

November 9, 2011

Large Trader Reporting FAQs

I. Introduction and Overview

Recently, the Securities and Exchange Commission (“SEC”) adopted its proposed Large Trader reporting rule, Rule 13h-1,¹ along with Form 13H, a reporting form designed to enhance the ability of the SEC to identify large market participants, collect information on their trading, and analyze their trading activity.²

Below we have provided a list of what we view as frequent questions relating to the new rule and the new form.

II. Frequently Asked Questions

1. What is a “Large Trader”?

A “Large Trader” is generally defined as a person, including a firm or individual, whose transactions in “NMS securities” (as defined in Item 4 below) equal or exceed (i) two million shares or \$20 million during any calendar day or (ii) 20 million shares or \$200 million during any calendar month.³ 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. Large Traders must identify themselves to the SEC using the new form 13H, and they must identify themselves to US broker-dealers with which they do business.

2. What is the identifying activity level (i.e., threshold) for Form 13H?

The identifying activity level is aggregate transactions in NMS securities that equal or exceed 2 million shares or \$20 million during any calendar day, or 20 million shares or \$200 million during any calendar month. Certain transactions are excluded from the identifying activity level for purposes of identification of Large Traders.

¹ The new rule (“Adopted Rule”) is described in “Large Trader Reporting” SEC Release 34-64976 (Jul. 27, 2011), 75 Fed. Reg. 46960 (Aug. 3, 2010), currently available at: <http://www.sec.gov/rules/final/2011/34-64976.pdf> (the “Adopting Release”).

² For a detailed discussion of the Adopted Rule, see our previous client publication, which is available at <http://www.shearman.com/preparing-for-large-trader-reporting-10-07-2011/>.

³ See Adopted Rule 13h-1(a)(1).

Those transactions are:

- any journal or bookkeeping 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 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;
- any transaction that constitutes a gift;
- any transaction effected by a court-appointed executor, administrator, or fiduciary pursuant to the distribution of a decedent's estate;
- any transaction effected pursuant to a court order or judgment;
- any transaction effected pursuant to a rollover of qualified plan or trust assets subject to Section 402(c)(1) of the Internal Revenue Code;
- any transaction between an employer and its employees effected pursuant to the award, allocation, sale, grant or exercise of an 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; and
- any transaction to effect a business combination, including a reclassification, merger, consolidation, or tender offer subject to Section 14(d) of the Securities Exchange Act, an issuer tender offer or other stock buyback by an issuer, or a stock loan or equity repurchase agreement.

3. How does a firm aggregate its transactions for purposes of determining the identifying activity level?

Market participants should use a “gross up” approach in calculating their activity levels. Accordingly, offsetting or netting transactions among or within accounts, even for hedged positions, would be added to a participant's activity level in order to show the full extent of a trader's purchase and sale activity. This approach reflects the fact that substantial trading activity has the potential to impact the market regardless of the trader's net position.

When aggregating transactions, the Large Trader should determine across all of the accounts over which it has investment discretion:

- The volume or fair market value of transactions in equity securities and the volume or fair market value of the equity securities underlying transactions in options on equity securities, purchased and sold; and
- The fair market value of transactions in options on a group or index of equity securities (or based on the value thereof), purchased and sold.

4. What is an “NMS security”?

An NMS security is “any security or class of securities for which transaction reports are collected, processed, and made available pursuant to an effective transaction reporting plan, or an effective national market system plan for reporting transactions in listed options.” This would generally include any security or class of securities listed on national exchanges or traded through NASDAQ, including equities and options (e.g., common stock, ETFs, ADRs, etc.). We have been informed by FINRA, the U.S. self-regulatory organization responsible for broker-dealers, that they consider the list of OATS-eligible securities to be a complete list of NMS securities.⁴

5. What is the definition of a “Person” for purposes of this Rule?

The Rule indirectly defines “person” to include “two or more persons acting as a partnership, limited partnership, syndicate, or other group, but does not include a foreign central bank.”⁵ Therefore, a non-US central bank will be exempt from Large Trader reporting. The SEC has not, however, commented on the status of sovereign wealth funds, including those that trade (in whole or in part) the funds of a foreign central bank.

6. What are the implementation dates?

The Adopted Rule became effective on October 3, 2011 (“Effective Date”).

Based on this Effective Date, the following are key dates:

- **On or before December 1, 2011:** Persons whose trading since the Effective Date qualifies them Large Traders must self-identify on Form 13H pursuant to Adopted Rule 13h-1(b).
- **On or before February 14, 2012:** Deadline for annual filing of Form 13H.
- **April 30, 2012:** Deadline for US-registered broker-dealers to implement the recordkeeping and reporting requirements applicable pursuant to Adopted Rules 13h-1(d), (e), and (f).
- **Within 10 days after the end of any calendar quarter:** Large Traders are required to amend any inaccurate or changed information promptly following the end of the calendar quarter (in no event later than January 10, 2012).⁶
- If a person becomes a Large Trader after December 1, 2011, that person must “**promptly**” file Form 13H with the SEC identifying itself as a Large Trader. The SEC states that what constitutes “prompt” filing will differ in different contexts, but that it would be “appropriate” for such filings to be made within 10 days after the Large Trader effects aggregate transactions at or above the identifying activity levels noted above.

⁴ That list is available at <http://www.finra.org/Industry/Compliance/MarketTransparency/OATS/>

⁵ Under Rule 13h-1, the term “person” has the same meaning as in Section 13(h)(8)(E) of the Securities Exchange Act of 1934, which incorporates Section 3(a)(9) of the Exchange Act.

⁶ Note that an amended filing of Form 13H must be filed promptly following the end of the calendar quarter in which any of the information contained in a Form 13H filing becomes inaccurate for any reason. As noted below, the SEC has provided interpretive guidance that in the context of Form 13H, a filing required to be made “promptly” would be made within 10 days of the applicable deadline.

7. What are the different types of filings that are required to be made on Form 13H?

Form 13H is a web-based form required by Rule 13h-1 under the Securities Exchange Act of 1934 (“Exchange Act”) to identify Large Traders. There are six types of Form 13H filings:

- **Initial Filing** – The Initial Filing is made to identify the Large Trader to the SEC. The requirement for Initial Filings due by the compliance date, December 1, 2011, is described above. Beginning November 21, 2011, the Initial Filing is due promptly (within 10 days) after the Large Trader meets or exceeds the identifying activity level.
- **Annual Filing** – All Large Traders must submit an Annual Filing of Form 13H within 45 days after the end of each full calendar year.
- **Amended Filing** – If any inaccuracy is found in a filing, an Amended Filing must be filed promptly following the end of the calendar quarter in which any of the information contained in a Form 13H filing becomes inaccurate for any reason. For example, changes to the name, business address, organization type, or organizational chart would require an amended filing.
- **Inactive Status** – If a trader or other person does not meet or exceed the identifying activity level, it would not be required to file Form 13H. In addition, if a person does not anticipate meeting the identifying activity level again (and has not met it during the previous full calendar year) it may file for “Inactive Status”. This filing permits a Large Trader who has not effected aggregated transactions over the threshold during the previous full calendar year to obtain Inactive Status through the submission of Form 13H. Inactive Status is designed to reduce the burden on infrequent traders who may trip the threshold in a limited on-off situation.⁷
- **Reactivated Status** – If an adviser on Inactive Status meets or exceeds the identifying activity level, it must file for Reactivated Status promptly (generally, within 10 days).
- **Termination Filing** – Persons can terminate their status as Large Traders by submitting a Termination Filing. For example, if the person ceases operations, dissolves, or is acquired, the Large Trader may be able to file a Termination Filing.

8. In a corporate group, who reports as a Large Trader?

The Adopted Rule is designed to focus on the ultimate parent entity that controls the persons making investment decisions. In this regard, the SEC notes that an ownership level of 25% would generally give rise to “control” for purposes of the Large Trader designation.⁸

Multiple persons within a corporate group may, however, qualify as Large Traders. If a natural person or a subsidiary entity within a large organization independently qualifies as a Large Trader, a parent company of that Large Trader is permitted to file on Form 13H and identify itself as the Large Trader on behalf of the group, thus removing the requirement of the

⁷ Filers on Inactive Status do not need to file Amended Filings or Annual Filings and can instruct their registered broker-dealers to cease maintaining records. A Large Trader on Inactive Status does not need to file any amendments.

⁸ See the Adopting Release at page 23.

subsidiary to separately identify itself as a Large Trader, file Form 13H, or be subject to the other requirements that would apply to Large Traders. Similarly, a parent entity may avoid the filing requirement if one or more Large Traders controlled by that parent company comply with the rule and the filing requirement.⁹

9. Are non-US entities that are Large Traders subject to a specific exemption? If a non-US entity effects transactions through a non-US intermediary, what are the required actions?

The Adopted Rule requires a non-US entity that is a Large Trader to comply with the identification requirements of Form 13H. With respect to the recordkeeping and reporting requirements, however, the SEC notes that recordkeeping and reporting requirements of the Adopted Rule explicitly apply only to US-registered broker-dealers.

In the Adopting Release, the SEC provides guidance regarding dealing with non-US intermediaries. The SEC states that when a U.S.-registered broker-dealer deals directly with a non-US entity that is an intermediary, it would treat that intermediary like any other customer: it must collect the information specified by Adopted Rule 13h-1(d)(2) about the non-U.S. intermediary's transactions (if it is a Large Trader) and, if it is an Unidentified Large Trader, the broker-dealer must also collect the information specified by Adopted Rule 13h-1(d)(3).¹⁰ The Adopted Rule does not require a registered broker-dealer to collect identifying information for the non-US intermediary's customers.

10. What are the requirements for U.S.-registered broker-dealers?

The Adopted Rule imposes the following obligations on registered broker-dealers: (1) maintain records of transactions effected in accounts identified to it as Large Trader accounts¹¹; (2) electronically report Large Trader transaction information to the SEC upon request¹²; and (3) monitor compliance with the Adopted Rule.¹³

11. What information must the broker-dealer maintain?

Every U.S.-registered broker-dealer must maintain records for all transactions effected directly or indirectly by or through (i) an account such registered broker-dealer carries for a Large Trader or an Unidentified Large Trader¹⁴ or (ii) if the registered broker-dealer is a Large Trader, any proprietary or other account over which such registered broker-dealer exercises investment discretion.¹⁵ In addition, where a non-broker-dealer carries an account for a Large Trader or an Unidentified

⁹ See Adopted Rule 13h-1(b)(3)(ii).

¹⁰ Adopted Rule 13h-1(d)(3) requires a broker-dealer to maintain the following additional information for an Unidentified Large Trader: name, address, date the account was opened, and tax identification number(s). If an Unidentified Large Trader is a non-US entity and does not have a US-issued tax identification number, then the broker-dealer would only need to maintain the entity's name, address, and date the account was opened.

¹¹ See Adopted Rule 13h-1(d).

¹² See Adopted Rule 13h-1(e).

¹³ See Adopted Rule 13h-1(f).

¹⁴ See Adopted Rule 13h-1(a)(9).

¹⁵ See Adopted Rule 13h-1(d).

Large Trader, the registered broker-dealer effecting transactions directly or indirectly for such Large Trader or Unidentified Large Trader must maintain records of all of the same information.¹⁶

12. What is the safe harbor provision regarding broker-dealer reporting?

Rule 13h-1(f) provides a safe harbor for broker-dealer's that is designed to reduce the burdens related to monitoring customers' trading for purposes of identifying possible Large Traders. Under this provision, 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 this Rule.

To qualify under the safe harbor, the broker-dealer must (i) implement policies and procedures reasonably designed to identify customers whose trading activity exceeds the identifying activity level, (ii) treat such customers as Unidentified Large Traders for purposes of the Rule, and (iii) notify such customers of their potential obligation to comply with the rule as a Large Trader.¹⁷

13. How long will broker-dealers be required to retain records and information under Rule 13h-1?

Registered broker-dealers will be required to retain records and information under Rule 13h-1 for a period of three years, the first two in an accessible place, in accordance with Rule 17a-4 under the Exchange Act.

14. What happens after the Form 13H is filed with the SEC?

When a market participant (including an investment adviser) files Form 13H, they identify themselves as a Large Trader. After receiving the Form 13H, the SEC will assign to each Large Trader an identification number (the "LTID") that will identify the Large Trader (Since the compliance date is December 1, 2011, the SEC will likely begin assigning LTID numbers in the beginning of December. It is yet to be specified how the SEC will communicate the LTID number to Large Traders). The Large Trader must provide the LTID to each of the registered broker-dealers through which it effects securities transactions. The Large Trader also must provide each of the registered broker-dealers with all of the account numbers of accounts beneficially held by the Large Trader at that registered broker-dealer. The SEC is requiring that the broker-dealers report Large Trader transaction information upon its request.

¹⁶ See Adopted Rule 13h-1(d)(2). In particular, the Adopted Rule requires registered broker-dealers to maintain the following transaction information: date the transaction was executed; account number; identifying symbol assigned to the security; transaction price; 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; clearinghouse number of the entity maintaining the information and the clearinghouse numbers of the entities on the opposite side of the transaction; designation of whether the transaction was effected or caused to be effected for the account of a customer of such registered broker-dealer, or was a proprietary transaction effected or caused to be effected for the account of such registered broker-dealer; identity of the exchange or other market center where the transaction was executed; time the transaction was executed; LTID(s) associated with the account, unless the account is for an Unidentified Large Trader; prime broker identifier; average price account identifier; and, if the transaction was processed by a depository institution, the identifier assigned to the account by the depository institution.

¹⁷ See Adopted Rule 13h-1(f)(1).

15. Are there any exceptions to filing Form 13H?

A person would not self-identify as a Large Trader, or could not file on Form 13H, if:

Identifying Activity Level: If a market participant does not meet or exceed the identifying activity level, it would not be required to file Form 13H.

Inactive Status: If a person has not met the identifying activity level during the previous full calendar year, it may file for Inactive Status. An inactive Large Trader does not need to provide its LTID to broker-dealers.

Parent/subsidiary relationships: A subsidiary that would be considered a Large Trader can generally rely on the parent company to file. In addition, a parent company that would be considered a Large Trader can generally rely on its subsidiaries to file instead of the parent company filing.

Exemption: Under Rule 13h-1(g), upon written application or upon its own motion, the SEC may exempt, upon specified terms and conditions or for stated periods, any person or class of persons or any transaction or class of transactions from the provisions of Form 13H reporting to the extent that such exemption is consistent with the purposes of the Exchange Act.

16. Are investment companies or pension fund managers excluded from the definition of a “Large Trader”?

No. In the adopting release, the SEC noted that an investment company is a legal structure for the management of pooled assets by an investment adviser. As such, the investment adviser exercises investment discretion over the assets of the investment company. Accordingly, the SEC determined that exclusion for regulated investment companies would be unnecessary given that an investment adviser to an investment company, like a pension manager to a pension fund, is the entity that exercises investment discretion either solely or in connection with other investment managers.

17. Is the Form 13H public?

No, while Form 13H filings will be processed through EDGAR, once filed, they will not be accessible through the website or otherwise be made publicly available. In addition, the LTID number will not be made publicly available.

18. Is it true that only the trustee of a retirement plan, not the plan sponsor and other parties involved in plan administration, must self-identify as a Large Trader?

No. Rule 13h-1 requires the person who exercises investment discretion over a certain level of transactions to identify as the Large Trader, which may be the trustee but could also, depending on the facts, be the plan sponsor or administrator. However, if neither the plan sponsor nor administrator exercise investment discretion, then neither will be viewed as Large Traders.

III. Conclusion

The adoption of Rule 13h-1 represents a significant change to the reporting obligations for large market participants that fall within the definition of “Large Traders” as well as broker-dealers that facilitate secondary market trading. Firms should take note of the upcoming compliance deadlines and begin developing internal reporting processes to ensure they are adequately prepared to meet these new reporting requirements.

This memorandum is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired.

If you wish to receive more information on the topics covered in this publication, you may contact your regular Shearman & Sterling contact person or any of the following:

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