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Large Trader Reporting Rule: A Temporary Reprieve for Broker-Dealers and Broadening of Exemptions for Capital Markets Transactions

On April 23, 2012, the US Securities and Exchange Commission (“SEC”) issued an order temporarily exempting registered broker-dealers from the Large Trader Identification requirements under Rule 13h-1 (the “Rule”).¹ This temporary exemption was issued in anticipation of the Rule’s original effective date of April 30, 2012, providing covered broker-dealers with additional time to ensure compliance with the recordkeeping, reporting, and monitoring requirements under the Rule. In addition, the SEC granted a permanent exemption for certain capital market transactions for the purposes of the large trader identification requirements.

Introduction and Overview

Rule 13h-1 will require a “large trader,” defined as a person whose transactions in 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 identify itself to the SEC and make certain disclosures to the SEC on Form 13H. Upon receipt of Form 13H, the SEC will assign to each large trader an identification number that will identify the trader, which the large trader must then provide to registered broker-dealers with which it conducts business. Such registered broker-dealers will then be required to maintain records relating to transactions effected through large traders’ accounts and to report large trader transaction information to the SEC upon request. The large trader reporting requirements are designed to provide the SEC with data to support its investigative and enforcement activities, as well as to facilitate the SEC’s ability to assess the impact of large trader activity on the securities markets including reconstructing trading activity following periods of unusual market volatility, and analyzing significant market events for regulatory purposes.

¹ For a detailed discussion of the Large Trader Reporting Rule, including regarding the definition of “large trader” and including answers to frequently asked questions, please refer to our previous client publications, which are available at <http://www.shearman.com/preparing-for-large-trader-reporting-10-07-2011> and <http://www.shearman.com/large-trader-reporting-faqs-11-09-2011>.

DATES: The Rule became effective on April 23, 2012; entities or groups of entities should now be monitoring trading to determine whether they meet the definition of "large trader" under the Rule (and therefore are required to file), or whether voluntary filing as a large trader is advisable.

Overview of the Recordkeeping, Reporting, and Monitoring Requirements of Rule 13h-1

Rule 13h-1 requires certain broker-dealers to (1) maintain records of transactions effected in accounts identified to it as Large Trader accounts; (2) electronically report Large Trader transaction information to the SEC upon request; and (3) monitor compliance with the Rule. Under the Rule, every registered broker-dealer must maintain records for all transactions effected directly or indirectly by or through (i) an account that the registered broker-dealer carries for a Large Trader or an Unidentified Large Trader² 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.

Two-Tiered Temporary Exemption for Broker-Dealers

In its April 23 release, the SEC extended the April 30, 2012 compliance date for registered broker-dealers by 12 months to May 1, 2013; however, certain broker-dealers that are either (a) large traders, or (b) have large trader customers that are either broker-dealers or trade through a "sponsored access" arrangement, must be in compliance by November 30, 2012. The purpose of the extension is to allow broker-dealers additional time to develop, test, and implement recordkeeping and reporting systems required for compliance, alleviating concerns regarding implementation and compliance costs. In the SEC's view, this temporary exemption should facilitate the orderly and meaningful implementation of the recordkeeping requirements and allow broker-dealers the additional time needed to develop, assess, and test their recordkeeping systems.

Permanent Exemption for Certain Capital Market Transactions

In addition to the temporary exemption for broker-dealers, the SEC adopted a permanent exemption for certain capital market transactions in connection with determining whether a person is a large trader. While the Rule originally excluded the vast majority of primary offerings³, certain offerings such as "dribble out" programs or offerings "crossed" on a national securities exchange were not exempted. In response to this, the SEC has determined that these transactions should not be counted for the purpose of determining whether a person meets the identifying activity level for a large trader. The newly exempted transactions are:

- (1) 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, regardless of whether such transaction is effected through the facilities of a national securities exchange; and

² An "Unidentified Large Trader" is a person who has not complied with the large trader registration and self-identification requirements and that a registered broker-dealer knows or has reason to know is a large trader based on such person's transactions in NMS securities effected by or through such broker-dealer.

³ For a detailed description of exempted transactions, please see "Large Trader Reporting FAQs", available at <http://www.shearman.com/large-trader-reporting-faqs-11-09-2011/>.

- (2) sales of securities by a selling shareholder in connection with an initial public offering or in a registered secondary offering if such selling shareholder is a current or former employee of the issuer and the securities being sold were acquired as part of the person's compensation as an employee of the issuer.

Conclusion

Rule 13h-1 represents an important change to the reporting obligations for Large Traders and for registered broker-dealers that facilitate secondary market trading. This temporary reprieve from the SEC should afford broker-dealers the time needed to focus resources toward enhancing their record keeping and reporting infrastructure necessary for compliance under this new regulatory regime. Equally important, the expansion of the list of exempted transactions better matches the list of reportable activities to the regulatory purposes underlying the Rule. Nonetheless, the Rule continues to be an important new compliance requirement for both traders and broker-dealers.

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.

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