

Applicability of Large Trader Rules to Private Equity Advisers

The U.S. Securities and Exchange Commission (the “SEC”) recently adopted Rule 13h-1 (the “Rule”) under the *Securities Exchange Act of 1934* with respect to large trader registration. The Rule requires persons that qualify as a “large trader” (as defined below) to file Form 13H with SEC to receive a large trader identification number (a “LTID”). Large traders must identify themselves in future transactions to broker-dealers through which they trade, using their LTID. Form 13H filings will be required for large traders beginning December 1, 2011. The questions set forth below highlight the general applicability of the Rule and the requirements contained in Form 13H.

How Does the Rule Apply to Private Equity Advisers?

The Rule requires that a person that exercises investment discretion, directly or indirectly (including through affiliates it controls), and effects transactions in publicly-traded securities, in excess of a specified threshold, must file Form 13H and be designated as a “large trader.” Although at first glance it might seem that private equity advisers would not need to comply with the Rule, there are several situations in which such advisers would need to file. In particular, (i) large transactions in publicly-traded securities (e.g., a block trade after an IPO of a portfolio company) could exceed the transaction threshold or (ii) under certain circumstances, the securities trading of a portfolio company could be attributed to the private equity adviser.

What is a Large Trader?

A “large trader” is a person who directly or indirectly (including through affiliates it controls) exercises investment discretion over transactions in NMS securities¹, that are equal to or greater than (i) 2 million shares or \$20 million in a calendar day, or (ii) 20 million shares or \$200 million in a calendar month (together, referred to herein as the “transaction threshold”). For purposes of the Rule, “control” is defined generally as the direct or indirect power to cause the direction of management and policies of a person. A presumption of control exists when a person owns 25% or more of the voting securities of another person or has contributed 25% or more of the capital of such other person.

To determine whether the transaction threshold is reached, a person must aggregate the trading activity of (i) all accounts over which such a person exercises investment discretion and (ii) all accounts over which any controlled affiliate of such person exercises investment discretion. This aggregation requirement generally puts the filing obligation on the ultimate parent company, and could thus apply to some private equity advisers.

When Would a Portfolio Company’s Trading be Attributed to the Private Equity Adviser?

If a private equity fund controls a portfolio company (see definition above), trades by that portfolio company for its own account or for the accounts of the portfolio company’s clients (e.g., if the portfolio company is itself an investment adviser) would be attributed to the private equity manager that manages such a fund.

¹ NMS Securities are defined in Regulation NMS, Rule 600(b)(46) as “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.” This generally refers to almost all publicly-traded securities in the U.S.

Should a Private Equity Adviser File Form 13H if it is Unsure Whether it has Reached the Transaction Threshold?

A person that is unsure whether its transactions have exceeded the transaction threshold (on an aggregated basis) may elect to file Form 13H and voluntarily register as a large trader. Voluntary registration alleviates the obligation of a person to monitor transactions in NMS securities on its behalf (and on behalf of its controlled affiliates) on an ongoing basis.

What are the Filing Mechanics for Form 13H?

Form 13H is filed with the SEC through EDGAR. Larger traders must file Form 13H with the SEC “promptly” after it crosses the transaction threshold and triggers a filing obligation. Pursuant to SEC guidance, a “prompt” filing should be made no later than ten (10) calendar days after the transaction threshold has been crossed. After a large trader initially files Form 13H, it must file annually thereafter, within forty five (45) calendar days after the end of the calendar year. If any information contained in Form 13H becomes inaccurate, the large trader must file an amended Form 13H no later than the end of the calendar quarter in which the information became inaccurate. If the large trader files Form 13H, any controlled affiliates will not need to file their own forms. Alternatively, if a large trader’s controlled affiliates all file on Form 13H, the large trader will not need to make its own filing. However, because it is unlikely that a private equity adviser’s controlled affiliates would all make such a filing on Form 13H, this exception may be of limited value.

What Information is Required on Form 13H?

Form 13H requires that large traders provide certain information about their operations and organization, as well as the operations and organization of any affiliate it controls that trades in publicly-traded securities (a “Securities Affiliate”). Additionally, Form 13H requires (among other things) a description of the business of the large trader and of any Securities Affiliates; organizational charts identifying the large trader and its Securities Affiliates; governance information relating to the large trader; information relating to other regulatory filings made by the large trader and its Securities Affiliates and a list of broker-dealers with which the large trader or its Securities Affiliates have an account. For the avoidance of doubt, a large trader does not need to report the trades it or its Securities Affiliates make in publicly-traded securities on Form 13H. Consequently, in most cases, Form 13H will not be a burdensome filing for a large trader.

What Should a Large Trader Do After it Receives a LTID?

Once a large trader files its initial Form 13H, it will receive a LTID. After a large trader receives a LTID, it (or its Securities Affiliate) must disclose its LTID to each broker-dealer every time the large trader (or its Securities Affiliate) trades NMS securities. This number allows the SEC to identify these large traders and trading activity done on their behalf.

May a Large Trader Deactivate or Terminate its “Large Trader” Status?

A large trader who has filed Form 13H may request to have its large trader status declared “inactive” if, following registration as a large trader, it does not meet the transaction threshold for one full calendar year. Such an inactive large trader will not need to file for a “reactivated status” unless it meets the transaction threshold again. A larger trader may only terminate its large trader status in very limited situations, including when it fully terminates its operations.

What are the Penalties for Failure to File Form 13H?

Neither Form 13H nor the related Rule specifies the penalty for failure to file Form 13H. However, failure to file Form 13H could result in an enforcement action brought by the SEC against the large trader.

When is the Rule Effective?

The Rule will be effective on October 3, 2011 and registration on Form 13H will be required for large reporters by December 1, 2011.

For additional information and guidance, the SEC's adopting release with respect to the Rule (which includes a draft Form 13H) is available [here](#).

If you have any additional questions about Form 13H or the larger trader reporting requirements, please contact Jason Brown at jebrown@ropesgray.com or Alyssa Clough at alyssa.clough@ropesgray.com.