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## Reminder: Rule 13h-1 (The Large Trader Reporting Rule) Compliance Date Is December 1, 2011; Effective Date Was October 3, 2011

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On October 3, 2011, the Securities and Exchange Commission's (the "SEC") Rule 13h-1 (the "Rule") became effective. The Rule, which was adopted on July 26, 2011, under Section 13(h) of the Securities and Exchange Act of 1934, as amended, establishes a new reporting system and filing requirements for "large traders" as well as their broker-dealers.<sup>1</sup> Persons meeting the thresholds set forth in the Rule after October 3, 2011 generally must identify themselves to the SEC by December 1, 2011 via a new web-based Form 13H, which is a nonpublic form that will be processed through the SEC's EDGAR system. Broker-dealer obligations under the Rule will begin effective April 30, 2012. A description of the Rule is set forth below.

### Definition Of A Large Trader

The Rule applies to certain "large traders," which are persons who directly or indirectly exercise investment discretion over one or more accounts and effect transactions for the purchase or sale of any NMS security<sup>2</sup> for or on behalf of such accounts in an aggregate amount

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equal to or greater than certain specified thresholds. These "identifying activity level" thresholds are (a) two million shares or \$20 million (determined by fair market value of the shares) in one calendar day, or (b) 20 million shares or \$200 million in one calendar month. Persons engaging in aggregate transactions that reach or surpass these thresholds will generally be required to identify themselves to the SEC via Form 13H and provide an SEC-assigned large trader identifier (LTID) to any broker-dealers through which such transactions are effected. Notwithstanding these thresholds, persons may voluntarily file Form 13H in order to register as a large trader.

In the case of larger organizations in which multiple persons or subsidiaries may individually meet the large trader description, the Rule notes that it is only necessary for the parent company to file Form 13H with the SEC. Additionally, large trader parent companies may voluntarily chose to assign LTID suffixes to subidentify persons, divisions, entities, and affiliates under their control.

### Calculating Activity Thresholds; Excluded Transactions

In order to calculate a trader's activity

level for the purposes of the Rule, traders generally include "all transactions in NMS securities, excluding exercises or assignments of option contracts." It should be noted that while exercises or assignments of option contracts are excluded from the calculation of the identifying activity level, the purchases and sales of options themselves are not. Furthermore, the volume and value of the options purchased or sold are determined with reference to the securities underlying the option. The purpose of this aspect of the Rule is to include the effects that the purchase or sale of options can have on the market and thus include such transactions in the aggregate total for purposes of the identifying activity level but avoid "double-counting" the securities underlying such options by excluding the exercise or assignment of the options from the total. As set forth in the Rule, certain additional securities transactions are also excluded for the purposes of calculating a trader's activity level. Specifically, such excluded transactions include the following:

- any journal or bookkeeping entry made to an account in order 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, as amended, provided, however, that this exemption shall not include an offering of securities effected through the

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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(a)(5) 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 preestablished price pursuant to a plan that 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.

### Form 13H

As discussed above, a large trader is required to identify itself to the SEC by filing Form 13H, which will be effected through the SEC's EDGAR system, and the form will not be made publicly available. Form 13H must be filed promptly after a trader's aggregate transactions reach or exceed the identifying activity levels discussed above. For the purposes of the Rule, the SEC considers a "prompt" filing to be no later than 10 days after the identifying activity level has been reached. Those persons reaching or exceeding the identifying activity between October 3, 2011, and November 21, 2011, will have until December 1, 2011, to file Form 13H.

In addition to the initial filing, a large trader must effect an amended filing promptly after the end of a calendar quarter during which any of the information contained in Form 13H becomes outdated or inaccurate. Large traders may file amended filings more often than quarterly but are not required to do so. Finally, every large trader, regardless of the number of amended filings previ-

ously effected, must file an annual amendment to Form 13H within 45 days of the end of each calendar year. Certain large traders that have not effected aggregate transactions that meet or exceed the identifying activity level in the previous calendar year may request to be considered "inactive" and therefore exempt from the Rule's reporting requirements, until such time as such traders again reach the identifying activity levels.

Form 13H comprises disclosures relating to six items: (1) a trader's line of business and trading strategies; (2) a description of other forms filed with the SEC; (3) registration with other regulators; (4) a trader's organization, which includes a requirement to file an organizational chart; (5) a description of a trader's governance structure (e.g., partnership, LLC), including the identification of executive officers, directors, and/or trustees; and (6) the disclosure of any broker-dealers with which the large trader or any of its affiliates has an account. Although Form 13H is generally straightforward, the breadth of certain defined terms often leads to questions on the scope of required information.

### Responsibilities Of Broker-Dealers

The Rule also creates a number of responsibilities and obligations on the part of registered broker-dealers. First, registered broker-dealers must maintain records for all transactions effectuated, either directly or indirectly, by or through any account carried for a large trader or "Unidentified Large Trader," or any proprietary or other account over which the broker-dealer exercises investment discretion if the broker-dealer is itself a large trader.<sup>3</sup> The term "Unidentified Large Trader" refers to any person or entity that has not yet complied with the identification requirements of Rule 13h-1 but that the broker-dealer knows (or has reason to know) is, in fact, a large trader.<sup>4</sup>

In addition to such record-keeping requirements, the Rule provides for certain reporting requirements for broker-dealers. Primarily, broker-dealers are required to provide to the SEC, upon its request, the information retained pursuant to the record-keeping requirements described above for all transactions that are equal to or greater than the reporting level activity. The reporting level activity is determined on an account-by-account

basis (i.e., not in the aggregate) and can be any of the following:

- each transaction of NMS securities of at least 100 shares effectuated in one calendar day;
- any other transaction in NMS securities effectuated in one calendar day that the broker-dealer deems fit to report; or
- other levels of shares that the SEC deems appropriate from time to time.

### Next Steps

As mentioned above, the effective date of the Rule was October 3, 2011. Any persons meeting or exceeding the identifying activity levels set forth in the Rule on or after such date must prepare and file Form 13H by the Rule's compliance date of December 1, 2011, or within 10 days of triggering the threshold if triggered on or after November 22, 2011. Registered broker-dealers should adopt policies and procedures to ensure compliance with the monitoring, reporting, and record-keeping obligations imposed by the Rule. Such broker-dealers should keep in mind that the compliance date for these items is April 30, 2012.

<sup>1</sup> A copy of the Rule is available at <http://www.sec.gov/rules/final/2011/34-64976fr.pdf>

<sup>2</sup> NMS securities include 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. The term refers generally to exchange-listed securities, including equities and options.

<sup>3</sup> The data that the broker-dealers are required to keep parallels, for the most part, that data required of broker-dealers under the Electronic Blue Sheets ("EBS") system. The only additional data required under Rule 13h-1 is that the broker-dealers must also record the LTID number (unless the transaction is carried out for an Unidentified Large Trader, in which case the broker-dealer is required to maintain records on the person's name, address, date the account was opened, and tax identification number(s)) as well as the time of the transaction. Finally, this data must be available the morning after the date on which the transaction was effectuated, including Saturdays and holidays.

<sup>4</sup> A broker-dealer has reason to know of a person's status as an Unidentified Large Trader only based on the transactions effectuated through that particular broker-dealer. Such broker-dealer does not have an obligation to find out whether other transactions conducted by the person would qualify the person for large trader status. The Rule contains a "safe harbor" provision for broker-dealers who do not identify Unidentified Large Traders as such if they do not have actual knowledge that the entity qualifies as a large trader and if they have policies and procedures in place that are designed to ensure compliance with the identification requirements of the Rule.