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## SEC Adopts Large Trader Reporting Regime

The Securities and Exchange Commission, in an effort to enhance its ability to identify large market participants and analyze their trading activity, has established a new reporting regime for so-called “large traders.” The SEC has done so through the promulgation of new Rule 13h-1 under the Securities Exchange Act of 1934, as amended (the “Exchange Act”).

### Summary

In its adopting release, the SEC noted that the U.S. securities markets have undergone significant transformation with rapid technological advancements affecting the structure of the markets and trading strategies. These technological advancements have allowed traders to employ sophisticated electronic trading methods to conduct transactions instantaneously in significant volumes. The market events of May 6, 2010, when the prices of many U.S. equity securities experienced an extraordinarily rapid decline and recovery, further highlighted the need for better data on active market participants.

The newly adopted Rule 13h-1 aims to strengthen the SEC’s oversight of securities trading activities and to identify potentially manipulative and abusive practices. As explained in more detail below, the new rule:

- requires large traders — defined as traders whose transactions in National Market System (“NMS”) securities equal or exceed 2 million shares or \$20 million during any calendar day, or 20 million shares or \$200 million during any calendar month — to register with the SEC using new Form 13H;
- requires large traders to disclose their status as such to broker-dealers; and
- imposes recordkeeping, reporting and limited monitoring requirements on registered broker-dealers through which large traders execute their transactions.

Rule 13h-1 will be effective 60 days after the date of publication in the Federal Register. Large traders will have two months after the effective date to comply with the identification requirements of the rule and registered broker-dealers will have seven months after the effective date to comply with the requirements to maintain records, report transaction data when requested, and monitor large trader activity.

### Definition of Large Trader

Rule 13h-1(a)(1) defines a “large trader” as a 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 sales 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 a Form 13H with the SEC.

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The definition of “investment discretion” carries the same meaning as in Section 3(a)(35) of the Exchange Act. Specifically, a person exercises “investment discretion” with respect to an account if, directly or indirectly, such person (A) is authorized to determine what securities or other property shall be purchased or sold by or for the account, or (B) 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)(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. In addition, 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 its capital, is presumed to control that entity.

With respect to complex organizations that may have more than one large trader, the rules permit registration at either the parent company level or at the level of the entities exercising investment discretion. A large trader is not required to separately file a Form 13H if the person that controls the large trader complies with all the requirements. Conversely, if one or more persons controlled by a large trader collectively comply with the requirements applicable to such large trader with respect to all of its accounts, the parent company large trader is not required to file a Form 13H. In determining whether to group independent trading persons together at the parent company level or whether to file separately at the subsidiary level, large traders should consider the most efficient approach to accurately tracking the trading for which they exercise investment discretion and to responding to any SEC request to further identify accounts or disaggregate trading data.

#### **Threshold Activity Level to Identify Large Traders**

Rule 13h-1(a)(7) defines “identifying activity level” as aggregate transactions in NMS securities that are equal to or exceed:

- 2 million shares or \$20 million during any calendar day, or
- 20 million shares or \$200 million during any calendar month.

The transactions that count towards the calculation of a large trader’s identifying activity level are all transactions in NMS securities, excluding the following transactions:

- the purchase or sale of such securities pursuant to exercises or assignments of option contracts;
- any entry made to an account to record or memorialize the receipt or delivery of funds or securities pursuant to the settlement of a transaction;
- any transaction that is part of an offering of securities (whether or not subject to registration under the Securities Act of 1933), except for an offering of securities effected through a national securities exchange;
- any transaction that is a gift;
- any transaction involving a distribution of a decedent’s estate;
- any transaction effected pursuant to a court order or judgment;

- any transaction pursuant to a rollover of qualified plan or trust assets subject to Section 402(a)(5) of the Internal Revenue Code;
- any transaction between an employer and employee as part of an issuer benefit plan or compensatory arrangement; and
- any transaction to effect a business combination, including a reclassification, merger, consolidation, or tender offer subject to Section 14(d) of the Exchange Act.

#### Registration of Large Traders

A large trader will be required to file a Form 13H with the SEC promptly after effecting transactions that reach the prescribed trading activity level. The SEC declined to specify a particular time period for the filing, preferring to retain the “promptly” standard, to underscore the need for filings to be made without delay, while affording filers some flexibility. In the adopting release, the SEC noted that under normal circumstances the Form 13H should be filed within 10 days after the large trader reaches the identifying trading activity level.

If a person nears the identifiable trading activity threshold, such person may voluntarily register as a large trader to reduce its need to actively monitor its trading levels. Any person that elects to voluntarily file will be treated as a large trader, and will be subject to all of the obligations under Rule 13h-1.

Information to be reported in the Form 13H includes, among other things:

- the identity and description of the large trader, including a general description of the large trader’s trading strategies;
- reference to any other SEC filings made by the large trader;
- whether the large trader is registered with the Commodity Futures Trading Commission or regulated by a foreign regulator;
- information on affiliates that exercise investment discretion over NMS securities;
- information about the governance of the large trader, including the identities of partners, executive officers, directors or trustees, as the case may be; and
- information on the broker-dealers at which the large trader has accounts.

The Form 13H must be submitted electronically through EDGAR, but will not be accessible through the SEC’s website or otherwise publicly available.

Upon the initial filing of a Form 13H, a large trader will thereafter be required to file the form annually 45 days after the end of each calendar year. The large trader will also be required to amend the form promptly following the end of each calendar quarter if the information contained in the Form 13H becomes inaccurate during such quarter. A large trader may also voluntarily file an amended Form 13H more frequently than quarterly, at its discretion. If a large trader does not effect any transaction that reaches the prescribed activity level in a calendar year, the trader may file a Form 13H to claim inactive status and thereafter be relieved from the ongoing filing obligations. However, if an “inactive” large trader effects transactions that reach the identifying activity threshold, it must promptly after effecting such transactions file a Form 13H with the SEC to report its “Reactivated Status.”

Finally, a large trader may permanently end its large trader status by submitting a termination filing under certain narrow circumstances where there is no possibility of it requalifying for large trader status in the future.

#### **Disclosure to Broker-Dealers**

Each large trader that files a Form 13H will be assigned a unique identification number (LTID) by the SEC. The purpose of the LTID is to enable the SEC to identify and analyze trading activity by large traders. The SEC encourages large traders to assign LTID suffixes to sub-identify persons, divisions, groups and controlled entities to more accurately and efficiently track the trading activity within a large trader.

Large traders will be required to disclose to registered broker-dealers effecting transactions on their behalf their LTID and each account with such broker-dealer to which it applies. This is an ongoing responsibility that is required to be discharged promptly.

#### **Recordkeeping, Reporting and Monitoring Requirements**

The new rule imposes recordkeeping, reporting, and limited monitoring requirements on certain registered broker-dealers through whom large traders execute their transactions. Pursuant to Rule 13h-1(d), registered broker-dealers are required to maintain records for all transactions with respect to accounts identified by their customers reporting their status as large traders (or if the registered broker-dealer is also a large trader, with respect to its own accounts).

Registered broker-dealers are to maintain and report data similar to the data required under the current Electronic Blue Sheets ("EBS") system – which includes, among other things, account number, type and symbol of security and transaction price. Additionally, registered broker-dealers are required to maintain and report the LTID and the time a transaction occurs.

Registered broker-dealers are required to make transaction data available to the SEC if such transaction falls within the "reporting activity level." The reporting activity level includes: (1) each transaction in NMS securities that equals or exceeds 100 shares during a calendar day, (2) any other transaction in NMS securities effected in a single account during a calendar day that a registered broker-dealer may deem appropriate, or (3) such other amount as may be established by the SEC. 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.

#### **Unidentified Large Traders**

Registered broker-dealers are also required to monitor whether any of their customers would meet the large trader threshold (based on transactions handled at the broker-dealer) in order to encourage compliance by their customers with the requirements to identify themselves as large traders to the SEC. If the registered broker-dealer "knows or has reason to know" that a person may be a large trader where such person has not complied with the identification requirement applicable to large traders, then the registered broker-dealer is required (for purposes of the recordkeeping and reporting provisions noted above) to treat such person as an "Unidentified Large Trader."

The SEC notes two methods whereby a registered broker-dealer may determine that it has no reason to know that a person is a large trader. First, the broker-dealer may simply conclude, based on its knowledge, that it has no reason to expect that such transactions meet the identifying activity level. Second, the registered broker-dealer may take advantage of the “safe harbor,” whereby a registered broker-dealer would not be deemed to know or have a “reason to know” that its customer is an Unidentified Large Trader if (1) it does not have actual knowledge that the customer is a large trader, and (2) it established and maintained policies and procedures reasonably designed to identify customers whose trading activity exceeds the identifying activity level, and, treats any customer that exceeds the identifying activity level as Unidentified Large Traders, and notifies such customer of its potential obligation to comply with the rule as a large trader. For purposes of determining whether a registered broker-dealer has reason to know that a person is a large trader, the registered broker-dealer need only take into account transactions effected by or through such broker-dealer.

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

Rule 13h-1 does not require a broker-dealer to stop doing business with an Unidentified Large Trader. Rather, the rule requires broker-dealers to maintain information on Unidentified Large Traders, and to report that information to the SEC upon request.

#### Foreign Entities

Non-U.S. entities that meet the definition of a large trader are required to comply with the identification requirements of the rule and to file reports on Form 13H. However, the recordkeeping and reporting requirements apply only to U.S. registered broker-dealers.

Many non-U.S. traders do not have a direct relationship with a U.S. registered broker-dealer, and utilize non-U.S. intermediaries. U.S. registered broker-dealers may identify non-U.S. intermediaries that exceed the identifying activity level, and inform the intermediary that it may be a large trader under Rule 13h-1. In such cases, the non-U.S. intermediary will then bear the principal burden of compliance in determining whether it is a large trader.

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This alert is not intended to provide legal advice, and no legal or business decision should be based on its content. Any questions concerning the issues addressed in this alert may be directed to:

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