large Traders.

Recordkeeping Requirements

Under Rule 13h-1, registered broker-dealers must maintain records for all transactions effected directly or indirectly by or through (i) an account such broker-dealer carries for a Large Trader or an Unidentified Large Trader or (ii) if the broker-dealer is a Large Trader, any proprietary or other account over which such broker-dealer exercises investment discretion. In addition, under Rule 13h-1, where a non-broker dealer carries an account for a Large Trader or an Unidentified Large Trader, the broker-dealer effecting transactions directly or indirectly for such Large Trader or Unidentified Large Trader is required to maintain records of all of the required information.

Reporting Requirements

Under Rule 13h-1, upon request of the Commission, every registered broker-dealer who is itself a Large Trader or carries an account for a Large Trader or an Unidentified Large Trader is required to report electronically to the Commission all information required under paragraphs (d)(2) and (d)(3) of Rule 13h-1 for all transactions effected directly or indirectly by or through accounts carried by such broker-dealer for Large Traders and Unidentified Large Traders, equal to or greater than the reporting activity level. Additionally, where a non-broker-dealer carries an account for a Large Trader or an Unidentified Large Trader, the broker-dealer effecting transactions directly or indirectly for such Large Trader or Unidentified Large Trader is required to report information, electronically, relating to such transactions.

Under the rule, broker-dealers will be required to report a particular day's trading activity if it equals or exceeds the "reporting activity level" of 100 shares.⁸ Transaction reports must be submitted to the Commission no later than the day and time specified in the request for transaction information, which shall be no earlier than the opening of business on the day following such request, unless in unusual circumstances the same-day submission of information is requested.

Monitoring Requirements

Rule 13h-1 requires that a registered broker-dealer treat as an Unidentified Large Trader (for purposes of the recordkeeping and reporting provisions in paragraphs (d) and (e) of Rule 13h-1) any person that the broker-dealer "knows or has reason to know" is a Large Trader where such person has not complied with the identification requirement applicable to Large Traders. Under Rule 13h-1, in considering whether the broker-dealer has "reason to know" that a person is a Large Trader, the broker-dealer needs to take into account only transactions in NMS securities

⁷ The term Unidentified Large Trader means each person who has not complied with the identification requirements of paragraphs (b)(1) and (b)(2) Rule 13h-1 that a registered broker-dealer knows or has reason to know is a Large Trader. For purposes of determining under this section whether a registered broker-dealer has reason to know that a person is Large Trader, a registered broker-dealer need take into account only transactions in NMS securities effected by or through such broker-dealer.

⁸ Rule 13h-1(a)(8) defines the reporting activity level as: "(i) each transaction in NMS securities, effected in a single account during a calendar day, that is equal to or greater than 100 shares; (ii) any other transaction in NMS securities, effected in a single account during a calendar day, that a registered broker-dealer may deem appropriate; or (iii) such other amount that may be established by order of the Commission from time to time."

effected by or through the broker-dealer. As such, the broker-dealer need not seek out information on transactions effected by that person through another broker-dealer.

The SEC indicated that a broker-dealer may determine that it has no “reason to know” that a person is a Large Trader through two methods. First, the broker-dealer may conclude, based on its knowledge of the nature of its customers and their trading activity with the broker-dealer, that it has no reason to expect that any of these customers’ transactions approach the identifying activity level. Second, the broker-dealer may rely on the safe harbor provision in Rule 13h-1(f), under which a registered broker-dealer would be deemed not to know or have reason to know that a person is a Large Trader if it does not have actual knowledge that a person is a Large Trader and it establishes policies and procedures reasonably designed to identify customers whose transactions at the broker-dealer equal or exceed the identifying activity level and, if so, to treat such persons as Unidentified Large Traders and notify them of their potential reporting obligations under Rule 13h-1. Under either of these approaches, the broker-dealer’s obligation is limited to compliance with the recordkeeping and reporting requirements of paragraphs (d) and (e) of Rule 13h-1, and the broker-dealer would not be required to cease trading or take other action with respect to that Unidentified Large Trader. In the Adopting Release, the SEC notes that, pursuant to the reporting requirements of Rule 13h-1, it may periodically request reports from broker-dealers regarding all customers they may be treating as Unidentified Large Traders.

Foreign Entities

Rule 13h-1 requires a foreign entity that is a Large Trader to comply with the identification requirements of Rule 13h-1(b). With respect to the recordkeeping and reporting requirements, however, the SEC indicates that paragraphs (d) and (e) of Rule 13h-1, explicitly apply only to U.S. registered broker-dealers.

Confidentiality

The SEC indicated that the information provided in connection with the Large Trader reporting requirements will be kept confidential from the public and will be exempt from disclosure under the Freedom of Information Act, provided, however, that the SEC is permitted to disclose such information to Congress, federal departments and agencies acting within the scope of their jurisdictions, and when compelled by a court order.

Impact of New Large Trader Reporting Requirements

Traders and Advisors

The scope of Rule 13h-1 captures investors trading for their own accounts, trading advisors to managed securities accounts, and investment managers and advisors to registered investment companies and private funds, including hedge funds, each of which will become subject to identification to the Commission as a result of effecting trades or carrying accounts with SEC registered broker-dealers. Persons who fall under the definition of a Large Trader will be required to identify themselves promptly to the Commission and file the Form 13H once the identifying activity level threshold has been met. Additional information allowing the Commission to identify Large Traders and their accounts, through which their transactions are effected, will also need to be provided to the Commission upon request. Further, traders are required to identify other Large Traders with whom they share investment discretion and other sensitive information regarding their ownership structures and businesses.

Broker-Dealers

Rule 13h-1 imposes new recordkeeping and reporting requirements on broker-dealers. Specifically, broker-dealers will be required to maintain and report to the Commission the LTID and Large Trader transaction information using the same technology that such broker-dealers currently use under the EBS reporting system. Such information would generally be required to be reported to the Commission the day after a request has been made by the Commission for such information. Additionally, Rule 13h-1 requires that a broker-dealer monitor whether its customers meet the threshold to constitute a Large Trader (based upon transactions completed at such broker-dealer; that is, if the broker-dealer knows or has reason to know that the customer meets the trading threshold) in order to facilitate compliance by their customers with the requirement that such customers identify themselves as Large Traders to the Commission.

Effective and Compliance Dates

Rule 13h-1 is effective October 3, 2011; however, compliance is not immediately required. The deadline for Large Traders to comply with the self-identification requirements of Rule 13h-1(b) is December 1, 2011. The deadline for broker-dealers to maintain books records, report, and monitor for Large Trader activity pursuant to Rules 13h-1(d), (e), and (f) is April 30, 2012.

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