SIFMA
Securities Industry and
Financial Markets Association

June 24, 2010

By Electronic Mail (rule-comments@sec.gov)

Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

Re: The Proposed Large Trader Reporting System – SEC Release No. 34-61908; File No. S7-10-10

Dear Secretary Murphy:

The Securities Industry and Financial Markets Association ("SIFMA")[1] welcomes the opportunity to comment on the recent proposal of the Securities and Exchange Commission (the "SEC") to establish a large trader reporting system (the "Proposal").[2] This proposal builds upon the SEC's prior proposals of a large trader reporting system in 1991 and 1994.[3] All three proposals are based on the authority granted to the SEC in the Market Reform Act of 1990 (the "Market Reform Act") to collect broad-based information on large traders, including their trading activity.

SIFMA supports the SEC's objective of creating a system to provide complete and timely data to regulators that is reasonably necessary to assist them in comprehensively monitoring the markets they oversee. This same objective is the basis for the SEC's near

[1] The Securities Industry and Financial Markets Association ("SIFMA") brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association ("GFMA"). For more information, visit www.sifma.org.

[2] Large Trader Reporting System, Exchange Act Rel. No. 61908, 75 Fed. Reg. 21456 (Apr. 23, 2010).

[3] Large Trader Reporting System, Exchange Act Rel. No. 29593, 56 Fed. Reg. 42550 (proposed Aug. 22, 1991); Large Trader Reporting System, Exchange Act Release No. 33608, 59 Fed. Reg. 7917 (Feb. 17, 1994).

simultaneous proposal of a comprehensive consolidated audit trail for NMS securities (the "Consolidated Audit Trail Proposal").[4] There is a high degree of overlap between the large trader reporting system and the consolidated audit trail. Some of this overlap is complementary, but there also appears to be considerable redundancy. Although we will comment on the consolidated audit trail in a separate letter, SIFMA strongly urges the SEC to harmonize the large trader reporting system with the consolidated audit trail proposal. In this regard, we respectfully request that the SEC work to identify and then mandate at this time only those elements of the large trader system that would continue to operate as part of the consolidated audit trail.

SIFMA believes that a focused, harmonized approach to addressing the goals of the consolidated audit trail and the large trader reporting system would be further achieved by forgoing the build out of the electronic blue sheets and instead expanding FINRA's Order Audit Trail System[5] ("OATS") in addition to otherwise relying on existing audit trail systems in the interim period. SIFMA also recommends that the SEC modify the proposed large trader reporting system to: (1) narrow the scope of traders and broker-dealers that would be subject to the proposed rule; (2) clarify the duties of broker-dealers with respect to unidentified large traders and foreign entities; (3) lengthen the time periods for broker-dealer reporting; (4) reduce the burdens associated with filing Form 13H; and (5) extend the implementation timeframes.[6] If the SEC decides to use the electronic blue sheets for the large trader reporting system, SIFMA recommends that the SEC further modify the rule to account for the challenges associated with using the electronic blue sheets for this purpose. These suggested modifications and other responses to the SEC's requests for comment are discussed below.

Finally, in light of the fact that the European Union is considering a pan-European investor identification system, SIFMA recommends that the SEC consider coordinating with the United Kingdom's Financial Services Authority and the Committee of European Securities Regulators to harmonize such systems. For example, it would substantially

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[4] Consolidated Audit Trail, Exchange Act Rel. No. 62174, 75 Fed. Reg. 32556 (June 8, 2010). "NMS security" is defined as "any security or class of securities for which transaction reports are collected, processed, and made available pursuant to an effective transaction reporting plan, or an effective national market system plan for reporting transactions in listed options." 17 C.F.R. § 240.600(b)(46) (2010). The term refers to all exchange-listed securities, including equities and options.

[5] Currently, all U.S. broker-dealers who are FINRA members must report transaction information regarding receipt and execution or routing of all NASDAQ-listed and over-the-counter equity securities (subject to certain exclusions) to FINRA on a next day basis (by 5:00 A.M.).

[6] These recommendations are in line with the requirement under Section 13(h)(5) of the Exchange Act that the SEC, in exercising its rulemaking authority for large trader reporting, take into account: (1) existing reporting systems; (2) the costs associated with maintaining information with respect to transactions effected by large traders and reporting such information to the Commission; and (3) the relationship between United States and international securities markets. 15 U.S.C. § 78m(h)(5) (2010).

reduce the operational burden on firms with cross-border operations to have a single large trader identification number across jurisdictions or for similar criteria to be used in allocating a large trader identification number. For large entities in particular, this would cut down on the potential duplicative work involved in identifying accounts they control for the purpose of compliance with U.S. and European rules.

I. Consolidated Audit Trail and the Large Trader Reporting System Should Be Reconciled

SIFMA supports the creation of a uniform cross-market audit trail for NMS securities. A single uniform cross-market order and execution tracking system is long overdue and would significantly enhance the surveillance capabilities of the SEC and the self-regulatory organizations ("SRO"). The proposed large trader reporting system and consolidated audit trail are both intended to enhance the SEC's and the SROs' capabilities to reconstruct market trading activity in NMS securities.

Because of its broad scope, the consolidated audit trail would require significantly more time and effort to implement than the large trader reporting system. The Consolidated Audit Trail Proposal indicates that the SEC believes that the full implementation of the consolidated audit trail will take at least two and a half years for NMS securities alone. The consolidated audit trail would require broker-dealers and SROs to report on a real-time basis all specified information concerning orders and executions, which goes far beyond what is currently required by the various SRO audit trails and what would be required by the large trader reporting system. Thus, it is likely that many aspects of the large trader reporting system would be significantly revamped or replaced by the consolidated audit trail in a few years.

Therefore, in staging the implementation of these two overlapping, somewhat redundant, systems, it is incumbent upon the SEC to minimize the enormous projected costs to the industry by mandating only those elements of the large trader system that would not be replaced or significantly altered by the consolidated audit trail. In particular, SIFMA believes that the SEC should implement only the large trader identification portion of the proposal, with certain modifications to Form 13H that are discussed in further detail below. Specifically, a large trader could be required to register with the SEC and disclose its large trader identification number to the broker-dealers effecting transactions on its behalf and to all others with whom it collectively exercises investment discretion. The consolidated audit trail contemplates the inclusion of the large trader identification number on every order, in addition to a unique customer order identifier on every order;[7] therefore, this aspect of the large trader reporting system could provide useful information to the SEC on a transitional basis and continue as a component of the consolidated audit trail.

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[7] Consolidated Audit Trail, 75 Fed. Reg. at 32,557.

In contrast, the SEC should forgo requiring a build-out of the electronic blue sheets and consider instead an incremental expansion of OATS. It is unlikely that the consolidated audit trail will use the electronic blue sheets as its infrastructure, whereas OATS provides a platform to build upon for the consolidated audit trail. Because blue sheets tend to be fed through the back office using a broker-dealer's books and records and do not capture trade execution times, building out the blue sheets would require building new systems for capturing and processing this information. Expanding the information required on the electronic blue sheets at this time would impose major costs on broker-dealers in restructuring their systems to drive electronic blue sheet reporting, only to have those systems discarded a short time later to accommodate the consolidated audit trail. Therefore, expansion of the electronic blue sheets at this time would not only unnecessarily strain the resources of broker-dealers and SROs, but also undoubtedly prolong the implementation of the consolidated audit trail.

Based on the current functionalities of OATS, leveraging that platform would be a more efficient, logical and effective means to implement the large trader reporting system and achieve the SEC's larger goal of a consolidated audit trail. OATS reporting processes are designed to provide front-office order and execution information on a next day reporting basis, whereas electronic blue sheets reporting systems at firms are generally designed to provide cleared and settled transaction information from the back office within ten business days. Because the consolidated audit trail would likely be based largely on feeds from front office order handling systems, providing large trader reporting system information through the incremental expansion of OATS would be more consistent with the future consolidated audit trail. Finally, an OATS-based approach would provide substantially more audit trail information than an expansion of the electronic blue sheets, which only include executed or allocated transactions and no information about orders. Because OATS includes information about unexecuted orders and routing of orders between market intermediaries, the SEC would be in a better position to reconstruct the market more comprehensively with an OATS-based approach rather than with the electronic blue sheets alone.

In addition, as highlighted in the following paragraphs and in section III A., forgoing the build-out of the electronic blue sheets would save the costs involved in significantly enhancing the related internal architecture that supports the electronic blue sheets. The electronic blue sheets infrastructure could not be leveraged for the consolidated audit trail because the consolidated audit trail will require real-time reporting of audit trail information and real-time reporting is incompatible with the electronic blue sheets infrastructure. Because electronic blue sheet reporting is done through a broker-dealer's books and records, passing execution times and large trader identification numbers downstream to the electronic blue sheets would require enhancements at every stage in the trade processing workflow. The work involved in doing so would be significantly more than if OATS were used, given that OATS information is generally sourced directly from front-office order handling and trading systems at firms and could be enhanced without changing the end-to-end flow of information to downstream books and records systems. Furthermore, because the electronic blue sheet requests have typically been made to clearing firms that do not necessarily execute trades, new mechanisms for obtaining execution times would need to be developed at such firms.

Reporting transaction execution times on the electronic blue sheets also would require significant, additional interpretative work in order to standardize guidance with respect to reporting execution time for average price transactions and clearing-only and prime brokerage transactions executed at other broker-dealers. Using OATS would allow broker-dealers and the SEC to leverage the existing interpretative guidance that OATS has developed for reporting execution times. In addition, OATS would be a better system for tracking large trader identification numbers associated with omnibus accounts. In OATS, large trader identification numbers underlying a transaction could be captured by the front office and then transmitted with additional transaction information; in contrast, the electronic blue sheet reporting system would require sending the large trader identification number downstream through the execution system, middle-office booking systems and the back office.

Finally, enhancing the electronic blue sheets to support new combinations of report generation criteria would require substantial resources at every reporting firm. The Proposal does not specify the type of large trader information requests that the SEC would make to broker-dealers; in other words, it is unclear whether the SEC would request information by date, large trader identification number, trade symbol or a combination thereof. If broker-dealers expanded the feed of information to OATS, FINRA could build a centralized capability for generating information requested by the SEC for its surveillance needs. Using a centralized reporting mechanism operated by FINRA could yield substantial savings for the industry in terms of implementation and ongoing monitoring and surveillance.[8]

Although using OATS would require certain incremental changes to ensure that FINRA would have the necessary information to provide to the SEC, those changes would not be as onerous. OATS enhancements also would appear to be more usable in the development of the consolidated audit trail. Using OATS for the large trader reporting system would require the following changes: (1) expanding the scope of equity transactions reportable to OATS to include all NMS securities, as well as currently exempted or excluded activities such as market making; (2) expanding OATS to include execution reports for orders that are routed to exchanges for execution (which today are

[8] Assuming that just the generation process alone would require three months of effort for each firm with an electronic blue sheets reporting responsibility and that conforming related systems would require additional time, and then multiplied across the approximately 300 broker-dealers that the SEC estimates would be subject to the proposed rule, the total build-out for the industry would require 75 years of effort on a cumulative basis.

reported as routes, but could be included as execution reports so that OATS would include execution details of orders that are executed on exchanges); (3) expanding the information on new order reports to include a new field to identify the large traders from which an order was received; and (4) building out the capabilities of persons who are not FINRA members. SIFMA also notes that adapting OATS for options reporting will require additional enhancements because options reports do not currently use a market participant identification field.

The OATS changes outlined above would be consistent with those required to support the future implementation of the consolidated audit trail. One firm has estimated that it would cost \$4 to \$5 million for the firm and take 18 to 24 months to expand OATS, whereas it would cost an estimated \$3 to \$4 million and take 12 to 18 months to build out the electronic blue sheets as proposed. Therefore, using the electronic blue sheets would require only slightly less investment and time to implement, but that investment and time would be of limited benefit to the SEC's larger goal of the consolidated audit trail and firms' build-out for the consolidated audit trail. The aggregate time and costs required to implement the large trader reporting system and consolidated audit trail would be greater if the blue sheets were used for the large trader reporting system. SIFMA urges the SEC to consider all alternatives that foster the most efficient use of resources while ensuring sufficient investor protection and SEC oversight of the markets.

If the SEC decides to follow this approach, there are certain other interim steps that SROs and broker-dealers could take to provide the SEC with the information it needs. In the period before the consolidated audit trail is developed, existing systems could be leveraged to enhance the information available to the SEC and SRO market surveillance systems. Broker-dealers could use existing reporting systems, in combination with large trader identification numbers, to provide the SEC with aggregate information on the trading activity of individual traders. These existing reporting systems include OATS, the New York Stock Exchange's (the "NYSE") Order Tracking System ("OTS"), the Large Options Positions Reports ("LOPRs") system and in-concert reports. Broker-dealers in turn could be required to collect and maintain trading activity records that are tagged with large trader identification numbers and provide such large trader identification numbers to the SEC upon request. This would allow the SEC to use existing audit trail data to understand customer trading activity.

The SEC could rely on broker-dealers to use reasonable efforts to provide the SEC and SROs with large trader transaction information within one business day of the request. Following the May 6, 2010 market events, firms were generally able to respond to SEC requests for information within this time period. SIFMA notes that it is currently not possible to provide such information for all transactions within one business day, and therefore does not support a requirement that information be provided within a specified time period. At the same time, SIFMA fully supports the goal of helping the SEC obtain the information it needs in a timely manner.

Also, harmonizing the large trader reporting system and the consolidated audit trail proposal would allow firms to manage internal resources in an efficient way, particularly as most firms would utilize the same operations and information technology personnel to develop and implement both systems.

Finally, we note that some firms believe that OATS may not be a perfect system, and also that the SEC may decide not to use an OATS framework for the consolidated audit trail. If that ends up being the case, SIFMA urges the SEC not to implement any broker-dealer reporting requirements under the large trader reporting system until the SEC determines the infrastructure that will be used for the consolidated audit trail. This approach will ensure that the build-out for the large trader reporting system is consistent with that required for the consolidated audit trail.

II. Scope of Application

A. The "Large Trader" Definition Is Too Broad

SIFMA believes that the scope of who must register as a large trader is overly broad and should be narrowed. The Proposal defines "large trader" as "any person that 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 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."[9] "Transaction" is broadly defined as "all transactions in NMS securities, including exercises or assignments of option contracts." The "identifying activity level" set by the Proposal is an amount equal to or greater than: (1) during a calendar day, either 2 million shares or shares with a fair market value of $20 million; or (2) during a calendar month, either 20 million shares or shares with a fair market value of $200 million.[10] Together, these definitions would sweep in a large and dissimilar set of market participants. SIFMA believes that the SEC has vastly underestimated the number and types of large traders that would be required to register under the rule. SIFMA estimates that 400 option traders alone would reach the large trader identification threshold and register as such. SIFMA believes that the SEC should review its proposed definitions and revise them as necessary to ensure that they do not inadvertently cover entities that the SEC did not intend to cover.

The SEC also should modify the requirement that a large trader aggregate its trading activities across entities. The Proposal's estimate that as few as 400 large traders

[9] Large Trader Reporting System, 75 Fed. Reg. at 21,460.

[10] Large Trader Reporting System, 75 Fed. Reg. at 21,459.

would be required to register must be based on an assumption that large traders would register only at the control person level. However, a control person aggregation approach is inconsistent with the management and operation of market participants that are constituent parts of complex organizations. Therefore, many complex entities may choose to register at their constituent levels.

Broaden Excepted Transactions

Although the SEC provides some exceptions from the definition of transaction, these exceptions do not appear to be tailored closely enough to the purposes of the rule and thus seem insufficient. SIFMA believes that the exceptions should be tailored to ensure they meet the SEC's goals of excluding transactions that "are not effected with an intent that is commonly associated with an arm's length purchase or sale of securities in the secondary market and therefore do not fall within the types of transactions that are characterized by the exercise of investment discretion."[11] For instance, the SEC should exclude entities and natural persons involved in large mergers and acquisitions and other purchases of assets; otherwise, a single large transaction of 2 million shares or $20 million dollars would trigger reporting requirements for a year and until the large trader could file for inactive status. This would cover, for example, a large stockholder of a public company who sells stock through a registration statement or otherwise. Infrequent traders should also be excluded from registration. Self-tenders, buybacks (including Rule 10b-18 buybacks), certain internal corporate actions (such as journals between accounts within the same entity where there is no change in the beneficial owner), and other non-trading activity could also trigger the registration requirement. Finally, stock loans, equity repurchases, in-kind creations of exchange-traded funds and cash settlements for options exercises and assignments also could trigger the registration requirements. Registration based on any of these activities would not further the purposes of the large trader reporting system, and SIFMA believes would be a waste of resources and overwhelm the SEC and SROs with unneeded data.

Raise the Activity Threshold

The proposed rule's identifying activity level also should be adjusted. The SEC should raise the threshold number and fair market value of shares traded that are specified in the rule to avoid sweeping in a large number of traders whose activities are not

[11] Large Trader Reporting System, 75 Fed. Reg. at 21,463.

significant compared to the overall market volume. Instead, their trading activity should be addressed by the consolidated audit trail.[12]

Narrow Control Person Scope

Under the Proposal, the "control person" is responsible for registering or ensuring that each of its constituent large traders register. In addition, the scope of accounts considered under an entity's control is very broad. The SEC should narrow the scope of underlying accounts of a large trader that must be aggregated across control persons for purposes of calculating the activity level. The rule should recognize information barriers (formerly known as "Chinese walls") and other forms of separation in organizations, including within legal entities, in identifying large traders, and also should not require the aggregation of trading across these separate entities where there is no coordination of investment decision-making. In addition, accounts attributed to a large trader should reflect majority ownership situations where the covered entities are actual operating subsidiaries as opposed to more remote, partially owned entities. The SEC should also clarify how large trader registration requirements should apply to situations in which large traders have a joint back office and where an asset manager or broker-dealer contractually delegates investment discretion for certain proprietary funds to a third party investment advisor. In the latter case, only the third party investment advisor, and not the broker-dealer or beneficial owner, should be required to report its investment discretion over such funds.

B. Broker-Dealers Should Not Be the Gatekeepers

SIFMA believes that the structure of the proposed rule imposes too great a responsibility for compliance with the large trader requirements on broker-dealers, particularly as compared with the burden placed on the large traders themselves. Broker-dealers would be responsible under the rule for implementing policies and procedures for monitoring large trader compliance with the rule, informing large traders of their duty to register, and tracking the activities of large traders that have not registered with the SEC, who are known as unidentified large traders. Although the Market Reform Act gives the SEC extensive authority over large traders reporting to the SEC, the proposed rule would impose on broker-dealers much of the operational monitoring regarding registration of large traders. This allocation of responsibilities raises not only mechanical problems, but

[12] In addition, the SEC could take a more individualized approach to setting the identifying activity level. The threshold could be adjusted up or down depending on the nature and number of the accounts that a large trader reports as being under its control. A large trader entity that has a high degree of coordination among its accounts should be subject to a lower threshold. Conversely, if a large trader entity has multiple accounts over which it does not exercise a high degree of coordination, then the amount could be adjusted upward; in this way, the parent entity may not be considered a large entity, but its constituent entities could have to register as large traders.

also very real issues regarding the broad scope of the rule, which are particularly acute with regard to foreign traders.

Guidance Needed for Unidentified Large Traders

SIFMA requests that the SEC provide more precise compliance guidance regarding the responsibility to monitor for large traders. The proposed rule imposes a duty on registered broker-dealers to assist the SEC in fostering compliance with the large trader reporting system by monitoring their customer accounts for unidentified large traders and informing any unidentified large trader customers of their duty to register with the SEC. A broker-dealer must maintain records of and report to the SEC information about transactions effected by any customer that the broker-dealer knows or has reason to know is an unidentified large trader. The proposed rule provides a "safe harbor" from identifying all unidentified large traders if the broker-dealer establishes policies and procedures reasonably designed to assure compliance with the identification requirements.

In addition to providing more guidance regarding monitoring responsibilities, the SEC should specify the types of systems that broker-dealers should maintain for recordkeeping and reporting. For example, does the recordkeeping and reporting duty imply that broker-dealers need to create dummy unidentified large trader numbers to track and report unidentified large trader trading activity? This would appear to be an efficient manner of capturing and organizing trade information that could be reported accurately and promptly to the SEC. The SEC should also consider preparing a standardized form and communication for broker-dealers to use to collect requisite information from unidentified large traders and inform them of their duty to register.

Further questions arise where a broker-dealer processes trades for a client that bring it close to the identifying activity threshold and the broker-dealer is aware that the client has a prime brokerage relationship with other broker-dealers as well. In this case, is the broker-dealer required to proactively contact the client to assure itself that the client is not an unidentified large trader? SIFMA therefore urges the SEC to state that a broker-dealer would not be required to undertake this additional diligence. Finally, there is also uncertainty as to a broker-dealer's responsibilities in the event it processes a large trade for a customer who is in the process of obtaining a large trader identification number and does not yet have one to disclose to the broker-dealer.

Given that unidentified large traders may not be complying with the large trader reporting requirements, and may even evoke concerns about potential criminal activity, the SEC should consider whether tagging such traders as unidentified large traders would then necessitate the filing of suspicious activity reports by broker-dealers.

The proposed obligation of broker-dealers to maintain records on unidentified large trader activities poses challenges where such unidentified large traders use omnibus accounts. If a broker-dealer recognizes that an account that it carries exceeds the identifying activity level and requests information about the unidentified large trader, the account owner may indicate that it is not a large trader itself and also refuse to provide the requested information about underlying customers to the broker-dealer.[13] The Proposal does not specify the appropriate course of action in such a situation.

Whether or not a trader is using an omnibus account, SIFMA is concerned that broker-dealers would face a penalty for processing trades on behalf of an unidentified large trader. SIFMA believes that the broker-dealer's duty in this case should be to record that information had been requested but not provided, and to append its own internal unidentified large trader number for future orders. As the SEC states in the Proposal, "the principal burden of compliance with the proposed identification requirements is placed squarely on large traders themselves."[14] Therefore, it would be inappropriate to further require broker-dealers to police compliance by large traders. In addition, if the SEC were to require broker-dealers to terminate relationships with such customers, this would likely have the unintended harmful consequence of driving clients to broker-dealers who are less diligent.

SIFMA is also concerned that the SEC's formulation of the broker-dealer's monitoring duty in the proposed rule is inconsistent with Section 13(h) of the Exchange Act.[15] Section 13(h) states that a broker-dealer would have "reason to know" that a client is an unidentified large trader "on the basis of transactions in securities effected by or through such broker or dealer." The rule, however, broadens the scope of inquiry to include "other information readily available to such broker-dealer." The Proposal gives some examples of such other information, but the SEC does not propose these to be exclusive examples. SIFMA is concerned, for example, that a broker-dealer with foreign affiliates may be deemed to have reason to know that one of its customers is a large trader by virtue of the customer's relationship with the foreign affiliate. In addition, in describing the broker-dealer's "reason to know" standard, the Proposal broadens the statutory test by adding "directly or indirectly" to the statutory language about transactions effected by or through the broker.[16] In effect, the rule's "safe harbor" in paragraph (f) is anything but safe: unlike the simple test in the statute, paragraph (h) requires a broker to implement policies and procedures, which appear nowhere in the statute, and to notify a client that it is or may be an unidentified large trader. SIFMA believes that, for these reasons, the SEC's approach in the rule deviates from and exceeds the authority given to the Commission in Section 13(h).

[13] SIFMA recognizes that this question currently may arise under 17 C.F.R. § 240.17a-3(a)(9) (2010).

[14] Large Trader Reporting System, 75 Fed. Reg. at 21,470.

[15] 15 U.S.C. § 78m(h) (2010).

[16] Large Trader Reporting System, 75 Fed. Reg. at 21,470.

Challenges of Foreign Entities

Perhaps the greatest obstacle to implementing the large trader reporting system is how to treat unidentified large traders that use foreign entities (such as foreign broker-dealers) to effect trades with registered broker-dealers. The SEC's ability to resolve this issue ultimately may determine the success or failure of the large trader reporting system.

Paragraph (d)(1) of the rule states that "where a non-broker-dealer carries an account for a large trader or an Unidentified Large Trader, the broker-dealer effecting transactions directly or indirectly for such a large trader shall maintain records of all of the information required under paragraphs (d)(2) and (d)(3) for those transactions." The information required under paragraph (d)(3) includes identifying information about unidentified large traders. SIFMA interprets these provisions to mean that if a registered broker-dealer effects transactions for an account carried by a foreign broker-dealer, the registered broker-dealer is obligated to monitor the transactions to determine if there is a large trader other than the foreign broker-dealer behind the trades and maintain records on such large trader, whether identified or unidentified. If the registered broker-dealer concludes that the customer appears to be an unidentified large trader, the registered broker-dealer would be required to collect the unidentified large trader's name, address, date the account was opened and tax identification number(s) and to inform the unidentified large trader of its duty to register with the SEC.

This situation presents significant challenges. A broker-dealer would face difficulty in this situation in fulfilling both its duties to inform the unidentified large trader and to collect information regarding the unidentified large trader. First, presumably, the broker-dealer would satisfy its duty to inform the unidentified large trader to register by notifying the foreign broker-dealer intermediary; however, this mechanism is not discussed in the Proposal and should be clarified. Second, and most important, the broker-dealer may not be able to obtain the information about the unidentified large trader if the foreign broker-dealer refuses to identify its customer, whether due to privacy laws, blocking statutes or otherwise. This fact pattern therefore produces great uncertainty as to the responsibilities of broker-dealers with respect to foreign customers.

SIFMA believes that, in situations where the unidentified large trader uses a foreign entity to effect trades with a registered broker-dealer, the responsibility of the registered broker-dealer should be to provide the name of its direct customer, whether a foreign broker-dealer, foreign bank or otherwise to the SEC. Penalizing U.S. broker-dealers by requiring that they refuse orders from such a foreign entity if the foreign entity does not provide the name of the large trader behind the trade could result in a loss of business to the broker-dealer, and to the U.S. market more generally as the foreign entity may trade outside of the United States altogether.[17]

The SEC struggled with this quandary when it first proposed the large trader reporting system in 1991.[18] Ultimately, the SEC was unable to provide a workable solution to the foreign entity problem, and the large trader reporting system was never implemented. Unfortunately, this issue has become only more challenging as markets have become increasingly globalized over the past two decades. SIFMA urges the SEC to solve this issue before it adopts the large trader reporting system, and to do so in a way that provides certainty to broker-dealers, bolsters the large trader reporting system and protects the U.S. markets. SIFMA welcomes the opportunity to discuss this issue further with the SEC.

III. Mechanics of the Rule

A. Broker-Dealers Face Excessive Reporting Burdens

The proposed rule imposes excessive reporting burdens on broker-dealers. Every registered broker-dealer that carries an account for a large trader or an unidentified large trader would be required to maintain records with specified information and electronically report upon request customer information to the SEC using the electronic blue sheets. These requirements pose enormous challenges for firms' existing systems. Currently, clearing systems, rather than execution systems, drive electronic blue sheets. Although firms store execution times for most transactions, it would be difficult to pass this information through to the electronic blue sheets without significant reprogramming and systems redesign. At the same time, some broker-dealers do not have access to execution times if the transaction is executed away from the firm. A broker-dealer would need to devote considerable resources to updating not only the electronic blue sheets but also the multiple systems that are involved in the information gathering, processing, transmitting and reviewing chain. For options reporting, firms would need to significantly update their storage and processing capabilities to be able to run all options with all execution times.

Broker-dealers would also face challenges in reporting large trader identification numbers where there are multiple large trader identification numbers associated with an account. For example, if there are multiple sub-advisors to an account, capturing all of the related large trader identification numbers could be difficult for some firms.[19] More

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[17] The risks of trading activity moving offshore entirely is more pronounced given the recent development of trading in U.S stocks offshore on NYSE Arca Europe and Turquoise.

[18] Large Trader Reporting System, 56 Fed. Reg.; Large Trader Reporting System, 59 Fed. Reg.

[19] The SEC should consider preparing a standardized form for broker-dealers to use in collecting large trader identification numbers from their customers.

importantly, in order for systems to be able to associate a particular large trader identification number with a particular trade, every system involved in the order processing, transmitting and information gathering chain would need to be enhanced, particularly if this is required on a trade-by-trade basis for accounts with multiple advisors.

The burden on broker-dealers is made greater by the Proposal's inclusion of its own "group" concept in determining who is a "person." Since group status is normally reflected, if at all, only in Section 13(d) filings, and then only by groups exceeding the 5% reporting thresholds, it often will be difficult if not impossible for broker-dealers to know whether their clients are part of a broader group as defined in the Proposal.

The SEC estimates in the Proposal that the one-time, initial annualized burden for registered broker-dealers to develop, reprogram and test systems to comply with the proposed rule would be approximately 133,500 hours and $31,818,000, or $106,060 in cost for each registered broker-dealer assuming that 300 broker-dealers would be subject to the rule.[20] SIFMA believes that the SEC has severely underestimated the time and resources required to comply with broker-dealer duties under the rule.

Unclear Status of a Large Trading Broker-Dealer

The SEC does not make clear what is required of a broker-dealer itself that executes a large trade or series of large trades. Given the responsibilities placed on broker-dealers under the large trader reporting system, the SEC should clarify how a broker-dealer itself becomes subject to the proposed rule's recordkeeping, reporting and monitoring requirements.

Reporting Issues for Transactions Involving Multiple Broker-Dealers

As the rule is currently formulated, a broker-dealer must comply with the recordkeeping, reporting and monitoring requirements of the rule for transactions that are effected directly or indirectly by or through an account such broker-dealer carries for a large trader or an unidentified large trader. It is unclear how these duties map onto a transaction involving multiple broker-dealers.

U.S. broker-dealers can act in a variety of roles – as introducing brokers, executing brokers, clearing brokers or prime brokers – and in each of these roles they have access to different information about the large trader or unidentified large trader. For example, an executing broker may have transaction execution time information that is not readily available to the prime broker. New mechanisms for information sharing among broker-dealers would be necessary in some cases to accomplish full reporting. In addition, there will be incremental costs associated with attaching large trader identification numbers to

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[20] Large Trader Reporting System, 75 Fed. Reg. at 21,481.

orders that are routed externally to another broker-dealer. A broker-dealer will not want to share a customer's large trader identification number with an executing broker and so the broker-dealer will need to reattach the large trader identification number, as well as obtain and record the execution time, to the customer's order after the transaction is executed. SIFMA requests that the SEC narrowly define the scope of broker-dealers that are covered under this portion of the rule to minimize the burden imposed on broker-dealers. The SEC should also provide guidance on how broker-dealers should manage any information asymmetries along a transaction chain to minimize operational costs.

Reporting Timeframes Are Unnecessarily Short

The SEC has proposed that broker-dealers respond to SEC requests for production of trade data in electronic, machine-readable form on the morning after the day the transactions occur. This timeframe, at least initially, is far too short given the significant infrastructure enhancements required to support next day submissions. Firms currently must provide data to the SEC on the electronic blue sheets within ten business days. The electronic blue sheets reporting processes at most broker-dealers are closely tied to their post-trade systems that use clearing and settlement transaction data on a non-real-time basis. In contrast, OATS processes are tied to front office order and execution information to provide next day reporting. In order to support next day reporting, the firms' electronic blue sheet processes would need to be extensively modified to accept transaction information directly from front-office or middle-office systems. As discussed previously, SIFMA principally recommends that the SEC use the OATS framework for the large trader reporting system and, in the interim period before OATS is built out for all NMS securities, use existing audit trail systems that can be immediately leveraged for next day reporting. However, if the SEC instead uses the electronic blue sheets, SIFMA urges the SEC to consider as a first step using the current ten business day delivery requirement before introducing a shorter reporting time.

The next-day reporting requirement also risks compromising the accuracy of the information reported to the SEC. SIFMA believes that a three business day period is needed to respond to requests in order to review the market data and ensure that accurate information is reported. SIFMA believes that this approach best balances the need for speed in data reporting with data integrity. In the event of an extraordinary market event, the SEC could request that firms report transaction information to the SEC as soon as possible in the way that they did following the May 6, 2010 market events.

Issues with Electronic Blue Sheets

The Proposal requires that "every registered broker-dealer who is itself a large trader, exercises investment discretion over an account together with a large trader or an Unidentified Large Trader, or carries an account for a large trader or an Unidentified Large

Trader" to report specified information to the SEC using the electronic blue sheets infrastructure.[21] SIFMA appreciates that the SEC has sought to use existing systems by proposing to use electronic blue sheets as the reporting infrastructure; however, adaptation of the electronic blue sheets for these purposes would entail considerable work and pose complex operational challenges. If the SEC decides to require a build out of the electronic blue sheets, the proposed rule should be modified to accommodate the challenges associated with using the electronic blue sheets system.

As discussed above, the timestamp requirement causes the greatest difficulty to broker-dealers because many existing reporting systems at broker-dealers do not capture transaction execution time. Because electronic blue sheets processes at most firms are fed from downstream books and records systems involved in the allocation, clearance and settlement of trades, passing execution time downstream to blue sheets reporting systems would require enhancements at every stage in the trade processing workflow. Both middle-office and back-office systems would need to be modified to capture and process the execution time attribute. Furthermore, with respect to institutional account activity, the clearing firm that handles electronic blue sheets reporting may not necessarily execute the order and, in that case, may not know the transaction execution time. Options reporting poses an added challenge because firms do not typically include all of the strike prices for an option; thus, there would be significant technology costs associated with updating reporting to include all exercise prices.

Additional difficulties would result from the use of average price accounts for the vast majority of institutional business. Because multiple executions for institutions often are combined into one or more average price trades, attributing a time to these trades is complicated. The majority of these allocated trades on the electronic blue sheets would have, at best, an incomplete "time of execution." SIFMA seeks guidance on how broker-dealers should handle such a situation and on how to report a transaction time, if any, for these average price trades. Furthermore, where multiple customers are involved in the average price trade, these average price accounts could not be associated with or contain a large trader identification number; only the actual client allocation account would be associated with a large trader identification number. Although front and middle office systems at broker-dealers could be enhanced to enrich these executions with the distinct large trader identification numbers of the accounts associated with them, these changes are substantial given the large number of systems and complex information flows involved.[22]

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[21] Large Trader Reporting System, 75 Fed. Reg. at 21,487.

[22] Furthermore, where transactions of multiple underlying large traders are processed through omnibus accounts, the only way to distinguish them would be to enable large trader identification numbers to be sent along with the orders themselves, and to have them captured in front-office order handling systems. Systems would need to be developed to process the large trader identification number through to the back office.

SIFMA also notes that the SEC does not specify whether trade reports for a particular large trader only include those trades that are made after the broker-dealer has received the large trader's identification number. SIFMA requests that the SEC confirm that broker-dealers are not required to tag trades that occurred prior to the effective date of the large trader identification number.

B. Large Trader Control Person Registration is Unduly Burdensome

SIFMA appreciates that the SEC's placement of the ultimate responsibility for large trader identification on the control person of an organization was intended to substantially reduce the number of large trader registrations and minimize the burden on natural persons. At the same time, the identification and updating requirements set forth on proposed Form 13H would impose significant administrative burdens on large complex entities. The breadth of information required to be reported on Form 13H in conjunction with the quarterly duty to update Form 13H to reflect any inaccuracies imposes a challenging monitoring responsibility on large traders. SIFMA urges the SEC to consider modifications to Form 13H and associated updating requirements.

Form 13H should be modified by limiting the information required where doing so would not hinder the goals of the large trader reporting system. Reducing the amount of information required to be included on Form 13H and clarifying the scope of such information would in turn reduce the monitoring burden associated with ensuring that Form 13H remains accurate. SIFMA's suggestions in this regard are below.

First, the SEC should reduce the amount of information that Form 13H requests about affiliates of the large trader. Form 13H requires a large trader to identify each affiliate that exercises investment discretion over accounts that hold NMS securities or that beneficially own NMS securities and the affiliate's relationship to the large trader. SIFMA recommends that the SEC request information pertaining to a smaller set of affiliates, such as requiring that only those affiliates that actually conduct trading in NMS securities be identified. Second, the SEC could reduce the burden associated with preparing Form 13H by clarifying the scope of what is meant by exercising investment discretion. The SEC states that a large trader must identify and keep track of all accounts over which it "exercises investment discretion."[23] SIFMA recommends that the SEC clarify what is

[23] The SEC proposes to incorporate the definition of investment discretion from Section 3(a)(35) of the Exchange Act into the definition of large trader. A person has investment discretion under Section 3(a)(35) of the Exchange Act, 15 U.S.C. § 78c(a)(35) (2010), if the person is "authorized to determine what securities or other property shall be purchased or sold by or for the account" or if the person that "makes decisions as to what securities or other property shall be purchased or sold by or for the account even though some other person may have responsibility for such investment decisions…." Experience with this definition of investment discretion has shown that it is fraught with ambiguities and cannot, therefore, be readily relied upon to assist in deciphering investment relationships.

meant by this term so as to minimize the burden associated with completing Form 13H. Third, the SEC defines large trader to include accounts over which a trader owns less than a 50% interest, which would create difficulties for many large traders in obtaining information about such accounts.[24] The SEC should consider narrowing the scope of large traders who are required to provide this information, particularly where the large trader is a minority owner that does not exercise day-to-day investment discretion. In particular, regulated investment companies and pension fund managers should be excluded.

Form 13H requires that a large trader file an "Interim Filing" promptly following the end of a calendar quarter in the event that any of the information contained in a Form 13H filing becomes inaccurate for any reason. SIFMA recommends that the SEC narrow the types of changes that would give rise to a large trader's duty to update Form 13H. The SEC proposes that a large trader must file an Interim Filing to correct any aspect of Form 13H, including when it adds or closes brokerage accounts through which it trades, acquires another entity or has an affiliate that becomes a large trader. Consequently, large trader entities would presumably need to monitor for every time an affiliate sets up a new account to manage, establishes a new broker-dealer relationship or goes above the identifying activity level for the first time. Firms that manage certain wrap account programs would face heightened burdens given that account turnover could range in the hundreds of thousands, such as in the case of a large, retail-based, mutual fund and exchange traded fund asset allocation program. Furthermore, it is unclear how wrap managers and the broker-dealers that currently report trades should allocate their reporting under the rule. Reporting issues of these types would require the development and implementation of an entirely new tracking system.

Therefore, SIFMA recommends that the SEC use a material change standard for requiring an Interim Filing. For example, the SEC could tag certain Form 13H items as high importance items for which an Interim Filing is always required in the event of any changes, while all other items would be required to be updated on an annual basis. This tiered approach to updating would significantly mitigate the monitoring burden associated with maintaining the accuracy of Form 13H.

SIFMA also requests that the SEC clarify what is meant by the requirement that a large trader "promptly" file an initial and interim Form 13H. SIFMA presumes that the

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[24] Form 13H requires that large traders supply the names of each general partner, 10% limited partner, officer, director and trustee of accounts of the large trader. Majority owners of such accounts may be unwilling to share this information with the large trader. In addition, jurisdictions such as Switzerland or Russia have statutes that could potentially restrict the ability of a large trader to obtain such information about one of its controlled accounts without consent from the underlying customers. The SEC recognizes this issue in the Proposal in the request for comments section, but does not explain how the issue could be resolved.

SEC would interpret promptly to mean 30 days, in accordance with the Form BD amendment requirement, but this is not specified in the Proposal.

C. Security of Reported Data

SIFMA respectfully recommends that the SEC pay close attention to the security of the large trader data it receives, particularly transaction data. The data may be highly sensitive and easily subject to abuse if not carefully guarded.[26] SIFMA expects that the SEC may conclude it will have to establish extraordinary means to limit access to the data to those having a "need to know" and to track who obtained access, when and why. The SEC's staff has a distinguished record of honesty, but there have been breaches.[27] The SEC should clarify whether it will share information about unidentified large traders with other regulatory agencies for supervisory or enforcement purposes and how it will protect the data.

IV. Implementation Period

The SEC has proposed a compressed timeline for implementing the large trader reporting system: large traders would be required to register with the SEC within three months and broker-dealers would be required to have systems in place to comply with the rule within six months following the effectiveness of the rule. SIFMA recognizes the urgency of strengthening the SEC's access to trading data; however, this rapid implementation period does not provide the time needed for system changes. SIFMA recommends a minimum implementation period of 18 months for both large traders and broker-dealers.

A. Broker-Dealer Implementation Period Should Be Longer

Given the complexities involved in implementing the rule, SIFMA believes the design, implementation and testing of systems would require at a minimum one year.

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[26] The Commission will recall that it recently brought an enforcement action alleging that a single market participant paid over $2 million for a single tip about a single equity security, which the market participant allegedly used to make an illegal trading profit of over $14 million. *See* Pequot Capital Management, Inc., SEC Litig. Rel. No. 21,540 (May 28, 2010).

[27] *See, e.g.*, U.S. Securities and Exchange Commission, Office of Inspector General, Semiannual Report to Congress, October 1, 2009-March 31, 2010, at 64: "Unauthorized Disclosure of Non-Public Information by Regional Office Attorneys (Report No. OIG-512). "The OIG had received a complaint on January 11, 2008, alleging that a known financial analyst and short-seller (Financial Analyst) had obtained non-public information about ongoing SEC investigations from employees of the SEC. In addition, the OIG received a subsequent complaint on July 27, 2009, alleging that certain SEC employees had released non-public information without authorization to the Financial Analyst and his associates. . . ." Available at: *http://www.sec-oig.gov/*

Many firms do not have any existing architecture that can be leveraged for the large trader system and would need to start from scratch. Some aspects of the proposal would be difficult for firms to automate. Vendor trading relationships will further complicate the implementation process. If required, the build out of the electronic blue sheets would be a particularly time-intensive process across firms. Furthermore, developing and implementing monitoring systems to rely on the safe harbor for unidentified large traders will take substantial time and resources.

The short timeframe for reporting will create new development demands. The existing electronic blue sheets reporting infrastructure at most firms was designed to meet a wholly different reporting schedule; typically, and as mentioned earlier, the reporting period is ten business days. Currently, firms have complex and often non-uniform internal systems for gathering trade data, moving data onto the books and records and then feeding the information from the books and records to the electronic blue sheets. Major revisions to the architecture of this reporting infrastructure would therefore be required at many firms to achieve a T+1 reporting requirement.

SIFMA expects that the SEC and SROs will need to test broker-dealers' systems to confirm that they capture the necessary information and report accurately. Unless the SEC requires broker-dealers to prepare reports in parallel with the testing period, this testing process could add several months to the implementation time. As a recent example, the industry spent significant resources to rebuild the LOPR system, which was tested for three months by the SROs before it was fully deployed in January 2010.

Finally, SIFMA believes it is also important for the SEC to review the current proposal in conjunction with other pending rule changes and their technology enhancement requirements. For example, the new short sale price test that goes into effect in November 2010 will require changes and enhancements to the current electronic blue sheet system. It is critical, therefore, that the SEC consider coordinating the roll out of all such new rule changes where possible, and take into account the efforts and costs associated with the various technology changes that are required and the need for appropriate, coordinated testing of such changes.

B. Large Trader Implementation Period Should Be Longer

SIFMA understands that, for most large traders, a period longer than the proposed three-month implementation period with respect to the large trader identification requirements is necessary. Large traders that are complex entities would need considerable time to identify their large trader accounts. Particular time-intensive inquiries are likely to arise in analyzing the extent of "investment discretion" in joint accounts and obtaining information from joint venture partners and minority-owned entities. Large traders would also need time to establish systems that would notify them of activity levels in individual accounts and across accounts that surpass the identifying activity level threshold. To the extent a controlling person forgoes the option of filing on behalf of all persons controlled by it, the controlling person would need to develop policies, procedures and systems for ensuring that all of its constituent large traders comply with the registration, updating and disclosure requirements.

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SIFMA appreciates the opportunity to comment on the large trader reporting system proposal and commends the SEC for taking steps to enhance its market surveillance role. SIFMA supports the objectives of the large trader reporting system but urges the SEC to modify the large trader reporting system to operate in tandem with the Consolidated Audit Trail Proposal. The SEC states in its Consolidated Audit Trail Proposal that "[t]he large trader proposal is designed to address in the near term the Commission's current need for access to more information about large traders and their activities." SIFMA believes that properly designing the large trader reporting system to be an interim step would address the near term needs of the SEC while laying the foundation and making progress towards the consolidated audit trail.

SIFMA prefers that the SEC use the OATS framework rather than the electronic blue sheets as the reporting infrastructure for the large trader reporting system. If, however, the SEC decides to use the electronic blue sheets for the large trader reporting system, SIFMA recommends that the SEC modify certain aspects of the proposed rule, as described above, to alleviate burdens on broker-dealers and large traders, clarify ambiguities and maximize efficiency.

We would be pleased to discuss the proposed rule and our comments in greater detail with the SEC and its staff. If you have any comments or questions, please do not hesitate to contact me at 202.962.7300 or at avlcek@sifma.org.

Sincerely,

Ann L. Vlcek
Managing Director and Associate General Counsel
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