

## SEC Large Trader Rule: Impact on Corporations and Related Individuals

---

The SEC's new Large Trader Reporting Rule<sup>1</sup> should be reviewed by corporations and individuals that exercise discretion over transactions in U.S.-listed stocks and options. Effecting even a single trade can require a corporation or individual to register as a "large trader." New Rule 13h-1 requires large traders to register with the SEC by December 1, 2011 by filing Form 13H.

In general, we expect that most corporations outside the financial services industry and most individuals will not be subject to the rule. Many ordinary corporate activities in listed stocks, such as self-tenders and other share repurchases, administering equity compensation plans, and engaging in mergers and acquisitions involving public companies, will not trigger registration.

### Who Must File?

Rule 13h-1 is designed to capture persons who trade actively, though the thresholds are low. As such, the rule does not apply to persons who merely hold large positions in securities or who purchase and sell securities as part of corporate business transactions.

"Large trader" is defined as a person who "directly or indirectly, including through other persons *controlled* by such person, exercises *investment discretion* over one or more accounts and effects transactions for the purchase or sale of any NMS security (*i.e.*, U.S.-listed stocks and options) 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*."

- "Identifying activity level" is defined as transactions in U.S.-listed stocks and options 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.
- The term "investment discretion" encompasses a person who has official authority to determine what securities should be purchased or sold by or for an account, as well as a person who actually makes decisions about what securities should be purchased or sold by or for an account even though some other person may have official responsibility for such investment decisions, except in certain circumstances where investment decision-making authority is completely delegated to a third party.
- "Control" is defined as the right to vote or direct the vote of 25% or more of a class of voting securities of an entity or the power to sell or direct the sale of 25% or more of a class of voting securities of such entity.
  - Large traders must aggregate, without offsetting or netting, all of their U.S.-listed stock and option transactions with those of their 25% "controlled" entities. Therefore, a corporation that controls 25% or more of an investment management or broker-dealer subsidiary that effects transactions, for itself, for an employee retirement fund or for third parties, equal to or greater than the thresholds described above, could be required to register as a large

---

<sup>1</sup> Exchange Act Release No. 34-64976 (July 27, 2011), 76 FR 46,960 (Aug 3, 2011). Available [here](#).

trader. In addition, a company may be required to register as a large trader if its employees exercise discretion to effect trades for the company's pension plan.

However, where a company (or a committee thereof) has the authority to manage its pension plan and delegates complete investment decision-making authority to one or more unaffiliated asset managers, the company would not be deemed to exercise investment discretion to effect trades for the plan. Furthermore, a company would not be viewed as exercising investment discretion over a defined contribution retirement plan (e.g., a 401(k) plan) where the company selects the plan's investment options but allows employees to make their own investment decisions in allocating their plan accounts among the investment options.

The rule also contains a number of important exclusions from the types of transactions that count toward the identifying activity level:

- any transaction that is part of an offering of securities by an issuer, or by an underwriter on behalf of an issuer, whether or not such offering is subject to registration under the Securities Act of 1933 other than an offering of securities effected through the facilities of a national securities exchange;
- 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 of 1934;
- self tender offers and other stock buybacks by an issuer;
- stock loan and equity repurchase agreements;
- any transaction between an employer and its employees effected pursuant to the award, allocation, sale, grant, or exercise of a U.S.-listed 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 effected pursuant to a rollover of a qualified plan or trust assets subject to Section 402(a)(5) of the Internal Revenue Code.

Single transactions that would trigger a registration requirement include:

- offerings by an issuer of at least 2 million shares or \$20 million "through the facilities of a national securities exchange," which would include not only "dribble out" programs but offerings "crossed" on a national securities exchange; and
- sales of at least 2 million shares or \$20 million by a selling shareholder, such as sales by management in connection with an option exercise or in a registered secondary offering.

Note that registration could be triggered by open market accumulations of the sort that are often a prelude to a tender offer or other M&A transaction. As a result, companies with active M&A programs should consider whether to voluntarily register as a large trader in advance so as to avoid the burden of assembling a filing on the fly.

## How Does One Register?

If you are required to register, you must file Form 13H with the SEC via EDGAR "promptly" (i.e., within 10 days) after crossing the threshold trading level.

Large traders must update Form 13H annually and amend the form on at least a quarterly basis if necessary to correct information that becomes inaccurate. For each of the quarterly and annual filings, the large trader need only amend the existing form on file by inputting new or changed information. A large trader, such as an infrequent trader, may also use Form 13H to file for inactive status if it does not reach the identifying activity level for a full calendar year after registering.

## What Follows Registration?

Upon receipt of Form 13H, the SEC will issue the large trader a unique identification number (a “large trader ID”). A large trader will be required to inform registered broker-dealers that effect transactions on its behalf of the large trader ID that applies to its accounts.

Large traders must promptly respond to requests from the SEC for additional information that would allow the SEC to obtain more detailed information about the large trader and its individual accounts.

## What Information Is Required?

Form 13H requires a significant amount of identifying information regarding large traders, including:

- the type of business of the large trader and its affiliates (e.g., broker, dealer, bank, investment adviser, or hedge fund);
- a general description of the operations and trading strategies of the large trader and any affiliates that exercise investment discretion over any amount of U.S.-listed securities and options (such affiliates are defined in Form 13H as “Securities Affiliates”);
- whether the large trader or any of its Securities Affiliates are regulated by a foreign regulator and, if so, a list of such entities and their regulators;
- an organizational chart that identifies the large trader, its parent, all Securities Affiliates and all entities that are registered with the CFTC, as well as a description of the business and the market participation identification number (“MPID”) of each such entity;
- the executive officers, directors, or trustees of the large trader;
- the jurisdiction in which the large trader is organized and its principal place of business; and
- a list of the registered broker-dealers at which the large trader and its Securities Affiliates have an account and the services provided (e.g., prime broker, executing broker, or clearing broker).

Form 13H will be confidential and exempt from Freedom of Information Act requests.

## What Are the Consequences of Not Filing, or Filing Late?

A failure to file Form 13H when required (whether or not inadvertent) could subject the offender to the range of penalties available under the Securities Exchange Act. However, according to informal SEC staff guidance issued in 2009, a failure to file or a late filing of Form 13H should not compromise Form S-3 shelf registration eligibility, since the filing is not required pursuant to Section 13(a), 15(d), 14(a) or 14(c) under the Securities Exchange Act.

---

If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your regular Davis Polk contact.

<b>Robert L.D. Colby</b>	202 962 7121	<a href="mailto:robert.colby@davispolk.com">robert.colby@davispolk.com</a>
<b>Edmond T. FitzGerald</b>	212 450 4644	<a href="mailto:edmond.fitzgerald@davispolk.com">edmond.fitzgerald@davispolk.com</a>
<b>Joseph A. Hall</b>	212 450 4565	<a href="mailto:joseph.hall@davispolk.com">joseph.hall@davispolk.com</a>
<b>Michael Kaplan</b>	212 450 4111	<a href="mailto:michael.kaplan@davispolk.com">michael.kaplan@davispolk.com</a>
<b>Yukako Kawata</b>	212 450 4896	<a href="mailto:yukako.kawata@davispolk.com">yukako.kawata@davispolk.com</a>
<b>William M. Kelly</b>	650 752 2003	<a href="mailto:william.kelly@davispolk.com">william.kelly@davispolk.com</a>
<b>Richard D. Truesdell, Jr.</b>	212 450 4674	<a href="mailto:richard.truesdell@davispolk.com">richard.truesdell@davispolk.com</a>
<b>E. Ashley Harris</b>	212 450 4780	<a href="mailto:ashley.harris@davispolk.com">ashley.harris@davispolk.com</a>

---

© 2011 Davis Polk & Wardwell LLP

---

Notice: This is a summary that we believe may be of interest to you for general information. It is not a full analysis of the matters presented and should not be relied upon as legal advice. If you would rather not receive these memoranda, please respond to this email and indicate that you would like to be removed from our distribution list. If you have any questions about the matters covered in this publication, the names and office locations of all of our partners appear on our website, [davispolk.com](http://davispolk.com).