



## SEC Release Adopts New Rule 13h-1 and Form 13H; Large Trader Reporting

### Introduction

In Release No. 34-64976 (the “Release”), the Securities and Exchange Commission (“SEC”) adopted new Rule 13h-1 and Form 13H under Section 13(h) of the Securities Exchange Act of 1934 (“Exchange Act”). Section 13(h) authorizes the SEC to establish a large trader reporting system.

The SEC has stated that it believes that large trader reporting requirements will provide the SEC with a valuable source of useful data that will greatly enhance the SEC’s ability to identify large market participants, and collect and analyze information on their trading activity. Prior to the Release, the SEC collected transaction data from registered broker-dealers through the Electronic Blue Sheets (“EBS”) system. Rule 17a-25, adopted in 2001, enhanced the EBS system and improved the SEC’s ability to obtain electronic transaction records.

The SEC’s adoption of Rule 13h-1 and Form 13H is designed to address certain limitations of the EBS system, since the SEC stated that EBS was insufficient to accomplish the objectives of 13(h) of the Exchange Act. The SEC stated that the limitations of the current EBS system also inhibit the usefulness of EBS data in the conduct of the SEC’s investigative and enforcement activities. The SEC noted that most importantly, the data gathered by the EBS system does not include information on the time of the trade or the identity of the trader. It also pointed out that large traders appear to be playing an increasingly prominent role in the securities market.

### Large Traders

Section 13(h) of the Exchange Act defines a “large trader” as “every person who, for his own or an account for which he exercises investment discretion, effects transactions for the purchase or sale of any publicly traded security or securities by use of any means or instrumentality of interstate commerce or of the mails, or of any facility of a national securities exchange, directly or indirectly by or through a registered broker or dealer in an aggregate amount equal to or in excess of the identifying activity level.” The term “identifying activity level” is defined in Section 13(h) as “transactions in publicly traded securities at or above a level of volume, fair market value, or exercise value as shall be fixed from time to time by the SEC by rule or regulation, specifying the time interval during which such transactions shall be aggregated.”

The large trader reporting requirements have two primary components: (1) registration of large traders with the SEC; and (2) recordkeeping, reporting, and monitoring duties imposed on registered broker-dealers that service large trader customers.

## Status Determinations

Rule 13h-1(a)(1) defines a “large trader” as “any person that: (i) directly or indirectly, including through other persons controlled by such person, exercises investment discretion over one or more accounts and effects transactions for the purchase or sale of any NMS security 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 SEC Form 13H.”

For purposes of determining whether a person is a large trader, under Rule 13h-1(c)(1), the following shall apply:

- The volume or fair market value of transactions in equity securities and the volume or fair market value of the equity securities underlying transactions in options on equity securities, purchased and sold, shall be aggregated;
- The fair market value of transactions in options on a group or index of equity securities (or based on the value thereof), purchased and sold, shall be aggregated; and
- Under no circumstances shall a person subtract, offset, or net purchase and sale transactions, in equity securities or option contracts, and among or within accounts, when aggregating the volume or fair market value of transactions for purposes of this section.

Further, under Rule 13h-1(c)(2), under no circumstances shall a person disaggregate accounts to avoid the identification requirements of the rule.

The definition of large trader is designed to focus on the ultimate parent company of an entity or entities that employ or otherwise control the individuals that exercise investment discretion. To the extent that 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 a large trader. The SEC noted that, 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. Controlled entities need produce only aggregated statistics in summary form, which would be added together at the parent level to determine whether the identifying activity level has been met.

Accordingly, the definition of large trader, in conjunction with the provision that allows the parent company to comply with the self-identification requirement on behalf of its subsidiaries, is intended to allow the SEC to gather information about the primary institutions that conduct a large trading business while at the same time mitigating the burden of the rule by focusing the filing requirement on persons and entities that control large traders. While the rule’s broader focus on identification at the parent company level may provide less detailed information on the activity of individual traders within a large trader complex, it nevertheless will facilitate the SEC’s ability to collect data on the full extent of trading by persons and entities under common control. Also, parent company level aggregation should enhance the SEC’s ability to reconstruct trading by significant market participants by providing the SEC with access to a broad set of useful data.

## Investment Discretion

Rule 13h-1(a)(4) provides that the term “investment discretion” has “the same meaning as in Section 3(a)(35) of the Securities Exchange Act of 1934.” The definition of “investment discretion” in Section 3(a)(35) of the Exchange Act encompasses a person who is “authorized to determine what securities or other property shall be purchased or sold by or for the account” as well as a person that “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) further specifies that a “person’s employees who exercise investment discretion within the scope of their employment are deemed to do so on behalf of such person.”

The SEC took the view that investment discretion may be exercised on behalf of defined contribution plans differently, depending on the particular structure of the plan. For example, in some defined contribution plans, participants select their own investments from among the choices offered by their employer. A trustee then effects the transactions pursuant to the instructions it receives from the plan participants. For purposes of determining who is a large trader, the participants in such plans are the ones who exercise investment discretion over the transactions that are effected on their behalf. In such plans, the SEC does not view the trustee as exercising investment discretion over the transactions for purposes of the rule. Additionally, solely for purposes of determining who is a large trader pursuant to Rule 13h-1, the SEC considers an employer to not exercise investment discretion merely by establishing investment options for its employees. Other types of defined contribution plans may be structured differently.

One commenter requested clarification that only the trustee of a retirement plan, not the plan sponsor and other parties involved in plan administration, must self-identify as a large trader. The rule requires the person who exercises investment discretion over a certain level of transactions to identify as the large trader, which may be the trustee but would generally not be the plan sponsor or administrator if neither exercises investment discretion.

## **Control**

Rule 13h-1(a)(3) 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.”

## **NMS Security**

NMS security has the meaning provided in Section 242.600(b)(46). An “NMS security” is “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.” The term refers generally to exchange-listed securities, including equities and options.

## **Use of LTID Suffixes**

Item 4(d) of Form 13H permits a large trader to assign LTID suffixes to subidentify persons, divisions, groups, and entities under its control. For example, a large trader may choose to assign a suffix to each independent division within the large trader. Use of suffixes to identify various sub-groups within a large trader could facilitate a large trader’s ability to accurately and efficiently track with more particularity the trading for which it exercises investment discretion, and as a consequence, could facilitate the ability of a large trader to respond to any SEC request to further identify accounts or disaggregate trading data, as discussed below. To the extent large traders utilize LTID suffixes, the need for the SEC to contact large traders for assistance in further identifying their accounts should be diminished. Accordingly, the SEC encourages large traders to utilize LTID suffixes.

## **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 SEC noted that nothing in Section 13(h) of the Exchange Act suggests that the SEC should focus its attention only on those large traders that are frequent traders. While frequency of trading is one factor that the SEC considered in defining who is a large trader, it was not the only factor. Nevertheless, the SEC recognizes the filing burden that could be placed on a trader whose activity only on very rare occasions meets the identifying activity threshold. These persons may be eligible for “Inactive Status,” a concept that is discussed below.

Rule 13h-1(a)(6) defines the term “transaction” to mean “all transactions in NMS securities, excluding exercises or assignments of option contracts,” except for certain specifically enumerated transactions. For purposes of the identifying activity level with respect to options, only purchases and sales of the options themselves, and not transactions in the underlying securities pursuant to exercises or assignments of such options, need to be counted. However, for purposes of the identifying activity level, the volume and value of options purchased or sold would be determined by reference to the securities underlying the option.

The specifically enumerated transactions exception from the term “transaction” is designed to exclude certain transactions from the identifying activity level calculation because they are not effected with an intent that is commonly associated with the arm’s-length trading of securities in the secondary market and therefore do not fall within the types of transactions that are characterized by the exercise of investment discretion.

Under the rule, the following will not be counted as “transactions” for the sole purpose of determining whether a person is a large trader: (i) any journal or bookkeeping entry made to an account in order to record or memorialize the receipt or delivery of funds or securities pursuant to the settlement of a transaction; (ii) any transaction that is part of an offering of securities by or on behalf of an issuer, or by an underwriter on behalf of an issuer, or an agent for an issuer, whether or not such offering is subject to registration under the Securities Act of 1933, provided, however, that this exemption shall not include an offering of securities effected through the facilities of a national securities exchange; (iii) any transaction that constitutes a gift; (iv) any transaction effected by a court-appointed executor, administrator, or fiduciary pursuant to the distribution of a decedent’s estate; (v) any transaction effected pursuant to a court order or judgment; (vi) any transaction effected pursuant to a rollover of qualified plan or trust assets subject to Section 402(a)(5) of the Internal Revenue Code; (vii) any transaction between an employer and its employees effected pursuant to the award, allocation, sale, grant, or exercise of an NMS security, option or other right to acquire securities at a preestablished price pursuant to a plan that is primarily for the purpose of an issuer benefit plan or compensatory arrangement; (viii) any transaction to effect a business combination, including a reclassification, merger, consolidation, or tender offer subject to Section 14(d) of the Securities Exchange Act; an issuer tender offer or other stock buyback by an issuer; or a stock loan or equity repurchase agreement. The SEC believes that these additional categories of transactions are effected for materially different reasons than those commonly associated with the arm’s-length trading of securities in the secondary market and the associated exercise of investment discretion.

The excluded specifically enumerated transactions are only excluded for the sole purpose of determining whether a person is a large trader. However, in response to an SEC request for data, a broker-dealer must report all transactions that it effected through the accounts of a large trader without excluding any transactions listed in Rule 13h-1(a)(6).

For purposes of the identifying activity level for large trader reporting, the SEC believes that it is appropriate to count transactions effected in the secondary market to assemble, or dispose of, securities that are transferred between an “authorized participant” and an ETF. An authorized participant is a trader that, on its own behalf or on behalf of others, presents securities (or other assets) to an ETF in order to create ETF shares or receives securities (or other assets) from an ETF in connection with the redemption of ETF shares. The SEC expects that, if authorized participants are large traders, it will be useful to monitor their secondary market trading and to be able to access records of their trading activity across broker-dealers. However, the SEC does not believe that the actual transfer of the basket of securities between an authorized participant and an ETF should be counted for

purposes of large trader reporting. Accordingly, the SEC will count toward the identifying activity level trading activity in the secondary market that relates to the acquisition or disposition of securities in connection with, for example, the creation or redemption of ETF shares, but not the transfer of such securities between an authorized participant and an ETF. Specifically, then, in connection with creation or redemption: (1) purchases of securities by an authorized participant for the purpose of assembling a basket would count toward an authorized participant's identifying activity level; (2) transfers of those securities by an authorized participant to the ETF would not be counted toward the ETF's identifying activity level; (3) acquisitions of securities by an authorized participant from the ETF would not count toward the authorized participant's identifying activity level; and (4) sales of securities by an authorized participant into the secondary market would count toward the authorized participant's identifying activity level. No transactions effected would be counted toward an ETF's identifying activity level because the ETF would not be exercising investment discretion by creating or redeeming ETF shares.

## **Voluntary Registration**

The SEC adopted: (1) a definition of large trader that includes those persons who voluntarily register as large traders; and (2) changes to Form 13H to require a large trader to indicate in its initial filing with the SEC whether it has chosen to voluntarily register. Any such person that elects to voluntarily file will be treated as a large trader for purposes of the rule, and will be subject to all of the obligations of a large trader under the rule, notwithstanding the fact that the person had not effected the requisite level of transactions at the time it registered as a large trader.

## **Duties of a Large Trader**

Pursuant to Rule 13h-1, a large trader must self-identify by filing Form 13H with the SEC. In addition, a large trader must disclose its LTID to the registered broker-dealers effecting transactions on its behalf and identify for them each account to which it applies.

## **File Form 13H with the SEC**

Form 13H provides for six types of filings: Initial Filing; Annual Filing; Amended Filing; Inactive Status; Termination Filing; and Reactivated Status. Large traders must file all Forms 13H through EDGAR. Accordingly, large traders will need to have or obtain permission to access and file through EDGAR, and can obtain the necessary access codes, if they do not already have them, by filing a Form ID (Uniform Application for Access Codes to File on EDGAR). Among other things, large traders will be given a Central Index Key ("CIK") number that uniquely identifies each filer and allows them to submit filings through EDGAR. While Form 13H filings will be processed through the SEC's EDGAR system, once filed, the Form 13H filings will not be accessible through the SEC's website or otherwise be publicly available.

## **Initial Filings – Who Must File?**

Except as provided below, each large trader must file a Form 13H "Initial Filing" to identify itself to the SEC. In complex organizations, more than one related entity can qualify as a large trader. Consider the following example:

- Holding Company owns a 100% ownership interest in Broker-Dealer and Investment Adviser. However, as a practical matter, Holding Company is not engaged in the day-to-day operation of either entity.
- Broker-Dealer owns a 33% ownership interest in Proprietary Trading Firm. None of the firm's other investors own a controlling interest of 25% or more of the firm and therefore no LTIDs, other than that of Broker-Dealer, would be attached to the trades of Proprietary Trading Firm.
- Investment Adviser owns a 100% ownership interest in Sub-Adviser #1 and Sub-Adviser #2.

- Sub-Adviser #1, on behalf of its clients, exercises investment discretion over accounts and effects transactions in NMS securities on behalf of those accounts in an aggregate amount greater than the identifying activity level.
- Sub-Adviser #2, on behalf of its clients, exercises investment discretion over accounts and effects transactions in NMS securities on behalf of those accounts in an aggregate amount less than the identifying activity level.
- While engaging in proprietary trading, Broker-Dealer exercises investment discretion over accounts and effects transactions in NMS securities on behalf of those accounts in an aggregate amount greater than the identifying activity level.
- The Proprietary Trading Firm effects transactions in NMS securities in an aggregate amount greater than the identifying activity level.

All of the identified entities, except Sub-Adviser #2, independently qualify as large traders under the Rule. Therefore, as discussed below, unless these entities rely on the provisions of Rule 13h-1(b)(3)(i), each must file separate Forms 13H with the SEC.

Rule 13h-1(b)(3)(i) provides that a large trader shall not be required to comply separately with the requirements of paragraph (b) if a person who controls the large trader complies with all of the requirements under paragraphs (b)(1), (b)(2), and (b)(4) applicable to such large trader with respect to all of its accounts. This provision allows the identification requirement to be pushed up the corporate hierarchy to the parent entity (i.e., Holding Company, in the example above).

Conversely, Rule 13h-1(b)(3)(ii) applies the same principle on a “top down” basis, providing that a large trader shall not be required to comply with the requirements of paragraph (b) if one or more persons controlled by such large trader collectively comply with all of the requirements under paragraphs (b)(1), (b)(2), and (b)(4) applicable to such large trader with respect to all of its accounts. In the above example, if Investment Adviser and Broker-Dealer separately register as large traders, Holding Company would not have to separately register as a large trader, assuming that those two entities capture all transactions and accounts controlled by Holding Company. Instead, Investment Adviser and Broker-Dealer would identify (in Item 4(c) of the Form) the other as an affiliate filing separately, and identify Holding Company as their affiliate’s parent company on their respective Form 13H filings. In this way, the SEC will be able to tell that the entities are under the common control of Holding Company, and the SEC could assign LTIDs that reference their common parent.

### **Initial Filings – When Must an Initial Filing be Submitted?**

Under Rule 13h-1(b)(1)(i), a large trader must file a Form 13H Initial Filing promptly after effecting aggregate transactions equal to or greater than the identifying activity level. The SEC believes that under normal circumstances, it would be appropriate for Initial Filings (and Reactivated Filings, discussed below) to be filed within 10 days after the large trader effects aggregate transactions equal to or greater than the identifying activity level.

### **Annual Filings**

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 (discussed below) are not required to file Form 13H while they are on Inactive Status.

## Amended Filings

If any of the information contained in a Form 13H filing becomes inaccurate, a large trader must file an Amended Filing no later than promptly following the end of the calendar quarter in which the information became stale. While not required by the rule, a large trader may voluntarily file an amended filing more frequently than quarterly at its discretion. A large trader on “Inactive Status” (described below) is not required to file any Amended Filings while it is on Inactive Status.

## Inactive Status

Rule 13h-1(b)(3)(iii) permits a large trader that has not effected aggregate transactions at any time during the previous full 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. Rule 13h-1(b)(3)(iii) provides: “A large trader that has not effected aggregate transactions at any time during the previous full calendar year in an amount equal to or greater than the identifying activity level shall become inactive upon filing a Form 13H and thereafter shall not be required to file Form 13H or disclose its large trader status unless and until its transactions again are equal to or greater than the identifying activity level. A large trader that has ceased operations may elect to become inactive by filing an amended Form 13H to indicate its terminated status.”

Inactive Status is designed to reduce the burden on infrequent traders who may trip the threshold on a particular occasion but do not regularly trade at sufficient levels to support continued status as a large trader. In particular, Inactive Status is designed to minimize the impact of the rule on natural persons who infrequently effect transactions of a magnitude that otherwise warrant the added regulatory requirements under the rule. Inactive status relieves the large trader from the requirement to file amended Form 13H. It also permits the large trader to request that its broker-dealers stop maintaining records of its transactions by LTID.

## 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. In addition, a person may voluntarily elect to file for Reactivated Status prior to effecting aggregate transactions that are equal to or greater than the identifying activity threshold. As with initial filings, a person may elect to file for Reactivated Status if it did not wish to monitor its trading for purposes of the identifying activity threshold.

Upon filing for Reactivated Status, the person once again would be subject to the filing requirements of Rule 13h-1 and, under Rule 13h-1(b)(2), must inform its broker-dealers of its reactivated status. In particular, the provision for reactivated status is designed to ensure that a large trader on Inactive Status that becomes active above the identifying activity threshold is once again required to file and update Form 13H and inform its broker-dealers of the need to record its trading activity by its LTID.

## Terminating Filings

Under Rule 13h-1(b)(3)(iii), a person, under certain narrow circumstances, may permanently end its large trader status by submitting a “Termination Filing.” This filing is designed to allow a large trader to inform the SEC that it has terminated operations, and therefore there is no chance of it requalifying for large trader status in the future. In the Release, the SEC provided examples to illustrate the narrow circumstances under which a large trader may file a “Termination Filing.” The examples also should provide guidance to large traders on how to amend their Form 13H when a large trader is involved in a merger.

## Other Information

Upon request, under Rule 13h-1(b)(4), a large trader must promptly provide additional descriptive or clarifying information that would allow the SEC to further identify the large trader and all accounts through which the large trader effects transactions.

## Self-Identification to Broker-Dealers

As adopted, Rule 13h-1(b)(2) requires a large trader to disclose to the registered broker-dealers effecting transactions on its behalf its LTID and each account to which it applies. The requirements that a large trader provide its LTID to all registered broker-dealers who effect transactions on its behalf, and identify each account to which it applies, are ongoing responsibilities that must be discharged promptly. For example, if a subsidiary of a large trader is acquired by another large trader, to the extent that subsidiary effects transactions in NMS securities equal to or greater than the reporting activity level, both large traders must promptly notify their registered broker-dealers of the LTID change. This responsibility is in addition to the large traders' duty to amend Form 13H pursuant to Rule 13h-1(b)(1).

## Form 13H

Form 13H is designed to collect basic identifying information about large traders that will allow the SEC to understand the character and operations of the large trader.

## Confidentiality

A number of commenters underscored the sensitive nature of the information collected on Form 13H. The SEC is committed to maintaining the information collected pursuant to Rule 13h-1 in a manner consistent with Section 13(h)(7) of the Exchange Act. The statute specifies that the SEC shall not be compelled to disclose information collected from large traders and registered broker-dealers under a large trader reporting system, subject to limited exceptions.

## Broker-Dealers: Recordkeeping, Reporting and Monitoring

### Recordkeeping Requirements

Under Rule 13h-1(d)(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. As a practical matter, however, the SEC will continue to have access to records of any account over which a broker-dealer exercises investment discretion together with a large trader or an Unidentified Large Trader by virtue of the fact that such an account is an account of a large trader subject to the recordkeeping requirements.

The rule does not require a broker-dealer to maintain records of transactions by an inactive large trader after receiving notice from the large trader that the trader had filed for inactive status with the SEC on Form 13H.

In addition, the SEC adopted as proposed the requirement that, 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 must maintain records of all of the required information under paragraphs (d)(2) and (d)(3) for those transactions.



Rule 13h-1(d)(5) requires that the “records and information required to be made and kept pursuant to the provisions of this rule shall be available on the morning after the day the transactions were effected (including Saturdays and holidays).”

Rule 13h-1(d)(2) sets forth the types of information that must be maintained for all transactions.

Rule 13h-1(d)(4) provides that the records and information required to be made and kept shall be kept for such periods of time as provided in § 240.17a-4(b).

### **Reporting Requirements**

As adopted, under Rule 13h-1(e), upon the request of the SEC, every registered broker-dealer who is itself a large trader or carries an account for a large trader or an Unidentified Large Trader shall electronically report to the SEC all information required under paragraphs (d)(2) and (d)(3) 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 such transactions directly or indirectly for a large trader shall electronically report such information.

Broker-dealers will be required to report a particular day’s trading activity if it equals or exceeds the “reporting activity level.” 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 for fewer than 100 shares, 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 SEC from time to time.”

Under Rule 13h-1(e), transaction reports must be submitted to the SEC no later than the day and time specified in the request for transaction information, which shall be no earlier than the opening of business of the day following such request, unless in unusual circumstances the same-day submission of information is requested. In case of same-day submission, the SEC recognizes that under these circumstances, depending on the nature of the broker-dealer’s systems, the report data may be preliminary and require updating by the opening of business of the day following the request. Rule 13h-1(e) requires that reports be submitted “electronically, in machine-readable form and in accordance with a format specified by the SEC that is based on the existing EBS system format.” Like Exchange Act Rule 17a-25, this provision does not require (or prohibit) preparation or transmission of reports by any intermediary.

### **Monitoring Requirements**

As adopted, the rule 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 the rule) 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 in paragraphs (b)(1) and (b)(2) (i.e., identified itself as a large trader to the broker-dealer and disclosed the accounts to which its LTID applies). As noted in Rule 13h-1(a)(9), in considering whether the broker-dealer has “reason to know” that a person is a large trader, however, the broker-dealer need take into account only transactions in NMS securities effected by or through such broker-dealer (i.e., it need not seek out information on transactions effected by that person through another broker-dealer). However, if a registered broker-dealer nevertheless has actual knowledge that a person is a large trader and the person has not provided the broker-dealer with an LTID, then the broker-dealer must treat the person as an Unidentified Large Trader under the recordkeeping and reporting requirements of the rule.

Moreover, 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 simply 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. For example, the broker-dealer may know, or learn from its customer, that the transactions over the identifying activity level were effected in connection with a tender offer, which are excluded under the rule for purposes of determining whether a person is a large trader. Alternatively, the broker-dealer may know, or learn from its customer, that the account in question is an omnibus account and that the individual subaccounts do not exceed the identifying activity level. Second, the broker-dealer may rely on the safe harbor provision in paragraph (f) of the rule. Under the safe harbor, 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 who have not complied with the identification requirements of paragraphs (b)(1) and (b)(2) but 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 the rule. Paragraph (f)(1) clarifies that—consistent with the definition of Unidentified Large Trader—the broker-dealer's policies and procedures for measuring a customer's trading activity need only consider transactions effected in accounts carried by the broker-dealer or through which the broker-dealer executes transactions. Those policies and procedures would need to be reasonably designed to identify potential large traders based upon transactions effected through an account or a group of accounts considering account name, tax identification number, or other identifying information available on the books and records of the broker-dealer. The rule does not require broker-dealers to definitively determine who is, in fact, a large trader.

The SEC noted that, pursuant to the reporting requirements of the rule, it may periodically request reports from broker-dealers regarding all customers they may be treating as Unidentified Large Traders.

Further, in response to questions regarding the scope of a broker-dealer's obligations with respect to an Unidentified Large Trader, the SEC notes that the rule does not require a broker-dealer to stop doing business with Unidentified Large Traders. Rather, paragraph (d)(3) of the rule requires broker-dealers to maintain information on Unidentified Large Traders, and paragraph (e) requires broker-dealers to report that information to the SEC on request. Moreover, the rule does not require a broker-dealer to proactively or affirmatively determine who is in fact a large trader. A potential large trader is required to assess for itself whether it meets the identifying activity threshold and thus qualifies as a large trader.

The SEC notes that in some cases only the potential large trader would know whether it in fact is a large trader because certain types of transactions are excluded from the identifying activity level calculation. For example, a broker-dealer may have a customer that effected \$22,000,000 worth of transactions through that broker-dealer in a given day, in excess of the identifying activity threshold. If that customer did not previously identify itself as a large trader to the broker-dealer by providing an LTID and identifying the accounts to which it applies, then the broker-dealer would treat the customer as an Unidentified Large Trader. However, the customer may not, in fact, be required to register as a large trader because the customer may not have exercised investment discretion over those transactions.

## **ATSS**

The SEC noted that the monitoring requirements are only applicable to registered broker-dealers that are large traders, carry accounts for large traders or Unidentified Large Traders, or effect transactions on behalf of large trader customers whose accounts are carried by non-broker-dealers. If an ATS is not operating in those capacities, then it is not subject to the monitoring requirements

## **Foreign Entities**

The statute contemplates that the SEC would be able to identify all persons who are large traders, not just large traders who are U.S. entities. Accordingly, the rule requires a foreign entity that is a large trader to comply with

the identification requirements of paragraph (b) of the rule. With respect to the recordkeeping and reporting requirements, however, the SEC notes that paragraphs (d) and (e) of the rule, concerning recordkeeping and reporting, respectively, explicitly apply only to U.S.-registered broker-dealers.

When a U.S.-registered broker-dealer deals directly with a foreign entity that is an intermediary, it would treat that foreign intermediary like any other customer. It must collect the information specified by Rule 13h-1(d)(2) about the foreign intermediary's transactions if it is a large trader and, if it is an Unidentified Large Trader, the broker-dealer must also collect the information specified by Rule 13h-1(d)(3). The rule does not require a registered broker-dealer to collect the identifying information about the foreign intermediary's customers.

In the case of foreign intermediaries, the SEC recognizes that the U.S.-registered broker-dealer may only know as its customer the foreign intermediary, not the persons trading through the account of the foreign intermediary. In such a case, the registered broker-dealer's policies and procedures would apply to its contact with the foreign intermediary. If the intermediary effects transactions through the U.S. broker-dealer that exceed the identifying activity level, then the safe harbor contemplates, as discussed above, that the broker-dealer inform the intermediary that the intermediary may be a large trader under Rule 13h-1. The foreign intermediary, then, bears the principal burden of compliance in determining whether it is a large trader.

In the event, which the SEC believes to be unlikely, that the laws of a large trader's foreign jurisdiction preclude or prohibit the large trader from waiving such restrictions or otherwise voluntarily filing Form 13H with the SEC, then such foreign large traders or representatives of foreign large traders may request an exemption from the SEC pursuant to Section 36 of the Exchange Act and paragraph (g) of the rule. A registered broker-dealer, however, would remain subject to the recordkeeping, reporting, and monitoring provisions of the rule with respect to any Unidentified Large Traders independent of whether any such entity had received an exemption from the requirements to file Form 13H with the SEC.

## Implementation and Compliance Dates

The deadline for implementing the recordkeeping and reporting requirements applicable to registered broker-dealers is seven months after the Effective Date of the rule. The self-identification requirement for large traders will commence two months after the Effective Date of the rule.

## Exemptive Authority

Section 13(h)(6) of the Exchange Act authorizes the SEC "by rule, regulation, or order, consistent with the purposes of this title, [to] exempt any person or class of persons or any transaction or class of transactions, either conditionally or upon specified terms and conditions or for stated periods, from the operation of [Section 13(h)], and the rules and regulations thereunder." Rule 13h-1(g) implements this authority, providing that: "[u]pon written application or upon its own motion, the SEC may by order exempt, upon specified terms and conditions or for stated periods, any person or class of persons or any transaction or class of transactions from the provisions of this rule to the extent that such exemption is consistent with the purposes of the Securities Exchange Act."

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