

Clients & Friends Memo

Final SEC Rule Regulating Large Trader Reporting*

September 23, 2011

On July 27, 2011, the Securities and Exchange Commission (the “SEC”) adopted Rule 13h-1 (“Rule 13h-1” or the “Large Trader Rule”) and related Form 13H as directed by Section 13(h) of the Securities Exchange Act of 1934 (“Exchange Act”).¹ Rule 13h-1 requires each “Large Trader” (as defined in the Large Trader Rule) to (i) identify itself by filing and periodically updating Form 13H with the SEC and (ii) disclose to each SEC-registered broker-dealer, through which it trades its large trader identification number (“LTID”) and all accounts to which that LTID applies. Rule 13h-1 also requires registered broker-dealers to (i) monitor accounts for the purpose of identifying “Unidentified Large Traders,” (ii) capture certain information relating to all transactions on behalf of Large Traders and Unidentified Large Traders that are effected directly or indirectly by or through it, and (iii) make such information available to the SEC through the already-established trade-reporting infrastructure, commonly referred to as the electronic blue sheets (“EBS”).

Rule 13h-1 will become technically effective on October 3, 2011, but (i) Large Traders will have until December 1, 2011 to comply with the requirements of the Large Trader Rule² and (ii) broker-dealers will have until April 30, 2012 to comply with the requirements under the Large Trader Rule to maintain records, report transaction data when requested, and monitor Large Trader activity.

The Large Trader Rule is intended to enhance the SEC’s ability to collect information on the trading activities of the most significant participants in the U.S. equities and options markets.³ The SEC believes this information will greatly “influence” its ability to analyze market movements, investigate

* A fully hyperlinked version of this memo is available to subscribers to [Lofchie’s Guide to Broker-Dealer Regulation](#).

¹ See SEC Release No. 34-64976 (July 27, 2011) (the “Adopting Release”), 76 Fed. Reg. 149 (August 3, 2011).

² Although the Adopting Release is silent on this issue, we read this to mean that any person who can be classified as a Large Trader as a result of trades entered into on any day from October 3, 2011 must self-identify to each SEC-registered broker-dealer through which it trades its LTID and all accounts to which that LTID applies no later than December 1, 2011.

³ See Adopting Release at 5.

the causes of market events and conduct investigations of regulated entities, and prosecute enforcement matters.⁴

Notwithstanding approval of the Large Trader Rule, the SEC has indicated that it continues to consider adoption of a consolidated audit trail for equities and options.⁵ Indeed, the SEC characterizes the requirements of the Large Trader Rule as “much more limited in terms of their scope, objectives, and implementation burden. . . .”⁶ Nevertheless, unlike the proposed consolidated audit trail, which the SEC seems to recognize would be a very significant undertaking requiring a significant implementation period, the SEC believes that the requirements of Rule 13h-1 requires “relatively modest steps” and can be “implemented more expeditiously and at less cost. . .”⁷

Part I below discusses the application of Rule 13h-1 and Form 13H to Large Traders; Part II discusses the application of Rule 13h-1 to registered broker-dealers. At the end of each Part, we have also set forth suggested steps that entities should take as part of their compliance with Rule 13h-1. Note that a registered broker-dealer can also be a Large Trader and, therefore, may have to comply with both sets of requirements.

I. Large Traders

A. Large Trader Status

For purposes of Rule 13h-1, a Large Trader is (i) any “person” that voluntarily registers as a Large Trader;⁸ (ii) any person that directly exercises “investment discretion” over one or more accounts through which transactions in national market system securities (“**NMS securities**” and each such security an “**NMS security**”)⁹ are effected through one or more registered broker-dealers in

⁴ *Id.* at 4.

⁵ *Id.* at 6.

⁶ *Id.* at 14.

⁷ *Id.*

⁸ See Rule 13h-1(a)(1).

⁹ The term “NMS security” is defined at Rule 600(b)(46) of Regulation NMS and includes all listed options and all equity securities listed on the NYSE, NYSE Amex and Nasdaq as well as equity securities listed on other national exchanges; provided that such securities, at the time of listing, meet the listing standards then in place for the NYSE or the NYSE Amex. See Regulation NMS Rule 600(b)(46), (47) and (82). The scope of securities that fall under this definition is narrower than the scope of securities that are subject to either (a) Rule 13d-1 (covers any equity security (1) registered pursuant to section 12 of the Exchange Act, (2) of any insurance company that is exempted under section 12(g)(2)(G) of the Exchange Act, or (3) issued by a closed-end investment company registered under the Investment Company Act of 1940; provided that such term shall not include securities of a class of non-voting securities) or (b) Rule 13f-1 (generally covers any equity security traded on a U.S. exchange, options on such securities, shares of closed-end funds and certain convertible debt securities). See Rule 13d-1(i) and Rule 13f-1(c).

amounts that, in the aggregate, satisfy the “identifying activity level;” (iii) any person that “controls” another person that is a Large Trader; and (iv) any person that would be a Large Trader if such person’s transactions were aggregated with the transactions of all other entities controlled by such person.

1. Definition of Person, Control and Investment Decision

The term “**person**” means “a natural person, company, government, or political subdivision, agency, or instrumentality of a government.”¹⁰ Unlike Section 13(f) of the Exchange Act, Section 13(h) does not provide an exemption for natural persons.

Rule 13h-1(a)(3) defines “**control**” as “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 Rule 13h-1, 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.

Rule 13h-1 adopts the definition of “**investment discretion**” set forth at Section 3(a)(35) of the Exchange Act.¹¹ As defined at Section 3(a)(35), the exercise of “investment discretion” includes both the authority to determine what securities to purchase or sell as well as the making of decisions as to purchases or sales even though another person may have responsibility for investment decisions. (The term “investment discretion” is used in Section 28(e) of the Exchange Act – the exemption for “soft dollars” – and a number of no-action letters issued under that Section discusses the meaning of the term.) An employee that exercises “investment discretion” within the scope of employment is deemed to do so on behalf of the employer.

Because a person is deemed to exercise “investment discretion” for purposes of Section 3(a)(35) merely by having “authority” it would appear that, for purposes of the Large Trader definition, a person would be deemed to exercise investment discretion over an account regardless of whether that person in fact exercised such discretion.

¹⁰ More specifically, Rule 13h-1(a)(2) states that “person” has the same meaning as in Section 13(h)(8)(E) of the Exchange Act, which, in turn, references the definition provided by Exchange Act Section 3(a)(9) (set forth above).

¹¹ See Rule 13h-1(a)(4).

2. Identifying Activity Level

a. General Rule

Rule 13h-1(a)(7) defines the term “identifying activity level” as aggregate “transactions” in NMS securities that are effected by or through one or more registered broker-dealers 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.

i. Registered Broker-Dealers

Significantly, transactions “count” only towards the identifying activity level if they are conducted through a “registered broker-dealer”: *i.e.*, an SEC-registered broker-dealer. Accordingly, while the Large Trader provisions of Rule 13h-1 apply equally to all U.S. and foreign persons (as discussed further at section B(1) of this Part I), transactions effected by or through a foreign broker-dealer (*i.e.*, a non-SEC-registered broker-dealer) would not count towards identifying activity level.

b. Transactions

The term “transaction” is defined to mean all transactions in NMS securities, excluding exercises or assignments of option contracts and certain specifically enumerated transactions, as discussed further at subsections (i) and (ii) below.

i. Options

For purposes of calculating the “identifying activity level,” the volume and fair market value of options on equity securities, other than options on indexes, purchased or sold is determined by reference to the equity securities underlying the option purchased or sold.¹² For example, an option to purchase 10,000 shares of equity XYZ, which then trades at \$10 per share, would constitute 10,000 shares of XYZ and have a fair market value of \$100,000 (10,000 times \$10).¹³

Transactions in index options are not required to be “burst” into share equivalents for each of the

¹² Rule 13h-1(c)(1)(i).

¹³ See Adopting Release at Note 64.

underlying component equities.”¹⁴ Instead, one looks only to the notional value of the index underlying the option and does not count such options towards the volume limit.¹⁵

Moreover, as noted above, 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. By excluding purchases and sales pursuant to exercises or assignments, the Large Trader Rule avoids double-counting towards the applicable identification threshold.

ii. Exclusions

Rule 13h-1(a)(6) provides an enumerated list of exclusions from the definition of “transaction” for the purposes of determining whether one meets the identifying activity level threshold.¹⁶ The SEC stated that such exceptions 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 and thus excluded such transactions from the identifying activity level calculation.¹⁷

c. No Offsets in Calculating Volume and Market Value

For purposes of calculating the “identifying activity level,” each qualifying transaction must be separately accounted for without taking into account offsetting transactions, whether in the same account or in different accounts.¹⁸ For example, a purchase of 100 shares of XYZ at \$10 a share in

¹⁴ *Id.*

¹⁵ *Id.* The number of shares of the underlying stock included in the options contract while the value of the option is deemed to be equal to the number of contracts purchased or sold times the market price of the options times the applicable multiplier (*i.e.*, the number of shares of the underlying stock included in the options contract).

¹⁶ Such transactions include: (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 a NMS security, option or other right to acquire securities at a pre-established price pursuant to a plan which is primarily for the purpose of an issuer benefit plan or compensatory arrangement; or (viii) any transaction to effect a business combination, including a reclassification, merger, consolidation, or tender offer subject to Section 14(d) of the Exchange Act, an issuer tender offer or other stock buyback by an issuer, or a stock loan or equity repurchase agreement.

¹⁷ See Adopting Release at 28.

¹⁸ Rule 13h-1(c)(1)(iii).

one account and a sale of 100 shares of XYZ at \$10 in another account would aggregate to 200 shares (100 shares purchased plus 100 shares sold) with a market value of \$2,000 (200 shares times \$10). Similarly, transactions that make up complex option strategies or stock/option strategies should be added for purposes of calculating volume and market value.

B. Requirements Applicable to Large Traders

1. Applicability to Foreign Persons

Rule 13h-1 does not contain any jurisdictional carve outs that would limit its applicability to U.S. persons. Nevertheless, it should be noted that the definition will apply only where transactions meeting the identifying activity level are conducted through SEC-registered broker-dealers.¹⁹ Accordingly, the Large Trader provisions of Rule 13h-1 will apply only to persons that either trade through SEC-registered broker-dealers or control persons who do so. This raises the question of whether non-U.S. persons will be incentivized to trade through foreign non-SEC-registered broker-dealers to avoid becoming Large Traders. However, assuming that the foreign non-SEC-registered broker-dealer itself executed trades in NMS securities through a SEC-registered broker-dealer, that foreign non-SEC-registered broker-dealer could be required to report as a Large Trader.²⁰

The SEC does, however, acknowledge the possibility that the laws of certain foreign jurisdictions may prevent a non-U.S. Large Trader (whether itself a broker-dealer or adviser) from disclosing certain personal identifying information of an underlying principal. In such event, 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 subsection (g) of Rule 13h-1.²¹

2. Form 13H

Rule 13h-1(b)(1) requires each Large Trader to identify itself to the SEC by filing a Form 13H but also allows this obligation to be pushed up to a parent or pushed down to a subsidiary so long as

¹⁹ See the discussion above at section A(2)(a)(i) of this Part I.

²⁰ As further discussed below in section B(2)(a)(i) of this Part I, the SEC may request a Large Trader to deliver additional information pursuant to Rule 13h-1(b)(4). Neither the Large Trader Rule nor the Adopting Release provides guidance as to the scope of such additional information the SEC may request. Therefore, it would seem likely that the SEC intends to use Rule 13h-1(b)(4) as a method to obtain additional information about the customers of a foreign non-SEC-registered broker-dealer that qualifies as a Large Trader under the Large Trader Rule (e.g., the information that SEC-registered broker-dealers are required to maintain pursuant to 13h-1(d)).

²¹ See Adopting Release at 80. The Adopting Release does not offer any guidance as to how the SEC will determine whether a foreign Large Trader should be exempt from the Large Trader Rule.

the parent or subsidiary (*i.e.*, the filing Large Trader), can comply with all of the requirements otherwise applicable to the non-filing Large Trader.²²

In practice, a parent can always satisfy the Form 13H filing requirement of its subsidiaries. Pushing down the Form 13H filing requirement is more problematic, however, and requires that every person under common control that exercises discretion directly or indirectly over an account with an SEC-registered broker-dealer through which covered transactions in NMS securities occur either itself files a Form 13H or is under the control, directly or indirectly, of a person that both files a Form 13H and is itself under the same common control.

As the foregoing suggests, the correct utilization of the push down option, and, therefore, whether a particular person needs to file a Form 13H, or can rely upon a filing by another person, is likely to require careful consideration. This is particularly true the more complex the structure of ownership and control becomes. For this reason, a number of examples illustrating the applicability of the push up and push down options in a variety of structures are set forth on Exhibit A attached hereto.

Where a Large Trader files on behalf of itself and one or more parent entities, it would still be required to identify the parent entity on its Form 13H filing, and where an affiliate of such Large Trader also files a Form 13H, both filing entities must identify the other in Item 4(c) of Form 13H as an affiliate filing separately. This enables the SEC to tell what entities are under common control of a parent company and allows the SEC to assign LTIDs that references such common parent.

As discussed further below, Form 13H provides for an initial filing as well as annual filings and filings related to amendments, inactive status, reactivation of active status and termination of status as a Large Trader.

a. Initial Filing

A Large Trader must file its initial Form 13H (“**Initial Filing**”) with the SEC “promptly” upon satisfaction of the identifying activity level. The SEC has indicated that under “normal” circumstances it would be appropriate for a Large Trader to make its Initial Filing (as discussed further at subsection (e)) within 10 days after the Large Trader effects aggregate transactions at

²² See Rule 13h-1(b)(3). The Adopting Release more clearly contemplates situations where a complex corporate structure may want to push down the filing requirement than did the adopting release for Rule 13f-1. See SEC Release No. 34-15292 (November 2, 1978). With respect to Rule 13f-1 and Form 13F filings, the SEC merely noted in the adopting release that if a subsidiary were to file on behalf of its parent, the parent would also be required to file a cover page and a separate statement indicating that the subsidiary would be filing on its behalf. *Id.*

least equal to the identifying activity level.²³ The SEC declined giving further guidance for circumstances that are not “normal,” stating that “promptly” is an appropriate standard because it emphasizes the need for filings to be submitted without delay to ensure their timeliness while affording filers a limited degree of flexibility.

i. Content

- **Introduction: Background Information About the Large Trader and its Authorized Person.** The introductory section of Form 13H requires the Large Trader to provide its mailing address. Additionally, the introductory section requires that the following information be provided about the natural person authorized to submit the Form 13H on behalf of the Large Trader (“**Authorized Person**”): business address, telephone number, facsimile number, and e-mail address.
- **Item 1: Businesses of the Large Trader.** In Item 1(a) of the Form, the Large Trader must indicate by checking off the appropriate boxes the types of businesses in which it or any of its affiliates engage.²⁴ Item 1(b) of the Form requires that the Large Trader provide the following for itself and its Securities Affiliates:²⁵ a description of the nature of its operations, including a general description of its trading strategies.²⁶ The SEC has stated that collection of this descriptive information will allow itself to better understand each Large Trader and will allow the SEC to more carefully tailor requests both to registered broker-dealers for Large Trader transaction data and, if necessary, to Large Traders for additional information pursuant to Rule 13h-1(b)(4).
- **Item 2: Securities and Exchange Commission Filings.** Item 2 requires the Large Trader to indicate whether it or any of its Securities Affiliates files any other forms with the SEC. If the Large Trader or any of its Securities Affiliates file other forms with the SEC, Item 2 requires the disclosure of each filing entity, the form(s) filed, and the CIK number.

²³ The SEC stated further that its guidance regarding the “promptly” standard for Form 13H filings is based on the scope of the Form, the expected time to complete the Form, and the required submission thereof through EDGAR, and accordingly this guidance is applicable only to Form 13H filings.

²⁴ A Large Trader’s options include broker or dealer; bank holding company; non-bank holding; company; government securities broker or dealer; municipal securities broker or dealer; bank; pension trustee; non-pension trustee; investment adviser to one or more registered investment companies; investment adviser to one or more hedge funds or other funds not registered under the Investment Company Act of 1934; insurance company; commodity pool operator; or futures commission merchant. A Large Trader also may check “Other” and disclose other types of financial businesses engaged in by the Large Trader.

²⁵ “Securities Affiliate” means any affiliate of the Large Trader that exercises investment discretion over NMS securities.

²⁶ The instructions provide guidance regarding the level of detail expected.

- **Item 3: CFTC Registration and Foreign Regulators.** The Large Trader must disclose on Item 3(a) whether it or any of its affiliates are registered with the Commodity Futures Trading Commission (“CFTC”). Item 3(b) is less expansive and requires only the Large Trader to disclose whether it or any of its Securities Affiliates are regulated by a foreign regulator. If so, the Large Trader is required to identify each entity and the CFTC registration number or primary foreign regulator, as applicable.
- **Item 4: Organization Information.** Item 4(a) requires the Large Trader to attach an organizational chart.²⁷ As part of Item 4(b), the Large Trader is required to list a narrative description of the relationship between the Large Trader and each Securities Affiliate and each entity identified in Item 3(a). Large Traders should anticipate that they may be questioned by the SEC not only about common ownership but also about shared employees and common or as coordinated trading or investment strategies. Additionally, the Large Trader must describe the business and disclose the market participation identification number (if any) for each of those entities. Item 4(c) requires the provision of the LTIDs, including LTID suffixes, for all entities within the Large Trader that file a separate Form 13H (if any). Finally, Item 4(d) allows the Large Trader to assign suffixes to its affiliates, that is, to append additional characters (a suffix)²⁸ to sub-identify particular units that directly control any of the Large Trader’s accounts.
- **Item 5: Legal Form of the Large Trader.** The Large Trader must choose one or more of the following statuses under Item 5(a): individual, partnership, limited liability partnership, limited partnership, corporation, trustee or limited liability company.²⁹ Partnerships must identify each of its partners and each partner in partnership status (*i.e.*, general partner or limited partner) under Item 5(b), while corporations and trustees must identify each of its executive officers, directors or trustees.
- **Item 6: List of Broker-Dealers at which the Large Trader or its Securities Affiliates Has an Account.** Item 6 requires the Large Trader to identify broker-dealers at which it 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. Note that the firms through which a Large Trader transacts is likely to change or be expanded periodically. Large Traders should be mindful to apprise new broker-dealers of their status and also to update their own Forms 13H at least quarterly.

²⁷ Such organizational chart requires the Large Trader to identify itself, its parent company (if applicable), all Securities Affiliates and all entities identified as registered with the CFTC under Item 3(a).

²⁸ A suffix should have no more than three characters, all of which must be numbers; no letters or special characters may be used. The same suffix may not be assigned to more than one affiliate using the same LTID.

²⁹ The Form permits the Large Trader to check “Other” and specify a form of organization that is not comparable to any of the enumerated organization types.

- **Instructions for Form 13H.** Further information regarding each of the items listed above can be found at the back of the Adopting Release under “Instructions for Form 13H.”

ii. Confidentiality

Addressing a number of commenters concerned about the sensitive nature of the information collected on Form 13H, the SEC stated in the Adopting Release that it is committed to protecting the confidentiality of such information to the fullest extent permitted by applicable law (that is, in a manner consistent with Section 13(h)(7) of the Exchange Act).

Section 13(h)(7) 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, such as the Large Trader Rule, subject to limited exceptions. On the other hand, the statute provides that nothing in Section 13(h)(7) shall authorize the SEC to withhold information from Congress or prevent the SEC from complying with a request for information from any other Federal department or agency requesting information for purposes within the scope of its jurisdiction, or complying with an order of a court of the United States in an action brought by the United States or the SEC. (The recent news stories as to the release by Congress of supposedly private information of futures traders is likely to give further concern to non-U.S. Large-Traders that may potentially be able to avoid disclosure of their information to U.S. regulators or Congress.)

b. Amended Filings

If any of the information contained in a Form 13H filing becomes inaccurate for any reason, a Large Trader must file an amended filing (“**Amended Filing**”) no later than the end of the calendar quarter in which the information becomes stale.³⁰ While not required by the Large Trader Rule, a Large Trader may voluntarily file an Amended Filing more frequently than quarterly at its discretion. A Large Trader on “Inactive Status” (as discussed further at subsection (d)) is not required to file any Amended Filings while it is on Inactive Status.

c. Annual Filings

All Large Traders (other than those on Inactive Status) must submit an annual filing (“**Annual Filing**”) within 45 days after the end of each full calendar year.

³⁰ The Adopting Release does not establish a grace period for Large Traders that determine they are required to make an Amended Filing at the very end of the applicable quarter. As drafted, the Large Trader Rule literally requires that a Large Trader that determines it must make an Amended Filing on the last day of any quarter will have until the close of business on the same day to make its Amended Filing.

d. Inactive Status

Rule 13h-1(b)(3)(iii) permits a Large Trader who 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. Inactive Status becomes effective upon such a filing. 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 Large Trader Rule on natural persons who infrequently effect transactions of a magnitude that otherwise warrant the added regulatory requirements under the Large Trader Rule. Inactive status relieves the Large Trader from the requirement to make Amended Filings and permits the Large Trader to request that its SEC-registered broker-dealers subject to sections (d) and (e) of the Large Trader Rule stop maintaining records of its transactions by LTID (as discussed further in section A to Part II).

e. Reactivated Status

A person or entity on Inactive Status who subsequently 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. Upon filing for Reactivated Status, the person once again would be subject to the filing requirements of Rule 13h-1 and 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.

f. Termination 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 primarily 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.

C. Obligation to Disclose to Registered Broker-Dealers

Rule 13h-1(b)(2) requires each Large Trader to disclose to each of the SEC-registered broker-dealers effecting transactions on its behalf its LTID and each account to which it applies (*i.e.*, each account at a SEC-registered broker-dealer as to which the Large Trader directly or indirectly exercises discretion).

This can result in multiple LTIDs being disclosed to a SEC-registered broker-dealer for a single account since this disclosure requirement applies equally to every Large Trader that both (i) exercises control of the owner of the account and (ii) has itself filed a Form 13H.³¹ For example, where an investment adviser that is a Large Trader is owned equally by two individuals that have themselves filed Form 13H, both of these individuals will have to disclose their LTIDs to the registered broker-dealers that hold each account over which the adviser exercises discretion.³²

D. To Do

1. Initial Determination

All persons should make a determination of whether there is any possibility that they may be a Large Trader. For most persons, natural or otherwise, this determination will be simple and obvious but for persons that either engage in significant trading or have a 25% or greater ownership interest in an entity, this inquiry becomes more complicated and requires knowledge of the trading activities of such controlled entity as well as awareness of any entities under the control of the controlled entity. Furthermore, Large Traders that are part of a larger group of persons under common control should determine whether to push up or push down their Form 13H filing obligation.

2. Monitoring

Persons that do not meet the identifying activity levels should determine whether they may need to monitor future activity to ensure timely filing their Form 13H should they subsequently exceed the identifying activity level. Alternatively, persons in such a position may decide to voluntarily elect Large Trader status and avoid the need to monitor their future trading activity.

Advisers must be mindful of the Large Trader Rule each time they take on (or lose) a client or establish a fund. If a new client or fund makes the adviser a Large Trader, all SEC-registered broker-dealers through which the adviser trades will have to be notified of all relevant accounts. If the adviser is already a Large Trader, all SEC-registered broker-dealers through which the new client or fund will trade must be so notified.

³¹ See Adopting Release at footnotes 320 and 385. See also SEC Release No. 34- 61908 (April 14, 2010), 75 Fed. Reg. 21456 (April 23, 2010) at footnote 48 and accompanying text.

³² See Adopting Release at 84 (stating that where an entity is controlled by a Large Trader, the controlled entity would be required to provide its SEC-registered broker-dealers with the controlling entity's LTID).

3. Procedures and Training

Large Traders and persons under the control of a Large Trader should implement written procedures that are designed to provide for:

- disclosure of the Large Trader's LTID in connection with any account at a SEC-registered broker-dealer (including new accounts of existing broker-dealers);
- timely notification to the Large Trader of any changes to the information disclosed on Form 13H; and
- timely filing of annual updates to Form 13H.

In addition, where the Form 13H filing is pushed down, the parent company and all affiliates that are not direct or indirect subsidiaries of a company that has itself filed Form 13H should maintain procedures that impose a complete prohibition on any activity that would result in a transaction covered by Rule 13h-1 as any such transaction would itself trigger a separate Form 13H filing requirement on the part of the parent entity.

Large Traders should also consider implementing a training program for the purpose of complying with the requirements of Rule 13h-1 and the foregoing procedures.

E. Effective Date

The filing and notification provisions of Rule 13h-1 applicable to Large Traders become effective on December 1, 2011.

II. Applicability to Registered Broker-Dealers

A. Recordkeeping

Under Rule 13h-1(d), every SEC-registered broker-dealer will be required to maintain records for each account such broker-dealer carries for a Large Trader or an Unidentified Large Trader. If the broker-dealer is itself a Large Trader, such broker-dealer will also be required to maintain records for any proprietary or other account over which such broker-dealer exercises investment discretion. 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 shall maintain records of all of the information required under the Large Trader Rule.³³ Where an inactive Large Trader gives notice to a broker-dealer that such Large

³³ See Rule 13h-1(d)(1)(iii).

Trader has filed for Inactive Status with the SEC on Form 13H, such broker-dealer should discontinue tagging such Large Trader's transactions with its LTID.³⁴

The information required to be maintained for all transactions shall include:

- the clearing house number or alpha symbol of the broker-dealer submitting the information and the clearing house numbers or alpha symbols of the entities on the opposite side of the transaction;
- the identifying symbol assigned to the security;
- the date the transaction was executed;
- the number of shares or option contracts traded in each specific transaction; whether each transaction was a purchase, sale, or short sale; and, if an option contract, whether the transaction was a call or put option, an opening purchase or sale, a closing purchase or sale, or an exercise or assignment;
- the transaction price;
- the account number;
- the exchange or other market center where the transaction was executed;
- a designation of whether the transaction was effected or caused to be effected for the account of a customer or was a proprietary transaction;
- if part or all of an account's transactions at the broker-dealer have been transferred or otherwise forwarded to one or more accounts at another registered broker-dealer, an identifier for this type of transaction; and, if part or all of an account's transactions at the reporting broker-dealer have been transferred or otherwise received from one or more other broker-dealers, an identifier for this type of transaction;
- if part or all of an account's transactions at the reporting broker-dealer have been transferred or otherwise received from another account at the reporting broker-dealer, an identifier for this type of transaction; and, if part or all of an account's transactions at the reporting broker-dealer have been transferred or otherwise forwarded to one or more other accounts at the reporting broker-dealer, an identifier for this type of transaction;
- if a transaction was processed by a depository institution, the identifier assigned to the account by the depository institution;

³⁴ See Adopting Release at 62 (noting that although the Large Trader Rule does not specifically require a U.S.-broker-dealer to discontinue tagging an inactive Large Trader's transactions with its LTID, each such broker-dealer should discontinue tagging any such inactive Large Trader's transactions with its LTID).

- the time that the transaction was executed; and
- the LTID associated with the account, unless the account is for an Unidentified Large Trader, in which case the broker-dealer shall also be required to maintain for all transactions such Unidentified Large Trader's name, address, date the account was opened, and tax identification number(s).

B. Retention and Reporting

Each broker-dealer that maintains the information described above shall preserve such information for a period of not less than three years, the first two in an accessible place,³⁵ and shall make available such information on the morning after the day such transactions were effected (including Saturdays and holidays).³⁶

Rule 13h-1(e) requires every registered broker-dealer governed by the Large Trader Rule to electronically report upon the SEC's request the information described above for all transactions effected directly or indirectly by or through accounts carried by such broker-dealer for Large Traders and Unidentified Large Traders.³⁷ SEC-registered broker-dealers will be required to report a particular day's trading activity if it equals or exceeds the "reporting activity level."³⁸ Such reports shall be submitted to the SEC electronically, in machine-readable form and in accordance with a format specified by the SEC that is based on the existing EBS system format 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.³⁹

1. Monitoring for Unidentified Large Traders

Each SEC-registered broker-dealer will be required to treat as an Unidentified Large Trader (for purposes of the recordkeeping and reporting provisions in subsections (d) and (e) of the Large

³⁵ See Rule 13h-1(d)(4).

³⁶ See Rule 13h-1(d)(5).

³⁷ This includes a broker-dealer who is itself a Large Trader, carries an account for a Large Trader or an Unidentified Large Trader, or effects transactions directly or indirectly for a Large Trader whose account is carried by a non-broker-dealer.

³⁸ See Rule 13h-1(a)(8). Rule 13h-1(a)(8) defines "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 SEC from time to time.

³⁹ The SEC noted in the Adopting Release that under unusual circumstances, it may request more immediate responses that may require some broker-dealers to perform a manual process in order to provide reports to the SEC sooner than could be accommodated by an overnight batch process.

Trader Rule) any person that such 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 (*i.e.*, where the customer has not identified itself as a Large Trader to the broker-dealer and disclosed the accounts to which its LTID applies).⁴⁰ In considering whether the broker-dealer has “reason to know” that a person is a Large Trader, the broker-dealer needs only to take into account transactions in NMS securities effected by or through such broker-dealer.

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.⁴¹ Second, the broker-dealer may rely on the safe harbor provision in Rule 13h-1(f). 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 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 Large Trader Rule.⁴² Under either approach, a SEC-registered broker-dealer’s obligation with respect to an Unidentified Large Trader is limited to compliance with the requirements of subsections (d) and (e) of the Large Trader Rule, and the broker-dealer would not be required to cease trading or take other action with respect to that Unidentified Large Trader.

C. Applicability to Foreign Broker-Dealers

While foreign entities that satisfy the definition of “Large Trader” are required to file a Form 13H in compliance with the Large Trader Rule, the SEC noted in the Adopting Release that subsections (d) and (e) of Rule 13h-1 (concerning recordkeeping and reporting, respectively) explicitly apply only to SEC-registered broker-dealers. Therefore, with respect to transactions that are routed through a foreign broker-dealer that then routes the transactions back to a SEC-registered broker-dealer, the SEC-registered broker-dealer is required only to collect identifying information about the

⁴⁰ See Adopting Release at 69.

⁴¹ See Adopting Release at 71.

⁴² See Rule 13h-1(a)(9). In complying with the Large Trader Rule, registered broker-dealers need not seek out information on transactions effected by a person through another broker-dealer. See *also* Adopting Release at 69. That said, the limits on the diligence that a broker-dealer must exercise are not entirely clear. For example: Would it be necessary to monitor trades of affiliated advisers? There is always some reason for worry where a firm is made responsible for monitoring another’s compliance.

foreign intermediary's transactions if it is a Large Trader or an Unidentified Large Trader but not the identifying information about the foreign broker-dealer's customers.⁴³

D. To Do

SEC-registered broker-dealers that effect transactions with respect to NMS securities for customers should:

- require each existing customer to provide written representations as to Large Trader status, whether of the customer or any person that controls the customer, together with the agreement to promptly notify the broker-dealer should such status change in the future;
- when a new account is opened for an existing customer that is a Large Trader, ensure the new account is properly identified;
- amend their customer agreement to reflect such representation and agreement;
- implement written procedures and controls to monitor for Unidentified Large Traders; and
- assuming that it is itself a Large Trader, analyze the application of the Large Trader Rule to itself and its affiliates and make appropriate filings.

Similarly, SEC-registered broker-dealers that clear on a disclosed or omnibus basis should obtain from their introducing brokers:

- representations as to the status of all introduced customers for purposes of compliance with paragraphs (d) or (e) of Rule 13h-1;
- representations as to having appropriate procedures and controls in place to monitor customers for Unidentified Large Traders; and
- an agreement to promptly notify the clearing broker-dealer should the Large Trader status of any customer change in the future.

Of course, all SEC-registered broker-dealers that may find themselves subject to paragraphs (d) and (e) of Rule 13h-1 must also implement processes, procedures and controls to provide for timely compliance with the Large Trader Rule's recordkeeping and reporting obligations and should implement appropriate training and testing with respect thereto.

⁴³ See Adopting Release at 78-79.

E. Effective Date

The provisions of Rule 13h-1 as applicable to SEC-registered broker-dealers, *i.e.*, the recordkeeping, reporting, and monitoring provisions of paragraphs (d) and (e), become effective on April 30, 2012.

* * * *

Please feel free to contact any of the following Cadwalader attorneys if you have any questions about this memorandum.

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Exhibit A**Form 13H Filing Obligation****Examples of the Push Up and Push Down Options**

Holding Company with Two Large Trader Subsidiaries. For example, assume a holding company (“**Holding Company**”) wholly owns a SEC-registered broker-dealer (“**Broker-Dealer**”) and an investment adviser (“**Adviser**”), each of which are themselves Large Traders but do not otherwise have an ownership interest of 25% or more in any other entity. Assume further that no person owns 25% or more of Holding Company. In this example, all three entities would be Large Traders – Broker-Dealer and Adviser because each is itself a Large Trader and Holding Company because it controls a Large Trader.

In this case, a number of options are available as to compliance with the Form 13H filing requirement. These include:

- each of Holding Company, Adviser and Broker-Dealer files;
- the filing requirement is pushed up to the parent such that only Holding Company files; or
- the filing requirement is pushed down, such that both Broker-Dealer and Adviser files.

In theory, it is also possible to push up the filing requirement of one, but not both, of the subsidiaries such that Holding Company files on its own behalf and on behalf of, for example, Adviser, while Broker-Dealer also files. Because Holding Company’s accounts will include Broker-Dealer, however, this option is unlikely to be utilized as a general matter.

Note, however, that because Broker-Dealer neither controls Adviser nor is controlled by Adviser, Broker-Dealer cannot file on behalf of Adviser and Adviser cannot file on behalf of Broker-Dealer.

Holding Company with Two Large Trader Subsidiaries and a Controlling Shareholder. Assume further that Holding Company had a shareholder (“**Controlling Shareholder**”), whether an individual or another entity, that owned 25% or more of Holding Company. Assuming that Controlling Shareholder does not control another entity that is a Large Trader, a number of options are available as to compliance with the Form 13H filing requirements. These include:

- each of Adviser, Broker-Dealer, Holding Company and Controlling Shareholder files;
- the filing requirements of Broker-Dealer and Adviser are pushed up to Holding Company and the filing requirement of Controlling Shareholder is pushed down to Holding Company such that only Holding Company files;
- the filing requirements of Broker-Dealer, Adviser and Holding Company are pushed up to Controlling Shareholder; or
- the filing requirements of both Holding Company and Controlling Shareholder are pushed down, in which case both Adviser and Broker-Dealer would have to file.

As before, additional combinations also exist, including filing by Controlling Shareholder and Holding Company or Controlling Shareholder and Adviser and Broker-Dealer.

Holding Company with Two Large Trader Subsidiaries and a Controlling Shareholder that also Controls Another Large Trader. If, however, Controlling Shareholder also owns a 25% or greater interest in another company (the “**Controlled Entity**”), which is itself a Large Trader, Controlling Shareholder would have to file unless (i) both Holding Company and Controlled Entity filed or (ii) Adviser, Broker-Dealer and Controlled Entity filed. This follows from the fact that because Controlled Entity neither controls nor is under the control of Broker-Dealer or Holding Company, neither entity could file on behalf of Controlled Entity. Put another way, only Controlling Shareholder can file on behalf of Controlled Entity. Of course, even where Controlling Shareholder filed, one or more of the Large Traders controlled by Controlling Shareholder could also file separately, which they might want to do so that they would not have to rely upon Controlling Shareholder.