



June 16, 2010

**Via Electronic Mail:** [rule-comments@sec.gov](mailto:rule-comments@sec.gov)

Elizabeth M. Murphy  
Secretary  
U.S. Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-1090

**Re: File Number S7-10-10; Establishment of Large Trader Reporting System**

Dear Ms. Murphy:

Managed Funds Association (“MFA”)<sup>1</sup> appreciates the opportunity to comment on Release No. 34-61908 (the “Release”) issued by the Securities and Exchange Commission (the “Commission”) regarding proposed Rule 13h-1 (the “Proposed Rule”) and Form 13(H) to establish a large trader reporting system pursuant to Section 13(h) of the Securities and Exchange Act of 1934, as amended.<sup>2</sup> MFA fully supports the Commission’s efforts “to detect and deter fraudulent and manipulative activity and other trading abuses”.<sup>3</sup> In addition, MFA generally supports the establishment of a large trader reporting system as a mechanism that will assist the Commission in these efforts. However, in an effort to assist the goals of the Commission, MFA is suggesting some clarifications and revisions to certain proposals in the Release, as discussed in greater detail below, that we believe would lead to greater efficiency and efficacy of the proposed large trader reporting system.

## **I. MFA Suggestions and Recommendations**

### **A. Implement Consolidated Audit Trail**

MFA understands that the Commission’s proposed large trader reporting system is an interim solution until the Commission can implement a consolidated audit trail, which would be the longer-term solution to address the Commission’s need for more detailed market order and trade information.<sup>4</sup> At the time of the Release, the Commissioners were uncertain as to when the audit trail proposal would be

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<sup>1</sup> MFA is the voice of the global alternative investment industry. Its members are professionals in hedge funds, funds of funds and managed futures funds, as well as industry service providers. Established in 1991, MFA is the primary source of information for policy makers and the media and the leading advocate for sound business practices and industry growth. MFA members include the vast majority of the largest hedge fund groups in the world who manage a substantial portion of the approximately \$1.5 trillion invested in absolute return strategies. MFA is headquartered in Washington, D.C., with an office in New York.

<sup>2</sup> Large Trader Reporting System, Securities Exchange Act Release No. 34-61908 (April 14, 2010), 75 FR 21456 (April 23, 2010) (“Release”).

<sup>3</sup> *Id.* at 1 and 48.

<sup>4</sup> *See* Release, page 12, footnote 32; Commissioner Luis A. Aguilar, Speech by SEC Commissioner: The Need for Effective Surveillance (April 14, 2010); Commissioner Elisse B. Walter, Speech by SEC Commissioner: Opening Remarks Regarding Large Trader Reporting Requirement (April 14, 2010).

operational; however, the Commission recently published the rule proposing release seeking to establish such an audit trail.<sup>5</sup> Since the establishment of the consolidated audit trail may provide the Commission the order and trade information that it requires, and thereby, eliminate the need for a large trader reporting system, we recommend that the Commission implement the consolidated audit trail prior to establishing a large trader reporting system. If after implementation, the Commission determines that the consolidated audit trail does not provide sufficient transparency or information to the Commission to oversee the activities of large traders, at such time, the Commission could reconsider whether a large trader reporting system is necessary as a supplemental measure to the consolidated audit trail. Proceeding in this manner would be a more efficient use of market participants' compliance resources as well as the Commission's time and resources.

#### **B. Reconsider "Identifying Activity Level" Thresholds**

MFA respectfully requests that you re-evaluate the "identifying activity level" thresholds to determine whether the proposed thresholds are appropriate. In the Release, the Commission estimated that approximately 400 large traders would be subject to the Proposed Rule.<sup>6</sup> In addition, the Commission indicated that its intention was not to regulate infrequent large traders, but instead to create two different thresholds so as to capture traders that engage in a large volume of trading over short periods as well as traders who have sustained trading at significant levels.<sup>7</sup> We recognize that the proposed identifying activity levels represent an increase over the thresholds proposed in the 1991 and 1994 rule releases;<sup>8</sup> however, we are concerned that even as increased, the proposed thresholds might inadvertently capture more than the estimated 400 large traders as well as traders that only infrequently reach the identifying activity levels. For example, due to the netting and aggregation of trading activities, the Proposed Rule would apply to a firm that in the aggregate exceeds the calendar day threshold one day during a calendar year, and subject that firm to the full scope of requirements mandated by the Proposed Rule.<sup>9</sup> Although the Commission might argue that any firm that exceeds either threshold during a calendar year is trading in such volume that they should be subject to these requirements, it seems unreasonable to impose such costly and burdensome requirements on a firm with such sporadic trading of substantial volume. As a result, MFA suggests that the Commission amend the Proposed Rule to substantially increase the proposed identifying activity level thresholds for a brief trial period, and after expiration of the period, the Commission could then evaluate the thresholds to determine whether the thresholds as set are capturing the appropriate large traders or whether adjustments are necessary.

#### **C. Clarify Application of Large Trader IDs ("LTIDs")**

MFA asks the Commission to clarify the application of LTIDs to the typical hedge fund firm structure. In describing how LTIDs would apply to complex organizational structures, the Release uses

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<sup>5</sup> See *Consolidated Audit Trail*, Release No. 34-62174; File No. S7-11-10, 75 FR 32556 (June 8, 2010). MFA may separately submit a comment letter on the proposed consolidated audit trail.

<sup>6</sup> Release, page 72.

<sup>7</sup> *Id.* at 30-31

<sup>8</sup> See Securities Exchange Act Release No. 29593 (August 22, 1991), 56 FR 42550 (August 28, 1991) (S7-24-91); Securities Exchange Act Release No. 33608 (February 9, 1994), 59 FR 7917 (February 17, 1994) (S7-24-91).

<sup>9</sup> See Release, page 33, which indicates that once a person exceeds the identifying activity levels and becomes a "large trader", such person is eligible for inactive status only if its "aggregate transactions during the previous full calendar year did not reach the identifying activity level at any time".

the terms “parent company” and “subsidiary”.<sup>10</sup> However, the terms “parent company” and “subsidiary” are imprecise and not meaningful in relation to the typical hedge fund firm structure. The typical hedge fund firm structure does not have a parent company and subsidiaries, but instead has various entities that manage or provide other services to the relevant hedge funds and that are affiliates or otherwise controlling, controlled by or under common control with each other. We believe that the Commission intends that in such a structure either: (i) the entity that has ultimate investment discretion over the relevant large trading hedge funds would aggregate the data and be the reporting entity; or (ii) each hedge fund that reached the identifying activity level would separately report and have its own LTID. However, for the avoidance of doubt, MFA would appreciate it if the Commission could provide additional guidance on this point.

**D. Impose Confidentiality Safeguards on Dealers**

We appreciate that information that the Commission receives from large traders pursuant to proposed Form 13H would not be subject to disclosure pursuant to the Freedom of Information Act,<sup>11</sup> and therefore, appropriate safeguards are in place to protect the confidential and proprietary information provided by large traders to the Commission. However, the Proposed Rule would also require dealers whose clients are large traders to keep records and retain substantial information with respect to clients that “it knows or has reason to know” are large traders.<sup>12</sup> With respect to information received by dealers from large traders, the Proposed Rule does not mandate that such dealers employ safeguards to protect the confidential or proprietary information that they receive or provide any other assurances of confidentiality to their large trader clients. Although we recognize that large traders can enter into their own confidentiality arrangements with dealers to protect their information, in practice only the largest managers are able to put such arrangements in place with dealers. MFA believes that because the Proposed Rule specifically requires more robust and long-term retention of large trader information by dealers, the Proposed Rule should emphasize the need for dealers to maintain information barriers between their purely proprietary trading businesses and client businesses and should also mandate that such dealers implement necessary confidentiality protections. As a result, we recommend that the Commission amend the Proposed Rule to incorporate these necessary protections and to remind dealers to respect and comply with their existing regulatory responsibilities and any additional contractual obligations to protect the confidentiality of large trader client information.

**E. Consult Industry Participants to Develop Protections Against Theft and Misappropriation of Data**

Due to the sensitivity and confidentiality of their business information, MFA’s members expend significant time and resources to employ safeguards to preserve their trade secrets and protect their proprietary information and work product.<sup>13</sup> In the event that the Commission implements the proposed

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<sup>10</sup> See Release, pages 16-20.

<sup>11</sup> Release, pages 40-41.

<sup>12</sup> Release, pages 52-55.

<sup>13</sup> MFA’s members have informed us that the protections that they have implemented include, without limitation: (i) entering into comprehensive non-disclosure agreements with employees, service providers and contractors; (ii) investing in technology-related security and consulting services, such as firewalls and other anti-hacking devices and techniques; (iii) adopting restrictions on transportability of data (*e.g.*, disabling USB ports and restricting any uploads to the Internet), and (iv) prohibiting the copying of information onto removable media (*e.g.*, disks and

large trader reporting system, the Commission will, in part, serve as a repository of investment manager-indexed datasets. As a result, MFA members are concerned about the potential for an unscrupulous individual to reverse engineer or otherwise misappropriate confidential and proprietary manager data received by the Commission. We recognize that the Commission is seeking to better understand the extent to which investment managers and their activities affect the broader market.<sup>14</sup> At the same time, we would hope that the Commission could achieve this goal in a manner that recognizes and addresses our members' concerns regarding the need to protect their significant investments in proprietary technology and intellectual property.

Therefore, we would ask that the Commission, prior to promulgating any final regulations related to the proposed large trader reporting system, engage in a dialogue with industry participants to identify, and/or seek additional public comment on, proposals that would limit the risk of theft or inadvertent disclosure of manager-indexed datasets. We expect that such a dialog with MFA members and other industry participants would provide a number of options for the Commission to implement suitable protections that would reduce industry concerns and reduce the cost or complexity of the responsibilities of the Commission's staff.

## II. Conclusion

MFA supports the Commission's efforts to deter and detect fraudulent and manipulative activity and other trading abuses. In addition, MFA generally supports the establishment of a large trader reporting as a mechanism that will assist the Commission in these efforts. Notwithstanding our support of the Commission's goals, MFA believes our suggested clarifications and revisions to certain proposals in the Release would lead to greater efficiency and efficacy of the proposed large trader reporting system

We welcome an opportunity to further discuss any of the above recommendations with Commissioners or its staff if it would assist in your efforts. If the Commissioners or their staffs have questions or comments, please contact Carlotta King or the undersigned at (202) 367-1140.

Respectfully submitted,

/s/ Stuart J. Kaswell

Stuart J. Kaswell  
Executive Vice President & Managing Director, General  
Counsel

CC: The Hon. Mary Schapiro, Chairman, SEC  
The Hon. Kathleen L. Casey, Commissioner, SEC  
The Hon. Elisse B. Walter, Commissioner, SEC  
The Hon. Luis A. Aguilar, Commissioner, SEC  
The Hon. Troy A. Paredes, Commissioner, SEC

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tapes). In addition to these "hard" investments in technology, MFA's members may also take more process-driven steps to limit the number and type of personnel who have access to, or possession of, their full trading records.

<sup>14</sup> Release, pages 4 and 11-14.