June 22, 2010

Via Electronic Filing
Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

RE: Comments on Proposed Rule 13h-1 and Form 13H, SEC Realease No. 34-61908

Ladies and Gentlemen:

Financial Engines respectfully submits the following comments in response to the Securities and Exchange Commission's ("Commission") proposed rule to establish a large trader reporting system, published in the April 23, 2010 Federal Register. Financial Engines Advisors, a wholly owned subsidiary of Financial Engines Inc., is a registered investment adviser that provides personalized investment advice and management services directly to plan participants in 401(k) and similar plans. Financial Engines is a leading provider of independent advisory services to large plan sponsors, working with many of the nation's largest employers and retirement service providers.[1]

We appreciate the opportunity to comment on the proposed rule and the additional questions posed in the rule. We believe that the Commission should have the ability to detect and deter fraudulent and manipulative activity and other trading abuses. We further agree that gathering data on large traders who conduct high-frequency trading activity have significant effects in creating volatility in the US securities markets.

We believe, however, that the proposed rule is overly broad in its scope and would impose unnecessary burdens on market participants whose long-term investment strategies necessitate relatively infrequent large-volume transactions. The following comments are intended to assist the Commission in clarifying several key elements of the proposed rule to further advance the goal of protecting investors from trading abuses and manipulative activity that lead to periods of unusual market volatility.

---

[1] Financial Engines offers retirement help, including investment advice and management services, to over 7 million plan participants through leading employers and financial institutions, including 115 of the Fortune 500 companies, as of March 31, 2010.

1804 Embarcadero Road • Palo Alto, CA 94303 • Telephone: (650) 565-4900 •
Fax: (650) 565-4905

Proposed Rule 13h-1

When Congress passed the Market Reform Act of 1990, their primary goal was to allow the Commission to collect information on large traders in order to assess the impact of high-frequency trading on market volatility and enhance the Commission's ability to detect fraudulent and manipulative activity and other trading abuses. Prior attempts at regulation of large trader activity include the adoption of Rule 17a-25 which enhances the Electronic Blue Sheets ("EBS") system. The rule requires broker-dealers to (1) submit transaction information to the Commission in electronic format; (2) update their contact person information to provide the SEC with up to date information; and (3) supply prime brokerage identifiers, prime account identifiers and depository institution identifiers to the Commission.

The Commission has conceded however, that Rule 17a-25 was insufficient for large-scale investigations and market reconstructions involving numerous stocks during peak trading volume periods and is therefore inadequate to properly monitor the impact of large trader activity on the securities markets. The Commission's proposed Rule 13h-1 is designed to enhance its ability to collect and analyze trading information more efficiently, especially with respect to the most active market participants.

The proposed rule would require any "large trader" to identify themselves and provide certain information on Form 13H. After the form is submitted, the Commission would issue a unique large trader identification number (LTID) to the large trader, which would in turn be provided to the large trader's registered broker-dealers. Registered broker-dealers would be required to maintain certain transaction records and report such information to the Commission upon request. In addition, registered broker-dealers would be required to adopt procedures to monitor their clients for activity that would trigger the identification requirements of the proposed rule.

The rule defines "large trader" as any person that directly or indirectly exercises investment discretion over one or more accounts whose transactions in NMS securities equal or exceed (i) two million shares or $20 million during any calendar day or (ii) 20 million shares or $200 million during any calendar month. The commission intends to capture data to track the trading methods of large traders who trade electronically in huge volumes and with great speed. The SEC has noted that market analysts estimate the level of attributable activity to high-frequency traders at a greater than 50% of total market volume.[2]

The Proposed Rule's Definition Of "Transaction" Is Overbroad

Rule 13h-1(a)(6) defines "transactions" as all transactions in NMS securities, except for limited exemptions designed to exempt certain small and otherwise infrequent trades as well as activity that is not characterized by active investment discretion or is associated

[2] *See* Large Trader Reporting System, Release No. 34-61908 (Apr. 14, 2010), Footnote 1.

with capital raising and employee compensation. This definition is overly broad because even infrequent traders who may go over the requisite threshold limit only once a year may become subject to the reporting requirements of the rule. As the Commission itself recognized, it may already be able to get information about a large enough one-time transaction that could have an impact on the market through other means, including the current EBS system.

Investors who conduct trading in defined contribution accounts currently fall under the reporting requirements of the proposed rule, despite the lack of high-frequency trading that the Commission seeks to identify and capture. Certain events, for instance, such as passive rollover of a 401(k) plan or new default enrollment of a plan's participants into an investment adviser's managed account program could necessitate large-volume trading within a short period of time.[3] Such a strategy of liquidating company stock holdings in 401(k) accounts that are overly invested in stock may be part of a fiduciary's prudent, long-term management of a defined contribution account.[4] High-frequency traders, on the other hand, generally do not undertake traditional fundamental research-based investment strategies, but rather implement trading methods that are designed to capture gains from short-term price fluctuations or statistical arbitrage opportunities.

Transactions in defined contribution plans, however, are not the type of transactions that the Commission seeks to monitor and track, primarily because its infrequent nature does not give rise to issues of manipulation and is unlikely to lead to volatility in the securities market. Though occasionally, such transactions may be large enough to trigger the proposed threshold activity level specified in the rule, these transactions are often trades in a single security as part of a re-allocation of company stock in individual participants' defined contribution plans. Such re-allocation transactions are part of plan advisers' long-term strategy in managing defined contribution accounts and are not designed to continue once an optimum balance is achieved in each account.

Under the proposed rule, however, such transactions would nevertheless be considered reporting events and must be disclosed on Form 13H. Capturing data on these transactions will frustrate the Commission's ability to identify and monitor the high-frequency, high-volume traders whose trading patterns may contribute to market volatility, because the data gathered will be obscured by large, one-time transactions even if they are not part of a short-term, high-frequency trading pattern.

In its concept release dated January 14, 2010, the Commission itself noted in explaining its concern about the effect of high-frequency traders on market volatility that particular strategies used by some of these traders may not necessarily involve a large number of

---

[3] *See* Pension Protection Act of 2006 Section 902 (allowing qualified automatic contribution arrangements where eligible employees are treated as having elected to have the employer make elective contributions in an amount equal to a qualified percentage of compensation until the employees otherwise make an affirmative election.)

[4] The duty to act prudently is one of a fiduciary's central responsibilities under ERISA. *See* 29 USC 1104(a)(1).

trades.[5] The proposed rule's definition of "transactions" thus does not capture all of the trading activity of high-frequency traders while diluting its gathered data by including entities that conduct large, one-time trades that are unlikely to have significant effects on market volatility. In addition, investors who trade in defined contribution plans are already governed by ERISA, so the threat of trading that disrupts orderly market activity or that constitutes fraudulent, manipulative activity or other trading abuses should be less severe than in trades conducted by professional short-term, high-frequency traders

We appreciate the Commission's concern that large market participants have a great impact on the US securities markets and thus the Commission needs to collect information on their trading and analyze their trading activity. The current EBS system, however, already performs effectively in allowing the commission to identify large trades in an individual security over a limited period of time. For instance, the current system allows the Commission to get aggregate data in securities transactions of certain entities trading through multiple accounts at more than one broker-dealer.[6] Trading activity in a single security within a defined contribution plan can thus already be captured through the current EBS system and further reporting on this activity on Form 13H would be unduly burdensome.

The Reporting Requirements Of Proposed Form 13H Are Unclear And Unduly Burdensome

The current proposed data required to be furnished on Form 13H should be clarified and more narrowly tailored in order to avoid imposing an undue burden to the reporting entities. Currently, the Commission's proposal would impose significant burdens on advisers to defined contribution plans because it requires reporting information that advisers may not have or may be impracticable to collect.

Item 6 and Schedule 6 (List of Large Trader Accounts) require large traders to provide certain account information including information about the name of the registered broker-dealer that holds the account, the broker-dealer account number and the name of the account. Item 6 further requires the reporting entity to list "accounts over which the large trader exercises investment discretion." There is no definition of "accounts" in the proposed rule or form, however, creating some confusion as to the type of information required to be reported in these sections. It seems unclear whether Item 6 and Schedule 6 require information regarding the account with the broker-dealer through which the large trader trades, rather than the account information of the clients of the large trader.

Moreover, it is not clear how the requirements of the form would apply to investment advisers who provide investment advice to defined contribution plans. For instance, there are some arrangements whereby an investment adviser may provide transaction instructions on behalf of a plan participant to the plan's record-keeper, as part of its

[5] *See* Concept Release on Equity Market Structure, Release No. 34-61358 (January 14, 2010) (discussing effects of high-frequency trading on market volatility).
[6] *See* 17 CFR 240.17a-25(b).

investment advisory services to the participant. Thus, although the adviser may execute trades with broker-dealers indirectly, the adviser does not technically maintain brokerage accounts with those broker-dealers. Instead, the adviser conducts transactions through the plan's record-keeper and would therefore not be privy to information about brokerage accounts, if any, maintained by the plan's record-keeper for purposes of transactions in company stock.

We therefore request that the Commission clarify that the account referred to in the proposed rule and form is an account with a broker-dealer and that the information that must be provided in Item 6 and Schedule 6 are not information regarding an investment manager's clients but the "accounts" or identifiers with broker-dealers through which large traders execute trades.

We further request that the Commission confirm that investment advisers to defined contribution plans are not required to provide either brokerage account information maintained by plan record-keepers or individual account information of each defined contribution plan participant under the proposed rule if (a) such investment adviser is authorized by a plan participant to provide transaction instructions to the plan's record-keeper, and (b) the adviser does not maintain a brokerage account for such trading itself.

If the Commission intends to require investment managers to report on the individual account information of their clients, the proposed rule would be unduly burdensome to many investment managers. The current Item 6 on Form 13H requires large traders who trigger the proposed activity thresholds to provide a list of all accounts over which the large trader exercises investment discretion. An adviser who provides investment advice to hundreds of thousands of defined contribution plan participants would find it impossible to identify each separate account for which investment discretion is exercised. Moreover, the information would necessarily change from quarter to quarter as employers hire and terminate employees from the plan, necessitating frequent Form 13H amendments. The costs associated with gathering this data and the constant filing of amendments is far greater than the incremental information that the Commission will be able to gather.

Schedule 6 to Form 13H also requires reporting entities to provide the LTIDs of other large traders that exercise investment discretion over its accounts. As noted above, it would be an undue burden for an adviser who provides investment advice to hundreds of thousands of defined contribution plan participants to provide the Commission information about each account. It would be extremely difficult for an adviser to gather and report accurate information about all the accounts to which it provides investment advice, especially since the number of such accounts varies from quarter to quarter. Furthermore, most of the transactions in the accounts, even when aggregated at a plan level, would rarely trigger the threshold activity levels of the rule. Rather, a single, large-volume yet one-time transaction in a calendar year would trigger the reporting requirements of the rule but would not provide the Commission with more meaningful data.

As noted above, while an adviser to a defined contribution plan may conduct large-volume transactions, because such transactions usually involve transactions in a single security within a defined contribution plan, the Commission already possesses the tools to monitor and track such activity. Subjecting advisers to defined contribution plans to the reporting requirements of proposed Rule 13h-1 would be unduly burdensome and would impose a great cost while providing the Commission with no more meaningful data than what it already can collect through the current EBS system.

The Commission Should Clarify That "NMS Securities" Excludes Pooled Investment Vehicles in Defined Contribution Plans

It is also unclear from the text of the proposed rule whether the definition of "NMS securities" excludes certain pooled investment vehicles in defined contribution plans. The proposed rule states that the term "NMS securities" refers to all exchange-listed securities, including equities and options. It is unclear whether such definition includes collective investment vehicles comprised primarily of company stock together with a liquidity component. Such pooled investment vehicles are often used by large companies who include exposure to the employer's stock as an investment option in their defined contribution plan. We therefore request the Commission to further clarify its definition of "NMS securities."

The Proposed Rule's Aggregate Threshold Limits Are So Low As To Be Unduly Burdensome

The proposed rule imposes a reporting requirement on large traders who conduct transactions in NMS securities that equal or exceed (1) two million shares or shares with a fair market value of $20 million during any calendar day, or (ii) 20 million shares or shares with a fair market value of $200 million during any calendar month.

The current identifying activity levels may still apply to infrequent traders who might trigger identification based on a single transaction. As noted in its release, the Commission wishes to exclude such transactions from the scope of the proposed rule.[7] The Commission has repeatedly made clear that its primary concern is in monitoring and tracking the activity of large market participants who routinely and frequently conduct transactions of a substantial volume. The current threshold limits nevertheless may trigger implicate entities who conduct certain transactions in defined contribution accounts, despite the fact that they do rarely or otherwise never trade anywhere near the proposed activity thresholds.

[7] *See* Large Trader Reporting System, Release No. 34-61908 (April 14, 2010) (noting in soliciting comments to the rule that it seeks to minimize the applicability of the rule to persons that effect one-time transactions greater than the identifying level, but who otherwise never or rarely trade anywhere near a substantial volume or a large fair market value)

We respectfully submits that if an exemption for trading in defined contribution plans is not included in the final Regulation, the Commission should instead increase its current daily and monthly threshold of identifying activity levels. Increasing the daily and monthly threshold from the current proposed level should allow the Commission to narrow its focus in identifying the largest market participants who contribute to market volatility. We propose that the Commission increase the daily threshold limits to shares with a fair market value of $100 million during any calendar day. Increasing the activity threshold limits should help the Commission in gathering data from the traders whose transactions are significant in magnitude compared to overall trading volume. Additionally, an increase in the applicable thresholds will help minimize the rule's applicability to entities that conduct one-time transactions that trigger the thresholds, but otherwise never or rarely trade in a manner that would implicate the proposed activity thresholds.

The Commission Should Continue To Protect Confidentiality Of Information

We agree with the Commission's decision to exempt from the disclosure requirements of FOIA the information provided by large traders on Form 13H or in response to a request by the Commission. We further agree with the Commission's decision to exempt any transaction information that a registered broker-dealer would report to the Commission under proposed Rule 13h-1 from disclosure under FOIA.

We believe that public and continuous disclosure of investment advisers' significant trading activities would allow professional traders and other individuals to take advantage of such strategies. We therefore encourage the Commission to maintain the confidentiality of information reported on Form 13H.

Responses To Questions Raised By The Commission

1) *Is the definition of "transaction" in proposed Rule 13h-1(a)(6) and the exceptions thereto appropriate to accomplish the Commission's goals of focusing on trading activity that constitutes an arm's length purchase or sale and warrants the continuing burdens associated with the proposed requirements? Should any other transactions be excluded from the definition of "transaction?"*

The Market Reform Act provides the Commission with the authority to exempt any person or class of persons or any transaction or class of transactions from the large trader reporting system requirements.[8] As noted above, the proposed rule's current definition of "transactions" is overbroad and will capture infrequent large-volume transactions in a single security as part of re-allocation transactions in defined contribution plans.

We respectfully request that the Commission provide an exemption for trading in defined contribution plans. Trading in defined contribution plans is not the type of activity that the Commission is attempting to monitor and study because such trading is necessarily

[8] *See* 15 U.S.C. 78m(h)(6).

part of investors' long-term investment strategy and is unlikely to contribute to unusual periods of market volatility. Where the interests of long-term investors and short-term professional traders diverge, the Commission repeatedly has emphasized that its duty is to uphold the interests of long-term investors.[9]

2) *Would basing the large trader definition on aggregated transactions during a different measuring period be more appropriate?*

It would be more appropriate to increase the current activity thresholds. The Commission noted in the release that the daily threshold limit is designed to identify large traders who effect transactions, on a daily basis, in a substantial volume. This threshold level, however, does not only gather data from traders who effect large-volume transactions on a daily basis. Rather, the current proposal will also apply to entities that effect one-time transactions of substantial value, but otherwise infrequently trade at the identifying activity level.

By increasing the daily limits as proposed above or considering activity over several days, the Commission should be able to minimize the applicability of the rule to persons who are not frequent high-volume traders. Additionally, increasing the volume and fair market value limits will assist the Commission in identifying the persons whose trading methods and patterns have significant effects on overall market volume.

Conclusion

Financial Engines appreciates the opportunity to comment on the proposed rule and may provide additional comments as we continue to evaluate the proposal. We support the Commission's efforts to gather useful data in order to study markets and market activity. We are concerned, however that the requirement to provide transaction information on one-time tractions at the threshold level proposed would result in information that may not be useful in identifying traders whose high-frequency trading activity potentially affect market volatility. We believe that an exemption for trading in defined contribution plans, or in the alternative, an increase in the activity thresholds will allow the Commission to receive more meaningful data. We welcome the opportunity to work with the Commission and to provide any further assistance that may be required. Please contact us should you have any questions.

---

[9] *See*, *e.g.*, Flash Order Release, 74 FR at 48635-48636; Regulation NMS Release, 70 FR at 37499-37501; Fragmentation Concept Release, 65 FR at 10581 n. 26; see also S. Rep. No. 73-1455, 73rd Cong., 2d Sess. 5 (1934) ("Transactions in securities on organized exchanges and over-the-counter are affected with the national public interest. . . . In former years transactions in securities were carried on by a relatively small portion of the American people. During the last decade, however, due largely to the development of means of communication . . . the entire Nation has become acutely sensitive to the activities on the securities exchanges. While only a fraction of the multitude who now own securities can be regarded as actively trading on the exchanges, the operations of these few profoundly affect the holdings of all.").

Very truly yours,

Anne Tuttle
EVP and General Counsel