



RISK ALERT

OFFICE OF COMPLIANCE INSPECTIONS AND EXAMINATIONS

December 16, 2020

Observations from Examinations of Broker-Dealers and Investment Advisers: Large Trader Obligations*

I. Introduction

This Risk Alert contains observations from the Office of Compliance Inspections and Examinations (“OCIE”) examinations of SEC-registered investment advisers (“investment advisers”) and broker-dealers (“broker-dealers”) for compliance with Rule 13h-1. The Securities and Exchange Commission adopted Rule 13h-1 (“Rule 13h-1” or the “Rule”) to assist the Commission in both identifying and obtaining information on market participants that conduct a substantial amount of trading activity, as measured by volume or market value, in national market system (“NMS”) securities (such persons are referred to as “Large Traders”).¹ The Large Trader reporting requirements are designed to provide the SEC with data to facilitate the SEC’s ability to assess the impact of Large Trader activity on the securities markets, to reconstruct trading activity following periods of unusual market volatility, and to analyze significant market events for regulatory purposes.

The Rule requires entities and individuals, such as investment advisers, whose transactions in NMS securities meet or exceed the daily or monthly thresholds identified by the Rule to self-identify to the SEC on Form 13H, and also requires certain recordkeeping, reporting, and monitoring responsibilities for broker-dealers.² During examinations, OCIE observed that some investment advisers and broker-dealers were either not aware of the Rule or were not familiar with certain requirements. This Risk Alert is intended to assist investment advisers and broker-dealers in reviewing and enhancing their compliance programs with respect to their Large Trader obligations. This Risk Alert is also intended to remind broker-dealers of their regulatory reporting obligations related to the reporting of Large Trader information in Electronic Blue

* The views expressed herein are those of the staff of OCIE. This Risk Alert is not a rule, regulation, or statement of the Securities and Exchange Commission (the “SEC” or the “Commission”). The Commission has neither approved nor disapproved the content of this Risk Alert. This Risk Alert has no legal force or effect: it does not alter or amend applicable law, and it creates no new or additional obligations for any person. This document was prepared by OCIE staff and is not legal advice.

¹ Large Trader Reporting, Exchange Act Rel. No. 34-64976 (July 27, 2011), *available at*: <https://www.sec.gov/rules/final/2011/34-64976.pdf> (“Large Trader Reporting”).

² See Rule 13h-1.

Sheets and their upcoming reporting obligations with respect to the Consolidated Audit Trail (“CAT”).³

II. Background

Rule 13h-1 defines a Large Trader as a person whose transactions in NMS securities 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 Rule also applies to persons that exercise investment discretion over trading in NMS securities. An investment adviser that exercises investment discretion directly or indirectly on behalf of itself or others, for example, will become a Large Trader if it meets the transaction thresholds in the definition.

A Large Trader must file and periodically update Form 13H, which provides the Commission with general information about its business, regulatory status, affiliates, governance, and broker-dealers where the Large Trader has an account.⁴ Upon receipt of Form 13H, the Commission will assign to each Large Trader a unique identification number (“LTID”). A Large Trader must then disclose its LTID to all broker-dealers effecting transactions on its behalf and must identify to each such broker-dealer all accounts at that broker-dealer to which the LTID applies.⁵

Under the recordkeeping requirements in Rule 13h-1, broker-dealers are required to maintain records for all transactions effected directly or indirectly by or through (i) an account such broker-dealer carries for a Large Trader or an Unidentified Large Trader⁶ or (ii) if the broker-dealer is a Large Trader, any proprietary or other account over which such broker-dealer exercises investment discretion. For Unidentified Large Traders, broker-dealers should assign their own unique identifier to the applicable account(s).⁷ In addition, the Rule requires that upon request of the Commission, broker-dealers report certain Large Trader information using the Electronic Blue Sheets infrastructure.

The Rule has a safe harbor for broker-dealers to detect and identify persons that may be Large Traders. A broker-dealer is deemed not to know or have reason to know that a person is a Large Trader if it does not have actual knowledge that the person is a Large Trader and it establishes policies and procedures that (1) identify persons who have not identified as a Large Trader under the rule but whose transactions effected through the broker-dealer equal or exceed the Large Trader identifying activity level;⁸ (2) treat any person identified in (1) as an Unidentified Large

³ See Rule 17a-25.

⁴ Form 13H, available at: <https://www.sec.gov/files/form13h.pdf>.

⁵ See Rule 13h-1(b)(2).

⁶ The Rule requires broker-dealers to treat as an Unidentified Large Trader (for purposes of the recordkeeping and reporting provisions in paragraphs (d) and (e) of the Rule) any person that the broker-dealer “knows or has reason to know” is a Large Trader where such person has not complied with the identification requirement applicable to Large Traders (i.e., has not identified itself as a Large Trader to the broker-dealer and disclosed the accounts to which its LTID applies).

⁷ Large Trader Reporting, at fn.165.

⁸ See Rule 13h-1(a)(7).

Trader; and (3) inform any person identified in (1) of its potential obligations under the Rule.⁹ The broker-dealer monitoring requirements are intended to promote awareness of and foster compliance with Rule 13h-1.¹⁰

III. Staff Observations

OCIE conducted a number of examinations that focused on broker-dealers and investment advisers' compliance with Rule 13h-1. During these examinations, staff observed numerous instances of potential non-compliance with the Rule including where Large Traders may not have self-identified with the SEC and/or may not have filed their annual Form 13H as required by the Rule.

In response to OCIE's observations, firms were responsive and improved their procedures, processes, and controls to help ensure compliance with the Rule. Additionally, firms that may have missed their filing obligations took steps to address these issues, including the submission of Forms 13H for prior years. OCIE encourages both investment advisers and broker-dealers to thoroughly review and, where appropriate, amend their supervisory and compliance policies and procedures to ensure compliance with the Rule.

Investment Advisers

An investment adviser that transact in NMS securities is encouraged to review its compliance policies and procedures around:

- Identifying situations that could lead the investment adviser to become a Large Trader under the Rule.
 - For example, if an investment adviser enters into a new discretionary client or customer agreement, the trading activity may meet the transaction thresholds of the Rule and result in the investment adviser being deemed a Large Trader.
- Timely filing of Form 13H, with respect to both the annual filing requirement and obligations to provide amended filings, where applicable.
- Promptly following the end of a calendar quarter amending Form 13H in the event that any of the information contained within the filing becomes inaccurate for any reason, including the list of broker-dealers effecting transactions in eligible securities by the investment adviser, or the investment adviser's affiliates.¹¹
- Notifying any broker-dealers through which the investment adviser executes transactions of its Large Trader status.

⁹ See Rule 13h-1(f).

¹⁰ Large Trader Reporting, at 16.

¹¹ See Rule 13h-1(b)(2) and Rule 13h-1(b)(1)(iii)

Broker-Dealers

Staff observed that firms had potential compliance issues in the following areas: (1) recordkeeping; (2) monitoring; and (3) reporting to Electronic Blue Sheets. For a broker-dealer that transact in NMS securities, OCIE encourages it to assess and make any necessary changes to its supervisory and compliance policies and procedures with respect to:

- Applicability of the Rule to the broker-dealer and its affiliates.
- Timely filing of both the annual filing and any amended filings of Form 13H, if applicable.
- Reporting requirements under Electronic Blue Sheets and the CAT, as well as applicable FINRA Rules.
- Monitoring customer activity to identify customers that may be Large Traders, but have not provided their LTIDs, and the process of contacting such customers.
- Identifying and associating new accounts for existing Large Traders.

OCIE encourages market participants to visit the Division of Trading and Markets' *Responses to Frequently Asked Questions Concerning Large Trader Reporting* for additional staff views.¹²

III. Broker-Dealer Reporting Responsibilities

Information to identify each Large Trader in a uniform manner across markets is necessary to permit the SEC to fully track and analyze Large Trader activity, especially with respect to Large Traders that trade through multiple accounts at multiple broker-dealers or trade using direct market access arrangements.¹³ The Rule requires that, upon a request from the Commission for transaction data, a broker-dealer that is itself a Large Trader or carries an account for a Large Trader or an Unidentified Large Trader must report that data to the Commission. The requirements that a Large Trader provide its LTID to all broker-dealers who effect transactions on its behalf, and identify each account to which it applies, are ongoing responsibilities that must be discharged promptly by each Large Trader.¹⁴

Additionally, where a non-broker-dealer carries an account for a Large Trader or an Unidentified Large Trader, the broker-dealer effecting such transactions directly or indirectly for the Large Trader or Unidentified Large Trader must electronically report transaction data to the

¹² See Responses to Frequently Asked Questions Concerning Large Trader Reporting, *available at*: <https://www.sec.gov/divisions/marketreg/large-trader-faqs.htm>.

¹³ Large Trader Reporting, at 12.

¹⁴ Large Trader Reporting, at 44.

Commission through the Electronic Blue Sheets system for such transactions equal to or greater than the reporting activity level.¹⁵

Consolidated Audit Trail Reporting Obligations

On July 18, 2012, the Commission adopted Rule 613 under Regulation NMS (“Rule 613”) to create a comprehensive consolidated audit trail that would allow regulators to track all activity throughout the U.S. markets in NMS securities.¹⁶ Among other things, Rule 613 requires the self-regulatory organizations (“SROs”) jointly to submit a plan – called the CAT NMS Plan – to create, implement and maintain the CAT. The rule specifies the type of data to be collected, as well as when the data is to be reported to the CAT. Whereas Electronic Blue Sheets are trading records requested by the Commission and SROs from clearing broker-dealers, reporting into the CAT applies to all broker-dealers. On April 20, 2020, the Commission issued two exemptive orders that together allow for the phased reporting of data by broker-dealers into the CAT.¹⁷

The reporting of customer identifying information as it relates to Large Traders begins on April 26, 2021. On that date, large broker-dealers are required to report to the CAT certain account information regarding account holders with a LTID or an Unidentified Large Trader Identification number (collectively called “LTID Account Information”).¹⁸ The reporting requirements and guidance for such reporting are set forth in the CAT Reporting Customer and Account Information Technical Specifications for Industry Members.¹⁹

Broker-dealers will be required to obtain and report LTIDs to the CAT for accounts with Reportable Events. Given that this requirement extends beyond clearing broker-dealers, the number of firms required to report LTIDs will increase. Firms for which this is a new requirement may have to change their current onboarding activities to verify whether an LTID exists, and is recorded and reported to the CAT, for any account with Reportable Events.²⁰ OCIE recommends that broker-dealers review the new reporting obligation requirements under

¹⁵ See Rule 13h-1(e).

¹⁶ See Consolidated Audit Trail, Exchange Act Rel. No. 34-67457 (July 18, 2012), available at: <https://www.sec.gov/rules/final/2012/34-67457.pdf>.

¹⁷ See Order Granting Conditional Exemptive Relief, Exchange Act Rel. No. 34-88702 (April 20, 2020), available at: <https://www.sec.gov/rules/exorders/2020/34-88702.pdf> and Order Granting Conditional Exemptive Relief, Exchange Act Rel. No. 34-88703 (April 20, 2020), available at: <https://www.sec.gov/rules/exorders/2020/34-88703.pdf>.

¹⁸ By December 13, 2021, all broker-dealers must report LTID Account Information related to all remaining active accounts, available at: <https://www.catnmsplan.com/faq>.

¹⁹ See Order Granting Conditional Exemptive Relief, Pursuant to Section 26 of the Exchange Act and Rule 608(e) of Regulation NMS Under the Exchange Act, from Section 6.4, 6.7 (a)(v) and 6.7(a)(vi) of the National Market System Plan Governing the Consolidated Audit Trail (April 20, 2020), available at <https://www.sec.gov/rules/exorders/2020/34-88702.pdf>. See also CAT Industry Members Specifications, available at: <https://www.catnmsplan.com/specifications/im>.

²⁰ See CAT NMS Plan Section 6.4. “Reportable Events” is defined in Section 1.1 of the CAT NMS Plan, available at: <https://www.sec.gov/rules/sro/nms/2016/34-79318-exhibit-a.pdf>.

the CAT NMS Plan related to Large Traders and ensure they are ready to meet these reporting requirements by April 26, 2021.

IV. Conclusion

Examinations of investment advisers and broker-dealers have resulted in a range of observations with respect to Large Trader regulatory obligations. OCIE encourages investment advisers and broker-dealers to review their practices, and written policies and procedures, including the implementation of those policies and procedures, to address the issues discussed in this Risk Alert. OCIE also encourages firms to review their applicable reporting obligations, currently for Electronic Blue Sheets, and forthcoming for the CAT.

This Risk Alert is intended to highlight for firms risks and issues that OCIE staff has identified. In addition, this Risk Alert describes factors that firms may consider to (i) assess their supervisory, compliance, and/or other risk management systems related to these risks, and (ii) make any changes, as may be appropriate, to address or strengthen such systems. These factors are not exhaustive, nor will they constitute a safe harbor. Other factors besides those described in this Risk Alert may be appropriate to consider, and some of the factors may not be applicable to a particular firm's business. While some of the factors discussed in this Risk Alert reflect existing regulatory requirements, they are not intended to alter such requirements. Moreover, future changes in laws or regulations may supersede some of the factors or issues raised here. The adequacy of supervisory, compliance, and other risk management systems can be determined only with reference to the profile of each specific firm and other facts and circumstances.
