

PAPERWORK REDUCTION ACT SUBMISSION

Rule 13h-1: Large Trader Reporting System

SUPPORTING STATEMENT

A. Justification

1. Need For Information Collection

Proposed Rule 13h-1 and Form 13H under Section 13(h) of the Securities Exchange Act of 1934 (“Exchange Act”) would establish a large trader reporting system. The proposal is intended to assist the Commission in identifying and obtaining certain baseline trading information about traders that conduct a substantial amount of trading activity, as measured by volume or market value, in the U.S. securities markets. In essence, a “large trader” would be defined as a person whose transactions in national market system (“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 proposed large trader reporting system is designed to facilitate the Commission’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. It also should enhance the Commission’s ability to detect and deter fraudulent and manipulative activity and other trading abuses, and should provide the Commission with a valuable source of useful data to study markets and market activity.

The proposed identification, recordkeeping, and reporting system would provide the Commission with a mechanism to identify large traders and their affiliates, accounts, and transactions. Specifically, proposed Rule 13h-1 would require large traders to identify themselves to the Commission and make certain disclosures to the Commission on proposed Form 13H. Upon receipt of Form 13H, the Commission would issue a unique identification number to the large trader,¹ which the large trader would then provide to its registered broker-dealers. Registered broker-dealers would be required to maintain transaction records for each large trader, and would be required to report that information to the Commission upon request. In addition, registered broker-dealers would be required to adopt procedures to monitor their customers for activity that would trigger the identification requirements of the proposed rule.

2. Purpose of, and Consequences of Not Requiring, the Information Collection

In light of the dramatic changes to the securities markets, including increased volumes, volatility, and the growing prominence of large traders, the Commission has

¹ The unique identification number would be called a Large Trader Identification Number or “LTID.”

proposed to establish a large trader reporting system. The information collection is necessary to enhance the Commission's ability to identify large market participants, collect information on their trading, and analyze their trading activity. This information would allow the Commission to more effectively and efficiently monitor the impact of large trader activity on the securities markets.

3. Role of Improved Information Technology and Obstacles to Reducing Burden

Proposed Rule 13h-1 would require large traders to self-identify to the Commission and inform their broker-dealers and others with whom they exercise investment discretion of their unique identification number and all accounts to which it applies. In addition, the proposed rule would impose recordkeeping, reporting, and monitoring requirements on registered broker-dealers. The Commission believes that proposed Rule 13h-1 would enhance the Commission's ability to obtain electronic data concerning the trading activity of large traders in an efficient manner utilizing existing electronic reporting systems. Moreover, the Commission believes that improvements in telecommunications and data processing technology may reduce any burdens associated with proposed Rule 13h-1.

4. Efforts To Identify Duplication

The Commission, pursuant to Rule 17a-25,² currently collects transaction data from registered broker-dealers through the Electronic Blue Sheets ("EBS") system to support its regulatory and enforcement activities. The Commission uses the EBS system to obtain securities transaction information to: (1) assist in the investigation of possible federal securities law violations, primarily involving insider trading or market manipulation; and (2) conduct market reconstructions. The EBS system can be inefficient, however, for conducting large-scale investigations and market reconstructions involving numerous stocks during peak trading volume periods in large part because the EBS system does not collect critical information such as the time of the trade and the identity of the trader. To address this limitation with respect to large traders, the Commission believes that its large trader proposal supplements the existing EBS system.

The proposed rule would not be duplicative of the existing EBS system because it would add two new fields, the time of the trade and the identity of the trader, to the system. These two fields do not currently exist, which makes enforcement investigations and market reconstructions much more difficult to conduct.

5. Effects on Small Entities

The rule requirements would have minimal, if any, effect on small entities. Among other things, the proposed rule would apply to "large traders," which is a term that implicates persons and entities with the resources and capital necessary to transact securities in substantial volumes relative to overall market volume in publicly traded

² See 17 CFR 240.17a-25.

securities. The Commission does not believe that any small entities would be engaged in the business of trading, over the course of the applicable measuring period, in a volume that approaches the threshold levels. Further, for purposes of determining whether a person effects the requisite amount of transactions in NMS securities to meet the definition of “large trader,” paragraph (a)(6) of the proposed rule would exclude a limited set of transactions from the term “transaction” and the requirements of the proposed rule in order to exempt certain small or infrequent traders who might trigger identification based on a single transaction. In addition, the proposed rule would apply to registered broker-dealers that serve large trader customers. Given the considerable volume in which a large trader would effect transactions, registered broker-dealers servicing large trader customers or broker-dealers that are large traders themselves likely would be larger entities that have systems and capacities capable of handling the trading associated with such accounts. Accordingly, the Commission estimates that no small entities will be affected by the proposed rule.

6. Consequences of Less Frequent Collection

Large trader self-identification on proposed Form 13H would be collected initially with mandatory annual updates and more frequent quarterly updates as necessary. Large trader trading data would be collected by the Commission from broker-dealers on an as-needed basis. The collection of this information would facilitate the Commission’s ability to identify large traders, assess the impact of large trader activity on the securities markets, to reconstruct their trading activity, and analyze significant market events for regulatory purposes. Less frequent collection of this information would undermine the purposes of the rule.

7. Inconsistencies With Guidelines In 5 CFR 1320.5(d)(2)

The collection of information would not be inconsistent with 5 CFR 1320.5(d)(2).

8. Consultations Outside the Agency

All Commission rule proposals are published in the Federal Register for public comment. The comment period for the release that discusses proposed Rule 13h-1 is 60 days.³ This comment period will afford the public an opportunity to respond to the proposal.

9. Payment or Gift to Respondents

Not applicable.

³ See Securities Exchange Act Release No. 61908 (Apr. 14, 2010); 75 FR 21456 (Apr. 23, 2010) (File No. S7-10-10).

10. Assurance of Confidentiality

The information collection under proposed Rule 13h-1 will be considered confidential subject to the limited exceptions provided by the Freedom of Information Act.⁴

11. Sensitive Questions

Not applicable. Questions of a sensitive nature are not asked.

12. Estimate of Respondent Reporting Burden

The proposed “collection of information” contained in proposed Rule 13h-1 would apply to approximately 400 large traders⁵ and 300 registered broker-dealers.⁶

a. Large Traders

Under the proposed rule, large traders would be required to identify themselves to the Commission by filing a Form 13H and submitting annual updates, as well as updates on a quarterly basis if necessary to correct information that becomes inaccurate. Additionally, each large trader would be required to identify itself to each registered broker-dealer through which it effects transactions and to all others with whom it collectively exercises investment discretion.

i. Initial Filing of Form 13H and Identifying as a Large Trader

The Commission estimates that the initial burden for a respondent to comply with the proposed requirements would be 20 burden hours.⁷ This figure includes the time to

⁴ See 5 U.S.C. 552 and 15 U.S.C. 78m(h)(7).

⁵ While the Commission is not aware of a database that would allow the Commission to calculate the precise number of persons that would meet the definition of large trader, based on the Commission’s experience in this area, the Commission estimates that there would be 400 large traders subject to the proposed rule. The estimated number of large traders accounts for the proposed filing requirement provision contained in Rule 13h-1(b)(3), which encourages large traders to report at the parent company level as opposed to reporting at the individual subsidiary level.

⁶ The Commission estimates from broker-dealer responses to FOCUS report filings with the Commission made in 2009 that there would be 300 registered broker-dealers subject to the proposed rule, including some of those broker-dealers that will also themselves be large traders.

⁷ The Commission derived this burden estimate from the following estimate, which is based on the Commission’s experience with and burden estimates for other existing reporting systems, including Rule 13f-1: (Compliance Manager at 3

calculate whether its trading activity qualifies it as a large trader, complete the initial Form 13H with all required information, obtain a LTID from the Commission, and inform its registered broker-dealers and other entities of its LTID and the accounts to which it applies. In addition, this figure takes into account the Commission's understanding that large traders currently maintain systems that capture their trading activity. Therefore, the Commission believes that these existing systems would be sufficient without further modification to enable a large trader to determine whether it effects transactions for the purchase or sale of any NMS security for or on behalf of accounts over which it exercises investment discretion in an aggregate amount equal to or greater than the identifying activity level. Accordingly, the Commission estimates that the one-time aggregate burden for large traders would be approximately 8,000 burden hours.⁸

ii. Annual and Quarterly Reporting

On an ongoing basis, a respondent may have to file interim updates, and would have to update its Form 13H annually. The Commission estimates that the ongoing annualized burden for a respondent to fulfill its reporting obligations would be approximately 17 burden hours.⁹ This estimate is based on the varied characteristics of large traders and the nature and scope of the items that would be disclosed on proposed Form 13H that would require updating and is based on the assumption that large traders would file one required annual update and three quarterly updates when information contained in the Form 13H becomes inaccurate. Accordingly, the Commission estimates that the ongoing annualized burden for large traders for complying with the proposed rule would be 6,800 burden hours for all large trader respondents.¹⁰

iii. Total Large Trader Burden

The total annual burden for all large trader respondents will be 8,000 hours in the first year, and 6,800 hours for each subsequent year.

hours) + (Compliance Attorney at 7 hours) + (Compliance Clerk at 10 hours) = 20 burden hours.

⁸ The Commission derived this aggregate burden estimate from the following: (20 initial burden hours) x 400 respondents = 8,000 total initial burden hours.

⁹ The Commission derived this burden estimate from the following estimates, which are based on the Commission's experience with and burden estimates for other existing reporting systems, including Rule 13f-1 and Rule 17a-25: (Compliance Manager at 2 hours) + (Compliance Attorney at 5 hours) + (Compliance Clerk at 10 hours) = 17 burden hours. Rule 17a-25 requires broker-dealers to disclose information that is very similar in scope and character to the information required under the proposed rule.

¹⁰ The Commission derived this aggregate burden estimate from the following: (17 annual burden hours) x 400 respondents = 6,800 total ongoing burden hours.

For purposes of submitting this request to OMB, the Commission has averaged these hourly burdens to determine the estimated annual burden hours required to comply with proposed Rule 13h-1. Accordingly, based on the Commission's estimates for the initial annual and ongoing annual burden hours the total average annual burden hours required to comply with proposed Rule 13h-1 will be 7,200 hours over a three year period. The Commission derived the estimated total hours figure from the following: (8,000 hours (aggregate initial annual burden) + (6,800 hours (aggregate ongoing annual burden) x 2 years)) / 3 years.

b. Registered Broker-Dealers

Under the proposed rule, registered broker-dealers would be required to comply with recordkeeping and monitoring and reporting requirements.

i. Recordkeeping

The Commission believes that the burden of the proposed rule for individual registered broker-dealers would likely vary due to differences in their recordkeeping systems. The Commission estimates that all registered broker-dealers that either have a client base that includes large traders and Unidentified Large Traders¹¹ or that are themselves large traders, would be required to make modifications to their existing systems to capture the additional data elements that are not currently captured by systems that are used in connection with the existing EBS system, including, for example, the LTID number.

1. Initial

The Commission preliminary estimates that the one-time, initial annualized burden for a respondent to conduct system development, including re-programming and testing of the systems to comply with the proposed rule, would be 445 burden hours.¹²

¹¹ Proposed Rule 13h-1(a)(9) defined the term “Unidentified Large Trader” to mean each person who has not complied with the identification requirements of paragraphs (b)(1) and (b)(2) of the rule that a registered broker-dealer knows or has reason to know is a large trader.

¹² The Commission derived the total estimated burden from the following estimates, which are based on the Commission's experience with, and burden estimates for, other existing reporting systems including Rule 13f-1 and Rule 17a-25: (Computer Ops Dept. Mgr. at 30 hours) + (Sr. Database Administrator at 25 hours) + (Sr. Programmer at 150 hours) + (Programmer Analyst at 100 hours) + (Compliance Manager at 20 hours) + (Compliance Attorney at 10 hours) + (Compliance Clerk at 20 hours) + (Sr. Systems Analyst at 50 hours) + (Director of Compliance at 5 hours) + (Sr. Computer Operator at 35 hours) = 445 burden hours. As noted in the release, the Commission acknowledges that, in some instances, multiple LTIDs may be disclosed to a registered broker-dealer for a single account. Therefore, our hourly burden estimate factors in the cost that registered broker-dealers would need to develop systems capable of tracking

This figure is based on the estimated number of hours for initial internal system development and implementation, including software development, taking into account the fact that new data elements are required to be captured and must be available for reporting to the Commission as of the morning following the day on which the transactions were effected. Because broker-dealers already capture, pursuant to Rule 17a-25 and the existing EBS system, most of the data that proposed Rule 13h-1 would capture, the Commission does not expect broker-dealers to incur any hardware costs. Accordingly, the Commission estimates that the aggregate one-time, initial annualized to comply with the proposed rule would be 133,500 hours.¹³

2. Ongoing

The Commission preliminarily believes that the ongoing annualized expense for the recordkeeping requirement for registered broker-dealers would not result in a burden, as registered broker-dealers already are required to provide to the Commission almost all of the proposed information for all of their customers pursuant to Rule 17a-25 under the Exchange Act. Once a registered broker-dealer's system is revised to capture the additional fields of information, the Commission does not believe that the additional fields would result in any ongoing annualized expense beyond what broker-dealers already incur under Rule 17a-25 and the existing EBS system.

3. Total Recordkeeping Burden

The total annual record keeping burden will be 133,500 hours in the first year, and 0 hours for each subsequent year.

For purposes of submitting this request to OMB, the Commission has averaged these hourly burdens to determine the estimated annual burden hours required to comply with the proposed rule. Accordingly, based on the Commission's estimates for the initial annual and ongoing annual burden hours the total average annual burden hours required to comply with proposed Rule 13h-1 will be 44,500 hours over a three year period. The Commission derived the estimated total hours figure from the following: (133,500 hours (aggregate initial annual burden) + (0 hours (aggregate ongoing annual burden) x 2 years)) / 3 years = 44,500.

ii. Monitoring

In addition to requiring registered broker-dealers to maintain records of account transactions, the proposed rule also would require registered broker-dealers to monitor for such transactions. In particular, the proposed rule would require registered broker-dealers to monitor large traders to help ensure compliance by large traders with the self-identification requirements of the rule. Paragraph (e) of the proposed rule would require

multiple LTIDs.

¹³ The Commission derived this estimate from the following: (445 initial burden hours) x 300 respondents = 133,500 total initial burden hours.

certain broker-dealers to maintain and report to the Commission certain information about all transactions effected by Unidentified Large Traders.

The Commission acknowledges that the duty to monitor would impose burdens on broker-dealers. To reduce the monitoring burden, the Commission has proposed a safe harbor provision for the monitoring duty. Specifically, registered broker-dealers would be deemed to not know or to have no reason to know that a person is an Unidentified Large Trader if: (1) it has established and maintains policies and procedures reasonably designed to assure compliance with the identification requirements of the proposed rule; and (2) it does not have actual knowledge that a person is a large trader.¹⁴

1. Initial

The Commission preliminary estimates that the one-time, initial burden for a respondent to comply with the proposed monitoring requirements by establishing a compliance system to detect and identify Unidentified Large Traders as well as monitoring in the first year would be 70 burden hours.¹⁵ This figure is based on the estimated number of hours to establish policies and procedures reasonably designed to assure compliance with the identification requirements of the proposed rule. Accordingly, the Commission estimates that the aggregate initial, one-time burden to comply with the monitoring requirements is 21,000 hours.¹⁶

2. Ongoing

The Commission preliminarily estimates that the ongoing annualized burden to a respondent for the monitoring requirements of the proposed rule, including the proposed requirement on broker-dealers to inform Unidentified Large Traders of their obligations to file Form 13H and disclose their large trader status under proposed Rule 13h-1, would be approximately 15 burden hours per year.¹⁷ Accordingly, the Commission estimates

¹⁴ See proposed Rule 13h-1(f).

¹⁵ The Commission derived the estimated total burden from the following estimates, which are based on the Commission's experience with, and burden estimates for, other existing reporting systems including Rule 13f-1: (Sr. Programmer at 10 hours) + (Compliance Manager at 10 hours) + (Compliance Attorney at 10 hours) + (Compliance Clerk at 20 hours) + (Sr. Systems Analyst at 10 hours) + (Director of Compliance at 2 hours) + (Sr. Computer Operator at 8 hours) = 70 burden hours. Rule 13f-1, like the proposed rule, requires monitoring of a certain trading threshold.

¹⁶ The Commission derived this estimate from the following: (70 initial burden hours) x 300 respondents = 21,000 total initial burden hours.

¹⁷ The Commission derived the estimated total burden from the following estimates, which are based on the Commission's experience with, and burden estimates for, other existing reporting systems including Rule 13f-1 and Rule 17a-25: (Compliance Attorney at 15 hours) = 15 burden hours. Rule 13f-1, like the proposed rule, requires monitoring of a certain threshold and, upon reaching that

that the ongoing annualized burden for all respondents for the monitoring requirements would be 4,500 burden hours.¹⁸

3. Total Monitoring Burden

The total annual monitoring burden will be 21,000 hours in the first year, and 4,500 hours for each subsequent year.

For purposes of submitting this request to OMB, the Commission has averaged these hourly burdens to determine the estimated annual burden hours required to comply with the proposed rule. Accordingly, based on the Commission's estimates for the initial annual and ongoing annual burden hours the total average annual burden hours required to comply with proposed Rule 13h-1 will be 10,000 hours over a three year period. The Commission derived the estimated total hours figure from the following: (21,000 hours (aggregate initial annual burden) + (4,500 hours (aggregate ongoing annual burden) x 2 years)) / 3 years = 10,000.

iii. Reporting

The proposed rule also would require registered broker-dealers to report large trader transactions to the Commission upon request. The Commission preliminarily believes that this collection of information would not involve any substantive or material change in the burden that already exists as part of registered broker-dealers providing transaction information to the Commission in the normal course of business, particularly in connection with the existing EBS system.¹⁹ However, the Commission notes that the information would need to be available for reporting to the Commission on a next-day basis, versus the 10 business day period that is generally associated with an EBS request for data.²⁰ Nevertheless, once the electronic recordkeeping system is in place to capture the information, where such system is specifically designed and built to furnish the information within the next-day time period specified in the proposal, the Commission preliminarily believes that the provision of such information to the Commission would result in minimal additional burden.

Although it is difficult to predict with certainty the Commission's future needs to obtain large trader data, taking into account the Commission's likely need for data to be used in market reconstruction purposes and investigative matters, the Commission estimates that it would likely send 100 requests for large trader data per year to each registered broker-dealer subject to the proposed rule.²¹ The Commission estimates that it would take a registered broker-dealer 2 hours to comply with each request, considering

threshold, disclosure of information.

¹⁸ The Commission derived this estimate from the following: (15 annual burden hours) x 300 respondents = 4,500 total ongoing burden hours.

¹⁹ See 17 CFR 240.17a-25.

²⁰ See Securities Exchange Act Release No. 44494 (June 29, 2001), 66 FR 35836 (July 9, 2001) (File No. S7-12-00) (17a-25 adopting release).

that a broker-dealer would need to run the database query of its records, download the data file, and transmit it to the Commission. Accordingly, the annual reporting hour burden for a respondent is estimated to be 200 burden hours (100 requests x 2 burden hours/request = 200 burden hours).²² The annual aggregate annual reporting burden is estimated to be 60,000 hours (200 annual burden hours x 300 respondents = 60,000 aggregate burden hours).

c. Total Broker-Dealer Burden

For the first year, the estimated aggregate annual burden hours for broker-dealers to comply with the proposed Rule 13h-1 are 214,500 hours. The Commission derived the estimated total hours figure from the following: (133,500 hours (estimated total initial burden for recordkeeping requirement) + 21,000 hours (estimated total initial burden for the monitoring requirement) + 60,000 hours (estimated total burden for reporting) = 214,500 total burden hours).

For subsequent years, the estimated aggregate annual burden hours required to comply with Rule 13h-1 are 64,500. The Commission derived the estimated total hours figure from the following: (4,500 hours (estimated total ongoing burden for the monitoring requirement) + 60,000 hours (estimated total burden for reporting) = 64,500 total burden hours).

For purposes of submitting this request to OMB, the Commission has averaged these hourly burdens to determine the estimated annual burden hours required to comply with the proposed rule. Accordingly, based on the Commission's estimates for the initial annual and ongoing annual burden hours of complying with Rule 13h-1, the total average

²¹ Compared to the EBS system, where the Commission sent 5,168 electronic blue sheets requests between January 2007 and June 2009, the Commission preliminarily expects to send fewer requests for large trader data, in particular because the Commission preliminarily expects that a request for large trader data would be broader and encompass a larger universe of securities and a longer time period than would be the case for the typically more targeted EBS requests it sends to broker-dealers.

²² The Commission derived the estimated total annual burden based on the Commission's experience with, and burden estimates for, other existing reporting systems, including Rule 17a-25. The Commission estimated that each broker-dealer who electronically responds to a request for data in connection with Rule 17a-25 and the EBS system spends 8 minutes per request. See 17a-25 adopting release, supra note 20, at 66 FR 35841. Unlike EBS, under proposed Rule 13h-1, a broker-dealer would also be required to report data on Unidentified Large Traders. The Commission therefore believes that the time to comply with a request for data under the proposed rule could take longer than would a similar request for data under the EBS system, as a broker-dealer likely would take additional time to review and report information on any Unidentified Large Traders, including the additional fields of information required by paragraph (d) (3) of the proposed rule.

annualized burden hours are estimated to be 114,500 hours over a three year period. This figure is derived from the following: (214,500 hours (aggregate initial annual burden) + (64,500 hours (aggregate ongoing annual burden) x 2 years)) / 3 years).

13. Estimate of Total Annualized Cost Burden

The Commission believes that compliance with the proposed rule does not require any capital or start up costs, or any recurring annual external operating and maintenance costs separate from the wages, salaries, or fees represented in the estimated hourly burdens discussed above.

14. Estimate of Cost to Federal Government

There would be no additional costs to the Federal Government.

15. Explanation of Changes in Burden

Not applicable. Proposed Rule 13h-1 would be a new rule.

16. Information Collection Planned for Statistical Purposes

Not applicable.

17. Explanation as to Why Expiration Date Will Not Be Displayed

Not applicable.

18. Exceptions to Certification

Not applicable.

B. Collection of Information Employing Statistical Methods

The collection of information does not employ statistical methods, nor would the implementation of such methods reduce the burden or improve the accuracy of results.