

Investment Funds Alert

SEC Adopts Large Trader Reporting Regime

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On July 26, 2011, the Securities and Exchange Commission (SEC) unanimously adopted a new reporting regime for persons whose transactions in NMS securities¹—together with transactions of persons subject to their control—equal or exceed (i) two million shares or shares with a fair market value of \$20 million during any calendar day or (ii) 20 million shares or shares with a fair market value of \$200 million during any calendar month (a “Large Trader”). A Large Trader will be required to electronically file a Form 13H with the SEC and update the Form 13H either annually or, if the information contained in the form has changed, quarterly.

After the initial filing of the Form 13H, the SEC will provide the Large Trader with a unique large trader identification number (LTID). The Large Trader will then notify its broker-dealers of the accounts that it directly or indirectly controls and provide its LTID. Each broker-dealer will associate the relevant accounts with the LTID and make specified information available to the SEC staff upon request. The SEC staff will 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 will be considered confidential and will not be subject to the Freedom of Information Act.

Large Traders must file their first Form 13H within 120 days after the adopting release is published in the *Federal Register*. Rule 13h-1 under the Securities Exchange Act of 1934 (the “Exchange Act”) implementing the reporting regime will become effective 60 days after the adopting release is published in the *Federal Register*.

Background

The U.S. Congress added Section 13(h) to 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 pre-existing 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

¹ An NMS security is generally any security, including options, listed on a national securities exchange, regardless of the venue through which such security is purchased or sold.



the SEC's recent decision to require broker-dealers to retain information regarding the ultimate parent trader and require Large Traders to self-identify pursuant to its authority under Section 13(h).

Filing Thresholds

Pursuant to Rule 13h-1 under the Exchange Act, any person, including a foreign person, that effects transactions for the purchase or sale of NMS securities by or through registered broker-dealers in excess of (i) two million shares or shares with a fair market value of \$20 million during any calendar day or (ii) 20 million shares or shares with a fair market value of \$200 million during any calendar month (the "Identifying Activity Level") will be required² to promptly file a Form 13H with the SEC identifying itself as a Large Trader. Potential Large Traders will be required to include transactions on behalf of all accounts over which they exercise investment discretion,³ including accounts that they directly or indirectly control.⁴ Also, whether a person has engaged in transactions in excess of the Identifying Activity Level will be calculated on an aggregate basis, without offsetting or netting opposite-way purchase and sale transactions, even if the transactions were for hedging purposes. Also, shares underlying options purchased or sold will be aggregated for purposes of computing the Identifying Activity Level.

Several types of acquisitions or dispositions will not be included within the definition of "transaction." The purchase or sale of shares pursuant to the exercise or assignment of an option contract would not be included as a transaction in order to avoid double counting. Certain other acquisitions or dispositions will be excluded because they are not the type of arm's-length purchases and sales in the secondary markets that are contemplated by the rule, such as (i) a primary offering of securities that is not conducted through a national securities exchange, (ii) a gift, (iii) a transaction in the distribution of a decedent's estate, (iv) a transaction that was ordered by a court, (v) a rollover of a qualified plan or trust assets, (vi) a transaction between an employer and its employees primarily for the purpose of an issuer benefit plan or compensatory arrangement, (vii) a transaction to effect a business combination, an issuer tender offer or other stock buyback, (viii) a stock loan or equity repurchase agreement or (ix) any journal entry made to an account to record or memorialize the receipt or delivery of funds or securities pursuant to the settlement of a transaction.

² A trader may also opt to be included in the Large Trader regime even if its transactions do not exceed the Identifying Activity Level.

³ 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, (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, or (C) otherwise exercises such influence with respect to the purchase and sale of securities or other property by or for the account as the Commission, by rule, determines, in the public interest or for the protection of investors, should be subject to the operation of the provisions of this title and the rules and regulations thereunder." (Section 3(a)(35) of the Exchange Act.) Rule 13h-1 slightly changes the definition in that a person's employees who exercise investment discretion within the scope of their employment are deemed to do so on behalf of their employer.

⁴ "Control" means 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 percent or more of a class of voting securities of an entity or has the power to sell or direct the sale of 25 percent 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 percent or more of the capital, is presumed to control that entity.

Form 13H Filings

A person must file a Form 13H promptly (no later than 10 days) after its transactions exceed the Identifying Activity Level for the month or calendar day. Unless it becomes inactive, a Large Trader must 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 will, however, be allowed to suspend its filing obligation if the Large Trader has not traded securities in excess of the Identifying Activity Level at any time during the preceding year.

Form 13H will require (i) the name and contact information of the Large Trader and its authorized person, (ii) the businesses of the Large Trader and each affiliate that exercises investment discretion over NMS securities (a "Securities Affiliate"), (iii) the names of any forms that the Large Trader and its Securities Affiliates file with the SEC, (iv) information regarding whether the Large Trader or its Securities Affiliates are regulated by the Commodity Futures Trade Commission or foreign regulators and, if regulated by a foreign regulator, the name of the regulator, (v) information regarding each Securities Affiliate that owns NMS securities, including its relationship to the Large Trader and an organizational chart, (vi) information regarding each officer, director, trustee and general partner as well as each limited partner with more than a 10 percent financial interest in the Large Trader, (vii) information regarding each broker-dealer account over which the Large Trader or any of its Securities Affiliates has investment discretion and (viii) the principal place of business and jurisdiction of organization of the Large Trader.

The Form 13H filing obligations of subsidiaries or other controlled persons will be satisfied if a controlling person files a Form 13H relating to the controlled persons' accounts and otherwise complies with the requirements of Rule 13h-1 applicable to Large Traders.⁵ Likewise, if each of a Large Trader's subsidiaries complies with Rule 13h-1 and reports each account for which a parent Large Trader has investment discretion, a parent Large Trader would not be required to file a Form 13H. 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 will be required to communicate its LTID to each broker-dealer carrying an account on its behalf, thereby allowing the broker-dealer to associate each identified account with an LTID. The broker-dealer will be required to maintain the following information with regard to each transaction in such account: (i) the clearing house number of the entity maintaining the information and the clearing information on the opposite side of the transaction, (ii) the symbol traded, (iii) the date of the execution of the transaction, (iv) the number of shares or option contracts and the type of transaction, (v) the transaction price, (vi) the account number, (vii) the exchange or other market center on which the transaction was executed, (viii) whether the account is a broker-dealer proprietary account or a customer account, (ix) an identifier for transactions transferred to or from another broker-dealer for execution, (x) the depository institution through which the transaction was processed, (xi) the time that the transaction was executed and (xii) the LTID.

⁵ A Large Trader that is filing for multiple subsidiaries or units will be permitted to add a suffix to the end of its LTID to track its subsidiary activities separately.

Broker-dealers will 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 will 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 will 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 will, however, be able to take advantage of a safe harbor if the broker-dealer has established policies and procedures that are reasonably designed to monitor for Unidentified Large Traders, retains the above-specified information for Unidentified Large Traders and informs Unidentified Large Traders of their obligation to file a Form 13H.

Conclusion

Investment advisers need to either begin monitoring their number and amount of transactions to ensure that they do not exceed the Identifying Activity Level or plan to voluntarily file a Form 13H.

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