

SEC Large Trader Identification Proposal

The SEC recently proposed new rules for large traders. Kevin Tyrrell of Bank of America Merrill Lynch provides us with a snapshot on what constitutes 'large traders,' and the scope of their responsibilities and the brokers' under this proposed rule.



U.S. equities and options trading has experienced several significant changes over the past few years. Some of the most important trends have been increased fragmentation, increased market volume, the growth of high-frequency trading (HFT), and (for equities trading) the rise in dark pool and other off-exchange trading. These factors have made analyzing market activity far more difficult, and the rapid growth of HFT has led many to question what that business entails. In response to this increased complexity and the general concerns about high-frequency trading, the SEC has proposed a Large Trader Identification rule in order to better review market activity.

A primary motivation for this rule is to allow the SEC to more easily review trading activity that can be dispersed across several executing brokers. Currently, the SEC has the ability to gather all information necessary to reconstruct market scenarios and determine which end users entered orders that affected securities prices. However, the process for gathering such data is slow. The SEC needs such end user information in a more accessible format in order to assess significant market activity. The dramatic events of May 6, 2010 and the subsequent search for the root cause of the dramatic price drops show the substantial challenges faced in

determining exactly what and how forces can impact the markets.

What is a "Large Trader"?

In the current proposal, the SEC defines a large trader as any entity (either a firm or individual) who, in exercising investment discretion over an account, executes a total of 2 million shares or \$20 million notional value of NMS (National Market System) securities in a single calendar day, or 20 million shares or \$200 million notional value in a calendar month¹. This definition encompasses all exchange-listed securities, both equities and options, with options activity determined by multiplying the

Learn to Speak FIX

INTRODUCTORY FIX TRAINING

Get the most out of your investment in FIX by training with the experts. With this one-day class, you will learn all the essentials of the FIX protocol including how to integrate FIX software into your trading environment and how to certify and support your connections. Geared towards trading and support staff, this training is a must if you are new to FIX or just need a refresher.



 NYSE Technologies.



Kevin Tyrrell,
*Head of Quantitative Consulting,
Bank of America Merrill Lynch*

“...brokers have a responsibility to assess their own activity and determine if they are required to register themselves as Large Traders.”

number of contracts traded by the contract amount (i.e., an options trade of 50 contracts would count as 5,000 shares). The SEC considers this to be a relevant benchmark for large traders as it represents 0.01% of the double-counted daily market volume. There are no specific or broad-based exemptions proposed to the definition of large trader: any firms or individuals meeting the activity thresholds will be considered large traders.

What Does Being a Large Trader Mean?

Any person or firm meeting the Large Trader definition must self-identify to the SEC, using the new SEC Form 13H. This form includes basic identifying information about

the firm, including its type(s) of trading activity, as well as account identification information for the accounts for which the Large Trading occurs. The SEC will then issue the Large Trader a Large Trader Identification Number (LTID), which the Large Trader must then provide to all of its executing brokers. A Large Trader is required to self-identify and register with the SEC promptly after the activity which triggers Large Trader status, and is also required to submit the form annually in recognition of its ongoing status as a Large Trader.

Broker Responsibilities

The executing broker is responsible for maintaining the LTID and related account information for all clients, and must be able to provide trade information including the LTID(s) as soon as T+1. To facilitate its analysis and market reconstruction capabilities the SEC is proposing two additions to the current Electronic Blue Sheet (EBS) system: LTID and execution time. The broker will then be expected to be able to respond to information requests as soon as T+1, and to provide the data, including the newly-required LTID and execution time fields, to the SEC within the time specified in the request. The data report should include all executions meeting the “reporting activity level” of at least 100 shares (and any other executions the broker deems relevant)². Additionally, in the event that multiple LTIDs maintain investment discretion over single account, the broker must be able to report the multiple LTIDs associated with that account’s activity.

Brokers also have responsibilities relating to firms not registered as Large Traders, but with a safe harbor provision. Essentially, brokers must have policies and procedures that can detect activity levels that approach or exceed the threshold amounts for Large Traders and confirm that the clients directing such activity are registered as Large Traders. The SEC says it would consider disclosure of Large Trader reporting requirements at the time of account

opening, as well as notifications to unregistered clients as they approach the threshold, to fulfill the notification aspect of the safe harbor provision. If the broker has such procedures in place, and also does not actually know that the trader is a Large Trader, the safe harbor provision would generally be considered fulfilled. If a broker is aware that a client meets the definition of being a large trader but has not registered (e.g., is an "Unidentified Large Trader") the broker is responsible for tracking that trader's activity in much the same way as a registered Large Trader is tracked. In lieu of the LTID, Unidentified Large Traders' activity must be identified by the Trader's name, address, account opening date, and tax ID number³.

Furthermore, brokers have a responsibility to assess their own activity and determine if they are required to register themselves as Large Traders. Like any other market participant, if the broker meets the execution threshold amounts by trading in an account over which it exercises investment discretion, it must file Form 13H and register as a Large Trader with the SEC. The broker must then share this LTID with any other broker through whom it may trade, and also be prepared to submit details of its own activity as it would for any of its Large Trader clients.

Application of New Information

The SEC may request transaction information including the newly-required LTID and execution time fields as soon as T+1. The inclusion of the LTID information should enable the SEC to reconstruct market situations in greater detail than it can currently. By using the LTID field, the SEC will be able to see activity from a single trader that may be distributed across multiple exchanges and ECNs through several brokers. The execution time field will allow the SEC to more easily reconstruct market situations in their true sequence, a task that is very cumbersome and imperfect given current data. In all, the proposed

requirements should allow the SEC to much more quickly and easily gather critical pieces of data. This data can be requested and received by the SEC currently, but often after several iterations of requests and submissions with brokers.

Impact of Proposed Rule

For brokers, most impacts from the new rule should be seen downstream from order entry and execution systems. Given the proposed framework of the rule, LTIDs and associated account information will be provided to brokers periodically, not on an order-by-order basis. Therefore, the actual matching of order and execution data to LTID information will occur in the broker's post-trade environment. While the actual matching in of LTID information will likely not be very difficult, the rule also calls for both content and process changes to the EBS data maintained by brokers. The additional content will be the LTID information and execution time; the process change is the required T+1 availability of EBS data. The EBS implementation challenges will likely vary significantly from firm to firm.

Conclusion

The comment period for the Large Trader rule is open until June 22. The SEC will then review the comments and consider that input as they craft the final rule language. The proposal indicates that these changes will become effective 6 months after the adoption of a final rule. If the rule is adopted substantially as proposed, we do not expect significant impact to order entry and execution systems. Downstream systems, however, will have to capture and track new data and be able to provide this larger amount of data to regulators far more quickly than is required today.

1- Large Trader Reporting System <http://sec.gov/rules/proposed/2010/34-61908.pdf>, page 13-14

2- *Ibid*, page 50

3- *Ibid*, page 46

Any thoughts about this or other articles?

Please send any comments direct to:
editorial@fixglobal.com

Training Agenda

FIX General Overview

What is FIX? Who created it? Why do we use it? Benefits of FIX

FIX in Detail

Examine FIX message types, components, layers, and business flows

FIX Engine

What is a FIX engine? What does it do? How does it interact with the rest of the trading environment?

Session Layer

Definition of "Session Layer" as well as message types, operation, and recovery in a FIX session

Application Layer

Definition of "Application Layer" as well as messages, business flows, required and conditional fields, and customization of messages

Connection On-boarding and Certification

Adding new connections, hosted vs. point-to-point connectivity, certification process, and best practices

What's new in FIX?

FIX 5.0, Asset Classes (Derivatives, FX, Fixed Income), Allocations/Confirmations

Attendees receive

Copies of the slides, FIX field definitions list, FIXionary CD (FIX reference guide), and certificate of completion.

2010 Dates and Locations

May 27	-	Sydney
June 8	-	Hong Kong
June 10	-	Toronto
June 15	-	San Francisco
June 24	-	Singapore
June 25	-	New York
July 8	-	Boston
July 13	-	London
July 22	-	Chicago
August 10	-	Hong Kong
August 26	-	New York
August 31	-	London
September 9	-	Los Angeles
September 23	-	Toronto
October 5	-	Hong Kong
October 12th	-	London
October 14	-	San Francisco
October 28	-	Chicago
October 22	-	Singapore
November 11	-	Boston
November 19	-	New York
November 30	-	London
December 2	-	Toronto
December 7	-	Hong Kong

To Register

Go to www.nyse.com/nyfix and click on the "Register Now" link for the session of your choice.

For More Information

New York: +1 212 510 3600

London: +44 207 987 5400

Hong Kong: +852 3973 6458

Tokyo: +81 3 3667 4730

Custom training courses are also available, please inquire.



NYSE Technologies.