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SEC Proposes Large Trader Reporting Regime

Investment Funds Alert

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On April 14, 2010, the Securities and Exchange Commission (SEC) unanimously proposed a new reporting regime for persons whose transactions in NMS securities—together with persons subject to its control—equal or exceed (1) two million shares or $20 million during any calendar day or (2) 20 million shares or $200 million during any calendar month (a “Large Trader”). Under the proposed regime, a Large Trader would be required to electronically file a Form 13H with the SEC and update the Form 13H either annually or, if the information contained therein changed, quarterly.

After the filing of the Form 13H, the SEC would provide the Large Trader with a large trader identification number (LTID). The Large Trader would then notify its broker-dealers of the accounts that it directly or indirectly controls and provide its LTID. Each broker-dealer would associate the relevant accounts with the LTID and make specified information available to the SEC staff upon request. The SEC staff would use the Large Trader reporting system to reconstruct trading activity as an aid to detecting fraud or market manipulation. All information collected from Large Traders and broker-dealers would be considered confidential.

Background

The U.S. Congress added Section 13(h) to the Securities Exchange Act of 1934 (the “Exchange Act”) through the Market Reform Act of 1990 in order to improve transparency of market information to the SEC. Section 13(h) allows the SEC to promulgate rules and regulations to request information from “large traders,” as defined by the SEC. While the SEC, in 1991 and again in 1994, proposed rules to enact the Large Trader reporting system contemplated in Section 13(h), the SEC ultimately decided to rely on reporting of trading information by broker-dealers through a modified version of the preexisting Electronic Blue Sheets (EBS) system. Broker-dealers’ delay in providing information through the EBS system and the SEC’s desire to immediately gather information on accounts that are coordinated through a single trader contributed to the SEC decision to implement a reporting system focused on traders pursuant to its authority under Section 13(h).

Form 13H Filing

Pursuant to proposed Rule 13h-1 under the Exchange Act, any person, including a foreign person, that effects transactions for the purchase or sale of any NMS security by or through registered broker-dealers in excess of (1) two million shares or $20 million during any calendar day or (2) 20 million shares or $200 million during any calendar month (the “Identifying Activity Level”) would be required to promptly file a Form 13H with the SEC identifying itself as a Large Trader (unless a control person or a group of entities that the trader controls has already filed a Form 13H with respect to its accounts). Potential Large Traders would be required to include transactions on behalf of all accounts over which they exercise investment discretion, including accounts that they indirectly control. Also, whether a person has engaged in transactions in excess of the Identifying Activity Level would be calculated on an aggregate basis, with shares underlying options purchased or sold and without offsetting or netting opposite-way purchase and sale transactions, even if the transactions were for hedging purposes.

Unless it becomes inactive, a Large Trader would be required to update its Form 13H within 45 days after the end of each calendar year and promptly following the end of a calendar quarter in the event that any information contained in the Form 13H becomes inaccurate. A Large Trader would, however, be allowed to suspend its filing obligation for any period in which the Large Trader does not trade securities in excess of the Identifying Activity Level.

Form 13H would require (1) the name and contact information of the Large Trader, (2) the businesses of the Large Trader, (3) the names of any forms that the Large Trader and its affiliates file with the SEC, (4) information on other government entities that regulate the Large Trader and its affiliates, including, but not limited to, the Commodity Futures Trade Commission, the Federal

Reserve Board or other banking regulators, insurance boards and foreign regulators, (5) information regarding affiliates that own NMS securities, (6) information regarding each officer, director, trustee, general partner and each limited partner with more than a 10 percent financial interest in the Large Trader, (7) account number and broker-dealer information regarding each account over which the Large Trader has investment discretion and (8) the principal place of business and jurisdiction of organization of the Large Trader. For a link to proposed Form 13H excerpted from the SEC's proposing release, click **[here]**

Role of Broker-Dealer

After a Large Trader files a Form 13H, it would be required to notify each broker-dealer maintaining an account on its behalf of its LTID, allowing the broker-dealer to associate each identified account with an LTID. The broker-dealer would be required to maintain the following information with regard to each transaction in such account: (1) the clearing house number of the entity maintaining the information and the clearing information on the opposite side of the transaction, (2) the symbol traded, (3) the date of the execution of the transaction, (4) the number of shares or option contracts and the type of transaction, (5) the transaction price, (6) the account number, (7) the exchange or other market center on which the transaction was executed, (8) whether the account is a broker-dealer proprietary account, (9) an identifier for transactions transferred to or from another broker-dealer for execution, (10) the depositary institution through which the transaction was processed, (11) the time that the transaction was executed and (12) the LTID.

Broker-dealers would be required to make any of the foregoing information available upon request of the SEC the morning after the transactions are effected (including Saturdays and holidays). Upon the request of the SEC, the broker-dealer would be required to electronically file such information with the SEC through the EBS system before the close of business on the date specified in the request.

Broker-dealers would be required to comply with the above requirements for all Large Traders, including any Large Trader that has neither filed a Form 13H nor provided its LTID to the broker-dealer (an "Unidentified Large Trader"). Broker-dealers would, however, be able to take advantage of a safe harbor if the broker-dealer implemented policies to monitor for Unidentified Large Traders and informed Unidentified Large Traders of their obligation to file a Form 13H.

Conclusion

While the Form 13H filing requirement for Large Traders would not be particularly burdensome to investment managers, the SEC would be able to use the immediately available information from broker-dealers through EBS to investigate trading occurring at the same time as a material transaction, such as the public announcement of an acquisition.

CONTACT INFORMATION

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