

# Legal Update

## REPORTING BY LARGE TRADERS REQUIRED ON FORM 13-H

November 2011

Rule 13h-1 under the Securities Exchange Act of 1934, as amended, became effective on October 3, 2011. The rule imposes certain obligations on “large traders” and brokers in order to gather information on large market participants and their trading activity. This update summarizes these obligations.

### Definition of “Large Trader”

A person is considered to be a “large trader” under Rule 13h-1 if it:

1. Directly or indirectly (including through other persons it controls<sup>1</sup>) exercises investment discretion over one or more accounts; and
2. Effects transactions (as described below) for the purchase or sale of NMS Securities (as defined below) for or on behalf of such account(s), by or through one or

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<sup>1</sup> The term “control” means direct or indirect possession 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. Solely for purposes of Rule 13h-1, 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 that entity.

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more registered broker-dealers, in an aggregate amount equal to or greater than either of the following thresholds (the “Identifying Activity Level”):

- a. 2 million shares or shares with a fair market value of \$20 million during a calendar day; or
- b. 20 million shares or shares with a fair market value of \$200 million during a calendar month.

A person would also be considered a “large trader” if it voluntarily files a Form 13H with the Securities and Exchange Commission (the “SEC”).

“NMS Securities” are securities or classes 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 U.S. exchange-listed securities, including equities and options.

The determination as to whether a person is a large trader will be made with respect to transactions effected on or after October 3, 2011, as follows:

*Prior to November 21, 2011:* If a person became a large trader on or after October 3, 2011 but prior to November 21, 2011, it must identify itself as such by filing a Form 13H with the SEC by December 1, 2011.

*After November 21, 2011:* If a person becomes a large trader on or after November 21, 2011, it must file a Form 13H with the SEC promptly (*i.e.*, generally, within 10 days) after becoming a large trader.

Upon receiving Form 13H, the SEC will assign the large trader a unique identification number (“LTID”). The large trader must then disclose its LTID to the broker-dealers effecting transactions on its behalf and identify to them all accounts to which the LTID applies.

#### Determining Who Should Register as a Large Trader

Rule 13h-1 allows for compliance by control persons. As such, if a control person files a Form 13H and complies with the large trader requirements under the rule, the persons and entities it controls are not required to file Form 13H, even if they are large traders.

The rule also allows for compliance by controlled persons. As such, a parent company is not required to file a Form 13H or comply with the large trader requirements under the rule if one or more persons controlled by it collectively do so. In such a case, each such controlled person would need to identify on its Form 13H its parent company and any affiliates that are filing separately, thereby enabling the SEC to determine which persons are under common control with the parent company.

The individuals who comprise an investment management team do not need to register as large traders so long as the investment manager entity itself (or its parent company) registers as a large trader and complies with all of the requirements for a large trader.

#### Determining Which Transactions Count Towards the Identifying Activity Level

The term “transaction” is broadly defined to mean all transactions in NMS securities, with certain exclusions for transactions that the SEC believes are effected for materially different reasons than those commonly associated with normal arms’ length transactions in the secondary market and the associated exercise of investment discretion.<sup>2</sup> With respect to options, only purchases and sales of the options themselves (and not the exercise or assignments of such options) are required to be counted as transactions. The volume and value of options purchased or sold is determined by reference to their underlying securities.<sup>3</sup> When

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<sup>2</sup> Each of the following transactions is excluded from the definition of “transaction” solely for the purpose of determining whether a person is a large trader: (i) any journal or bookkeeping entry with respect to the settlement of a transaction; (ii) any offering of securities by or on behalf of an issuer, its underwriter or agent (excluding an offering effected through the facilities of a national securities exchange); (iii) gifts; (iv) any transaction effected by a court appointed executor, administrator, or fiduciary pursuant to the distribution of a decedent’s estate; (v) any transaction effected pursuant to a court order or judgment; (vi) any transaction effected pursuant to a rollover of qualified plan or trust assets; (vii) any transaction between an employer and its employees which is primarily for the purpose of an issuer benefit plan or compensatory arrangement; or (viii) any transaction to effect a business combination, including a reclassification, merger, consolidation, or tender offer; an issuer tender offer or other stock buyback by an issuer; or a stock loan or equity repurchase agreement.

<sup>3</sup> For example, a purchase of 50,000 shares of XYZ stock and 500 XYZ call options would count as an aggregate transaction of 100,000 shares in XYZ (*i.e.*,  $50,000 + 500 \times 100 = 100,000$ ). With respect to index options, the market value would be computed by multiplying the number of contracts purchased or sold by the market price of the options and the applicable multiplier. For example, if ABC Index has a multiplier of 100, a person who purchased 200 ABC call options for \$400 would have effected an aggregate transaction of \$8 million (*i.e.*,  $200 \times \$400 \times 100 = \$8,000,000$ ). Transactions in index options are not required to be “burst” into share equivalents for each of the underlying component equities.

aggregating the fair market value of transactions for purposes of the rule, purchase and sale transactions may not be netted.

#### What is a Large Trader Required to Do?

A large trader must (i) file a Form 13H, (ii) disclose its LTID and each account to which the identifier applies to its broker-dealers and (iii) provide additional identifying information to the SEC upon request.<sup>4</sup> Each of these requirements is discussed below in more detail.

1. Filing Form 13H. A large trader must identify itself by electronically filing Form 13H with the SEC, which contains a description of the nature of its business, a list of any other forms it or its affiliates file with the SEC, whether it or any of its affiliates are registered with the Commodity Futures Trading Commission (the “CFTC”), whether it or any of its affiliates are regulated by a foreign regulator, information about its governance, a list of broker-dealers at which it has an account, information about its affiliates that exercise investment discretion over NMS securities (“Securities Affiliates”), and an organizational chart that identifies the large trader, its parent company (if applicable), its Securities Affiliates and any other affiliate that is registered with the CFTC.

There are six types of Form 13H filings:

- a. Initial Filing. Must be filed within the time periods set forth above.
- b. Annual Filing. Must be filed within 45 days after the end of each full calendar year, unless a large trader is on inactive status (as discussed below).
- c. Amended Filing. Must be filed promptly following the end of a calendar quarter in the event that any information contained in a Form 13H filing becomes inaccurate, unless a large trader is on inactive status.

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<sup>4</sup> A large trader may request an exemption from compliance with Rule 13h-1 in certain circumstances. For example, a foreign large trader may request an exemption if the laws of its jurisdiction prohibit it from disclosing certain personal identifying information, or otherwise voluntarily filing Form 13H with the SEC.

- d. Inactive Status Filing. A large trader that has not effected aggregate transactions in NMS securities at any time during the previous full calendar year in an amount equal to or greater than the Identifying Activity Level may switch to inactive status by filing an amended Form 13H indicating such status. A large trader's inactive status becomes effective upon the filing of such Form 13H. Once such status is effective, the trader is relieved from filing annual and amended Forms 13H and may request that its broker-dealers stop maintaining its transaction records.
  - e. Reactivated Status Filing. Must be filed "promptly"<sup>5</sup> after a large trader on inactive status engages in transactions in NMS Securities that meet or exceed the Identifying Activity Level. Upon filing, the large trader's Form 13H filing obligations resume and the trader must inform its broker-dealers of its reactivated status.
  - f. Termination Filing. May be filed to permanently end large trader status. This filing should be done only in very limited circumstances, such as when the trader has dissolved or ceased doing business.
2. Disclosing LTID to Broker-Dealers. A large trader must promptly disclose to the broker-dealers effecting transactions on its behalf its LTID and each account to which such identifier applies. If a control person files Form 13H on behalf of itself and the persons and entities it controls, such controlled persons and entities would need to provide their broker-dealers with the control person's LTID.

U.S. registered broker-dealers must come into compliance with the following requirements by April 30, 2012:

- a. Recordkeeping: U.S. registered broker-dealers will be required to maintain records that include detailed information regarding transactions in NMS securities by large traders. These records must be available by the

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<sup>5</sup> The adopting release for Rule 13h-1 is unclear as to whether the 10-day time frame for initial Form 13H filings also applies to reactivated status filings.

morning after the day the transactions were effected (including Saturdays and holidays).

b. Reporting: Currently, broker-dealers must submit certain transaction data through the Electronic Blue Sheets (“EBS”) system upon request from the SEC. Upon request from the SEC, U.S. registered broker-dealers will be required to report a particular day’s trading activity in NMS securities by a large trader or Unidentified Large Trader if the trading activity by such trader equals or exceeds the “reporting activity level” of 100 shares (or fewer, if the broker-dealer deems appropriate) through the EBS system. In its request, the SEC will specify the date and time such report must be submitted and may require same-day submission in unusual circumstances.

c. Monitoring: U.S. registered broker-dealers will be required to perform limited monitoring to identify traders that they know or have reason to know are large traders (“Unidentified Large Traders”) that have not identified themselves as such.

3. Providing Additional Information. Upon request by the SEC, a large trader must promptly provide additional information that would allow the SEC to further identify the large trader and all accounts through which the large trader effects transactions.

#### Confidentiality

Form 13H filings are made confidentially and are generally not available to the public. The SEC may not be compelled to disclose information collected from large traders and registered broker-dealers under a large trader reporting system, subject to limited exceptions. Specifically, the SEC: (i) may not withhold such information from Congress, (ii) is required to disclose such information upon request by any other federal agency or federal department requesting such information for a purpose within its jurisdiction, and (iii) must disclose such information pursuant to an order issued by a court of the United States in an action brought by the United States or the SEC. Such information is, however, exempt disclosure under the Freedom of Information Act.

The text of the final rule and Form 13H can be found on SEC Release No. 34-64976 and is available at <http://www.sec.gov/rules/final/2011/34-64976.pdf>.

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