

Financial Services

August 3, 2011

SEC Adopts Large Trader Reporting Rule

Overview

The Securities and Exchange Commission adopted the “large trader” reporting rule on July 26, 2011.¹ New Rule 13h-1 will require all “large traders” to register with the SEC on Form 13H and obtain a unique large trader identification number, which the large trader must then provide to its registered broker-dealers. Broker-dealers must maintain the records specified in Rule 13h-1 for all large traders and provide large trader transaction information to the SEC upon request. Broker-dealers will provide the required information to the SEC through the Electronic Blue Sheets system currently used by broker-dealers for reporting trade information.

As described in more detail below, large traders are defined as traders with aggregate transactions in NMS securities (listed options and equities) that are equal to or greater than (i) 2 million shares or shares with a fair market value of \$20 million per calendar day or (ii) 20 million shares or shares with a fair market value of \$200 million per calendar month.

Rule 13h-1 will be effective October 3, 2011. Large traders will have until December 1, 2011, to comply with the registration requirements of the rule. Broker-dealers will have until April 30, 2012, to comply with the requirements to maintain records, report transaction data when requested and monitor large trader activity.

Definition of “Large Trader”

The SEC states that 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. The parent company can comply with the registration requirement on behalf of its subsidiaries or other entities that it controls. Alternatively, the rule permits a controlled entity to file Form 13H, in which case the Commission would assign large trader identifiers with a reference to the other related entities disclosed on Form 13H.

Rule 13h-1 defines a “large trader” as any person that “directly or indirectly, including through other persons controlled by such person, exercises investment discretion over one or more accounts and effects transaction 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.”² As noted above, the “identifying activity level” is 2 million shares or shares with a fair market value of \$20 million per calendar day or (ii) 20 million shares or shares with a fair market value of \$200 million per calendar month.³

¹ The Securities and Exchange Commission adopted new Rule 13-1 and Form 13H under Section 13(h) of the Securities Exchange Act of 1934.

² Rule 13h-1(a)(1).

³ Rule 13h-1(a)(7).

For more information, please contact your Katten Muchin Rosenman LLP attorney, or any of the following members of Katten’s **Financial Services Practice**.

Janet M. Angstadt

312.902.5494 / janet.angstadt@kattenlaw.com

Daren R. Domina

212.940.6517 / daren.domina@kattenlaw.com

Joseph Iskowitz

212.940.6351 / joseph.iskowitz@kattenlaw.com

Ross Pazzol

312.902.5554 / ross.pazzol@kattenlaw.com

Marybeth Sorady

202.625.3727 / marybeth.sorady@kattenlaw.com

James D. Van De Graaff

312.902.5227 / james.vandegraaff@kattenlaw.com

It is important to note that the term “investment discretion” in Rule 13h-1 has the same meaning as in Section 3(a)(35) of the Securities Exchange Act of 1934.⁴ In this way, it is possible that an investment adviser could become a large trader under the rule.⁵

The definition of “control” under Rule 13h-1 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.”⁶ 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” the entity.⁷ The rule does not state whether this presumption is rebuttable and the Commission does not address this in the adopting release.

Aggregation of Transactions

To determine whether a person meets the identifying activity level, Rule 13h-1 requires that a person count the volume or fair market value of the equity securities and the volume or fair value of underlying transactions in options for both purchases and sales. The rule does not provide for any offsets or netting of positions within an entity or entities.

Certain transactions are not included within the scope of the rule, such as the exercise or assignment of options. Other transactions excluded from the rule are over-the-counter securities offerings, gifts, stock loan or equity repurchase agreements, tender offers and issuer stock buybacks.⁸

Registration and Timing of Filings

A large trader is required to register by filing Form 13H with the SEC. Rule 13h-1 requires that the filing be made “promptly” after the large trader transactions meet or exceed the volume or market value thresholds under the rule.⁹ While the rule does not provide a specific time frame for the filing, the Commission stated in the adopting release that it expects entities subject to the registration requirement to file the Form 13H within 10 days of reaching the identifying activity level.¹⁰ Once a large trader has a large trader identification number, the large trader is required to disclose the trader identification number to the registered broker-dealers effecting transactions on its behalf.

After the initial filing, large traders must update the information on Form 13H following the end of a calendar quarter in the event the filing becomes inaccurate for any reason.¹¹ On an annual basis, large traders must file Form 13H within 45 days after the end of the full calendar year. If a large trader no longer meets the identifying activity level or terminates its operations, the large trader can indicate this status upon filing a Form 13H. In either case, the entity no longer has a filing obligation unless and until the entity meets the identifying activity level again.

Monitoring, Recordkeeping and Reporting Obligations of Broker-Dealers

Broker-dealers that themselves are large traders or broker-dealers that carry the account for a large trader must maintain the records required by Rule 13h-1. This information is generally the data already required of broker-dealers through the Electronic Blue Sheet system with the addition of the time of order execution and the large trader identifying number. Should a broker-dealer receive a request for records, the records must be available on the morning of T+1 (including on Saturdays and holidays).¹²

⁴ Rule 13h-1(a)(4). 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” 15 U.S.C. 78c(3)(a)(35) (2011).

⁵ 76 Fed. Reg. 46960, 46965 n. 42 (Aug. 3, 2011).

⁶ Rule 13h-1(a)(3).

⁷ *Id.*

⁸ Rule 13h-1(a)(6).

⁹ Rule 13h-1(b)(1)(i).

¹⁰ 76 Fed. Reg. 46960, 46970 n. 93 (Aug. 3, 2011).

¹¹ Rule 13h-1(b)(iii).

¹² Rule 13h-1(e).

Under the rule, a registered broker-dealer also is required to monitor whether its customers meet the threshold levels that define a large trader. A registered broker-dealer is required to treat any person as an “unidentified large trader” that the broker-dealer knows or has reason to know is a large trader and such person has not complied with applicable large trader requirements.¹³ There is, however, a safe harbor provision for broker-dealers that (1) implement policies and procedures reasonably designed to identify customers whose trading activity exceeds the identifying activity level; (2) treat such customers as unidentified large traders for the purposes of Rule 13h-1; and (3) notify such customers of their potential obligations to comply with large trader requirements (e.g., registration).¹⁴

Foreign Entities

Foreign entities that meet the standards for large traders are also subject to Rule 13h-1.¹⁵ The rule requires that a foreign entity that is a large trader identify itself to the Commission on Form 13H. The foreign entity would not be subject to the recordkeeping and reporting obligations of Rule 13h-1(d) or (e), as those responsibilities only pertain to U.S. broker-dealers.¹⁶

The SEC final rules may be found [here](#).

¹³ Rule 13h-1(a)(9).

¹⁴ Rule 13h-1(f).

¹⁵ 76 Fed. Reg. 46960, 46980-81 (Aug. 3, 2011).

¹⁶ *Id.*

Katten

KattenMuchinRosenman LLP

www.kattenlaw.com

CHARLOTTE CHICAGO IRVING LONDON LOS ANGELES NEW YORK OAKLAND WASHINGTON, DC

Published as a source of information only. The material contained herein is not to be construed as legal advice or opinion.

©2011 Katten Muchin Rosenman LLP. All rights reserved.

Circular 230 Disclosure: Pursuant to regulations governing practice before the Internal Revenue Service, any tax advice contained herein is not intended or written to be used and cannot be used by a taxpayer for the purpose of avoiding tax penalties that may be imposed on the taxpayer. Katten Muchin Rosenman LLP is an Illinois limited liability partnership including professional corporations that has elected to be governed by the Illinois Uniform Partnership Act (1997). London affiliate: Katten Muchin Rosenman UK LLP.