



February 13, 2013

Mr. David Shillman  
Associate Director  
Division of Trading and Markets  
Securities and Exchange Commission  
100 F Street, NE  
Washington, D.C. 20549-1090

Re: SEC Rule 13h-1 Large Trader Implementation Issues for Broker-Dealers

Dear Mr. Shillman:

The Securities Industry and Financial Markets Association (“**SIFMA**”)<sup>1</sup> appreciates the Securities and Exchange Commission (“**SEC**”) staff’s ongoing consideration of SIFMA members’ concerns regarding implementation of the SEC’s final rule on large trader reporting (“**Rule 13h-1**”).<sup>2</sup> SIFMA also appreciates the action taken by the SEC on April 20, 2012 to delay implementation of the broker-dealer duties under Rule 13h-1 (the “**April Order**”).<sup>3</sup> The April Order temporarily exempted registered broker-dealers from Rule 13h-1’s recordkeeping and reporting requirements until November 30, 2012 for a certain limited category of transactions (“**Phase I**”) and temporarily exempted registered broker-dealers until May 1, 2013 from recordkeeping, reporting and monitoring requirements for all remaining transactions subject to Rule 13h-1 (“**Phase II**”).

While the April Order was welcomed by SIFMA and its members, it left unresolved many of the central implementation issues associated with Rule 13h-1 that we have raised in our meetings with the SEC staff and in our March 29, 2012 comment

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<sup>1</sup> 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 <http://www.sifma.org>.

<sup>2</sup> Large Trader Reporting, Rel. No. 34-64976 (76 FR 46,960) (Aug. 3, 2011), *available at* <http://www.sec.gov/rules/final/2011/34-64976fr.pdf>.

<sup>3</sup> Order Temporarily Exempting Broker-Dealers from the Recordkeeping, Reporting, and Monitoring Requirements of Rule 13h-1 under the Securities Exchange Act of 1934 and Granting an Exemption for Certain Securities Transactions, Rel. No. 34-66839 (77 FR 25,007) (Apr. 26, 2012), *available at* <http://www.sec.gov/rules/exorders/2012/34-66839.pdf>.

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letter.<sup>4</sup> The requests for interpretive guidance and exemptive relief set forth in our March 29, 2012 letter remain outstanding and, as such, the issues raised in that letter continue to pose significant implementation challenges. Many of these issues are critical gating issues to designing and implementing an appropriate solution to the large trader requirements. Decisions and guidance on these issues by the SEC are necessary before the implementation process can move forward.

SIFMA is submitting this letter to provide information to the SEC in response to specific questions raised at our meeting with the SEC staff on January 16, 2013 regarding significant practical implementation challenges faced by broker-dealers in meeting their upcoming reporting obligations under Rule 13h-1. In addition, this letter requests (i) specific clarification or interpretation from the SEC regarding certain of the requirements under Rule 13h-1 for broker-dealers, and (ii) a further staged implementation of Phase II, including with respect to unidentified large trader monitoring requirements.<sup>5</sup>

This letter is divided into five parts. First, and most urgently, we discuss the implementation schedule for Phase II generally and request specific guidance on that schedule. This is an urgent request; our member firms need an immediate response on this issue. Second, we describe SIFMA members' experience with Phase I implementation. Third, we outline the key challenges that broker-dealers face in attempting to comply with Phase II. Fourth, we set forth specific requests for interpretive relief for Phase II implementation. Finally, we propose solutions for those challenges and ask for specific guidance from the SEC on these proposed solutions. We note that SIFMA represents a wide range of broker-dealers, including prime brokers, clearing brokers, introducing brokers and executing brokers. Therefore, the experiences, challenges and recommendations discussed in this letter reflect the views of, and have been considered by the full spectrum of, broker-dealers that are affected by Rule 13h-1.

## **I. Implementation Schedule**

We understand that the April Order contemplates a staged implementation period for Phase II that would extend beyond the May 1, 2013 compliance date. Footnote 19 of the April Order states, "In connection with any potential relief that the Commission may grant on or before the new May 1, 2013 date, the Commission would consider the appropriateness of an implementation period as well as a systems testing schedule beyond May 1, 2013." We seek confirmation from the SEC immediately that it will grant an

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<sup>4</sup> Letter from Ann L. Vlcek, Managing Director and Associate General Counsel, SIFMA, to David Shillman, Associate Director, Division of Trading and Markets, Securities and Exchange Commission, dated March 29, 2012, *available at* <http://www.sec.gov/comments/s7-10-10/s71010-100.pdf>. Similar issues have been raised by the Financial Information Forum in letters and meetings. *See* Letter from Manisha Kimmel, Executive Director, Financial Information Forum, to Robert Cook, Director, and David Shillman, Associate Director, Division of Trading and Markets, Securities and Exchange Commission, dated January 25, 2012, *available at* <http://www.sec.gov/comments/s7-10-10/s71010-98.pdf>.

<sup>5</sup> We note that further complications arise with respect to options reporting and that issues related to that subject are not covered by this letter.

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extension of compliance for Phase II beyond the May 1, 2013 deadline for such new broker-dealer requirements. Broker-dealers need a significant amount of advance notice that such relief will be forthcoming, as well as assurance that there will be an adequate implementation period between the time that such relief is issued and compliance is required in order to plan technology development and strategy, and to implement required technological and structural changes. This is critically important because, regardless of the form of any relief that the SEC issues, individual broker-dealers must make significant internal changes to their systems, the fundamental restructuring of certain industry standard clearing processes may be required, and concerted and coordinated development activities will be required throughout the broker-dealer industry. In sum, as the industry has communicated on multiple occasions, broker-dealers and their clients need immediate guidance from the SEC on how it will proceed on these issues to ensure that broker-dealers' efforts and resources will be utilized in the most effective and efficient manner possible and to provide firms a reasonable period in which to make adjustments to their activities to the extent any such changes would be needed.

SIFMA has canvassed its members and recommends a nine-month minimum implementation period for full compliance with the remaining broker-dealer reporting requirements, and for unidentified large trader monitoring requirements, beginning on the date that the SEC issues written guidance that addresses the fundamental open issues highlighted in this letter. There could be a staged implementation approach prior to the expiration of the nine-month period with respect to certain aspects of the rule where necessary information is already available to the carrying broker and significant technological development is not necessary. For example, SIFMA believes it may be appropriate for the SEC to require carrying brokers to add large trader identification numbers (“**LTIDs**”) to their current electronic blue sheets at an earlier date. However, as SIFMA recommends in Part V below, the requirement for reporting the underlying street side execution fill details along with associated LTIDs should become effective for the executing broker, or the clearing broker for the executing broker, at a later date.

We note that the April Order also states that the delayed compliance date would give the SEC “an opportunity to work with market participants to more fully examine the implementation issues . . . , assess the appropriateness of any exemptive relief, and allow broker-dealers time to develop, test, and implement the necessary systems changes once the examination of implementation issues is complete.” We understand that the SEC continues to examine the implementation issues associated with Phase II, and we appreciate the SEC staff's consideration of the industry's viewpoints during this process. However, given that the examination process is still under way and relief and systems changes have not yet been addressed, with less than three months before the May 1 deadline, we believe that the logic of the April Order mandates that further time beyond May 1 be provided before Phase II compliance is required.

## **II. Broker-Dealer Experience with Phase I**

At our January 16, 2013 meeting, the SEC staff asked SIFMA to provide information regarding members' experiences with meeting the challenges of complying

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with Phase I. As noted above, Phase I involved compliance with a discrete portion of the Rule 13h-1 broker-dealer requirements. Of significance, although Phase I raised some of the same implementation challenges addressed in this letter, neither the scope nor the volume of those challenges compares to those faced by broker-dealers in implementing Phase II. This is because the April Order narrowly tailored Phase I in a way that required reporting of information that was more readily available to broker-dealers. Even if information was not readily available, the relatively small number of transactions and customers covered by Phase I facilitated certain solutions that would not be workable in Phase II when the vast majority of trades will be subject to reporting. A further distinguishing feature of Phase I implementation was that carrying broker-dealers generally were able to leverage methodologies where the execution and trade processing was already segregated by client (*i.e.*, where dedicated MPIDs for proprietary broker-dealers or for clients for which the broker-dealer provided sponsored access already existed and could be used to identify the associated executions and apply the LTIDs).

In Phase I, where individual trades and execution times were not readily available to carrying brokers with the reporting duty, those carrying brokers faced the challenge of having to obtain the individual trades and execution times from executing brokers. With significant efforts, they addressed this problem in various ways, including:

- requesting individual trades and execution times from executing broker-dealers, in an uncompressed format;
- receiving ad hoc reports of these trades and execution times;
- creating and supporting files consisting of execution-level detail with execution times; and
- manually matching the individual execution fill details and times to particular LTIDs.

Phase I implementation, in certain circumstances, also forced broker-dealers' clients to clear trades on a trade-for-trade basis with custody clearing brokers utilizing various clearing methods such as correspondent clearing and reporting through ACT or QSR, which resulted in increased costs for both executing and clearing brokers. These manual processes are very time- and labor intensive. While the processes developed in Phase I were feasible for the relatively small number of trades subject to Phase I, they cannot be effectively leveraged for Phase II, which has a significantly greater scale and covers the overwhelming majority of trades. If firms attempted to adopt this manual implementation process for Phase II, it would create a logjam for trade processing in an area where the industry has spent many years optimizing straight-through processing.

One of the outstanding challenges for a minority of transactions subject to Phase I relates to the reporting of individual execution fill details by the carrying broker with respect to the broker-dealer DTC ID clearance flow. This flow is substantially similar to the clearing and prime brokerage flows that are the subject of Phase II implementation, where the carrying broker for the large trader is dependent upon a separate executing

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broker to provide it with underlying execution information not otherwise available to such carrying broker. In this flow, which represented a relatively small overall percentage of the trading activity covered in Phase I, a broker-dealer (the “**initiating broker**”) submits orders to an executing broker for its own account. The executing broker then reports and clears those trades either by itself or by utilizing a separate clearing broker. The executing broker or its clearing broker then aggregates individual executions and reports average price trades via the DTC ID system to clear and settle versus the separate clearing firm for the initiating broker (the “**carrying broker**”). In this DTC ID flow, because the carrying broker receives allocations at an average price and does not have transparency to the underlying execution fill details, they face the same challenges for ascertaining the execution fill details as in clearing and prime brokerage.

### **III. Key Challenges Associated with Phase II**

As we have advised the SEC staff in previous meetings and letters, and reiterated in our meeting with you on January 16, there are critical gating issues that must be resolved before technological development and implementation can proceed. These relate primarily to two issues: (i) capture and reporting of the execution fill details (*e.g.*, times, quantities and prices) of each underlying execution that makes up average price transactions when there are multiple broker-dealers involved in the execution and clearance chain and (ii) capture and reporting of the execution fill details in average price transactions.

Rule 13h-1 generally requires that the carrying broker capture the LTID(s) associated with a large trader’s or unidentified large trader’s account and the execution times of the trades in that account, record the information in its electronic blue sheets records and, upon request, report the information to the SEC.<sup>6</sup> The term “carrying broker” is not defined in Rule 13h-1, but the SEC has informally indicated that this would be the broker that carries the account for the large trader, which would typically be the clearing broker or prime broker for the large trader (as opposed to the clearing broker for the executing broker).

Placing the reporting burden entirely on the carrying broker is problematic in that there are often multiple broker-dealers involved in the chain of execution of a transaction, each of which has access to different types of information that is required to be captured and reported but which may not be disclosed to other broker-dealers in the chain. In the current structure of execution, clearance and settlement flows, no one broker-dealer will have ready access to all of the individual pieces of information required to be captured, maintained and reported by the carrying broker under Rule 13h-1. It would require a

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<sup>6</sup> The exception to this is where a large trader’s account is not carried by a registered broker-dealer, in which case the executing broker-dealer has a duty to keep records and report to the SEC.

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massive restructuring of most of the current execution and clearing flows and systems at considerable cost to aggregate all of that information at one broker-dealer.<sup>7</sup>

A number of fundamental structural issues arise when there is more than one broker-dealer in the chain of the transaction.

- First, in transactions that are effected by an executing broker on behalf of an introducing broker (“**IB**”) that is transacting for multiple large trader clients and then transferred to the IB’s separate clearing brokers for clearance and settlement, the executing broker (or its clearing broker) may be the only broker-dealer that maintains a record of the execution fill details. Executions are commonly aggregated (sometimes referred to as compressed) and communicated to the clearing broker of the IB in average price executions, since this is the only information necessary for clearance and settlement of the transactions transferred to the clearing broker from the executing broker. As such, the IB’s clearing broker does not currently receive the execution fill details for these transactions. For example, a large trader client of an IB may trade 800,000 shares of an NMS security using multiple orders which will be filled through numerous individual executions from various execution venues, each with different execution details. The IB’s clearing broker will not receive the individual executions but instead will receive the total share quantity of 800,000 shares at an average price for allocation to each of the IB’s large trader clients’ accounts.
- Second, prime brokers are not involved in clearing the underlying executions that are reported to the consolidated tape and, therefore, do not receive execution fill details. Instead, prime brokers clear and settle trades allocated from the underlying executions that have already been cleared and settled by a clearing broker for the executing broker. The prime broker is, therefore, one step further removed from, and has no direct role with respect to, the executions that are reported to the consolidated tape.<sup>8</sup>

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<sup>7</sup> We do not believe that this result would be consistent with Congressional intent. In footnote 220 in the proposing release for Rule 13h-1, the SEC provided the following background:

“The legislative history indicates Congress’s expectation that the Commission, in implementing a large trader reporting system, ‘would not impose requirements on broker-dealers to report beneficial ownership information that is not recorded in the normal course of business.’... The Committee specifically noted that many broker-dealers did not maintain beneficial ownership records of transactions of foreign persons that are carried out through banks, particularly foreign banks, which serve as the record holder of such securities... The Committee expected that such beneficial owners would not be assigned LTIDs... As discussed above, for all persons (both foreign and domestic), large trader status is triggered by the exercise of investment discretion, not mere beneficial ownership of NMS securities.”

<sup>8</sup> In fact, the prime broker only assumes settlement responsibility for trades for which the prime broker can confirm in a timely manner that the trade details provided by the clearing broker of the executing broker match the trade details reported by the customer, and then, only on an average price and (...continued)

Further, large traders routinely engage multiple prime brokers. The large trader will commonly allocate a *pro rata* portion of its daily trading activity to each prime broker. Any individual prime broker will only be allocated a portion of each large trader's daily trading activity. Accordingly, the quantity of shares reported to any individual prime broker may not match the quantity of shares of the underlying executions that were actually reported to the consolidated tape by the executing broker. Further, allocating underlying fills may require the allocation of fractional shares to each prime broker in order to enable reconciliation between the average price allocation and the underlying executions. This serves to complicate the SEC's ability to tick and tie the underlying execution fills to the average price trades allocated to the prime broker. By going straight to the clearing broker for the executing firm, as suggested below, rather than to multiple prime brokers, the SEC should be able to more directly tie LTIDs to executions reported on the consolidated tape.

- Third, since a common method of transmitting trade data for clearance and settlement is to do so in an aggregated trade format, there is no systematic universal mechanism for passing individual execution times from the executing broker to the large trader's clearing broker or prime broker.
- Fourth, there is no existing industry standard or mechanism to facilitate the generation of execution files to be sent by the clearing broker for the executing broker to the carrying broker for the large trader when they are separate brokers, nor is there an existing industry standard or mechanism at the carrying brokers for the large trader for capturing the execution fill details that they may receive from the executing broker. This information is generally irrelevant to the carrying broker's clearance and settlement activities.
- Fifth, even if there were a reliable mechanism for capturing and transferring execution fill details to the carrying brokers, many carrying brokers do not currently have a system for matching execution fill details with account-level LTIDs.
- Sixth, the carrying broker for the large trader has no way to readily validate the accuracy of the information provided by the clearing broker of the executing broker in a timely and efficient manner prior to electronic

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(continued....)

aggregated level. Therefore, some trades reported to the prime brokers by the clearing brokers for the executing brokers may not be cleared and settled by the prime brokers, particularly if a large trader in a time of market stress fails to timely and accurately report trade details to the prime broker. SIFMA believes that the SEC should still be entitled to request electronic blue sheet reporting of the execution fill details and corresponding LTIDs from the clearing broker of the executing broker for these trades.

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blue sheet reporting deadlines. Although brokers can contract to transfer information between each other, a broker-to-broker contractual requirement will not adequately protect the carrying broker for the large trader from regulatory liability for erroneous information provided by the clearing broker on behalf of executing broker. Further, in some instances, contractual relationships may not currently exist and will need to be developed.

- Finally, there is no straightforward mechanism for matching average price execution details with ultimate allocations received by the carrying broker for the large traders. This is particularly true in the case of many-to-many trade scenarios, in which multiple customer trades are aggregated for the clearance and settlement of the executions, and the resulting multiple executions are allocated back to multiple customers. In these many-to-many cases, the carrying broker for the large trader would face significant challenges reporting execution fill details for particular accounts.

We note that the problem of average price transactions, in which a number of executions are performed in a single average price account and are then sent in a compressed file to one or more clearing brokers for one or more different client trades, could and frequently does arise in and further complicates any of the above scenarios.

#### **IV. Requests for Interpretive Guidance for Phase II**

In our meeting with you on January 16, we discussed our request for the issuance of critical interpretive guidance that could be relied upon by broker-dealers in developing potential solutions to the challenges described above. While the SEC staff did not agree at the meeting to provide definitive guidance on the assumptions that we requested, we understand that you may be willing to favorably consider these requests and our proposed reporting solutions that flow from them.

We request that the SEC staff issue this guidance in the form of a FAQ, in writing, or other interpretive relief. Specifically, we propose solutions in Section V of this letter that are premised upon receiving, in connection with the issuance of an FAQ, confirmation of the below assumptions discussed during our January meeting:

- The term “carrying broker,” for purposes of reporting execution trade fill details, would exclude prime brokers. Therefore, the prime broker would not be obligated to capture or report execution fill details for trades that were cleared by another broker-dealer. The prime broker would still be obligated to capture or report average price allocation details and corresponding LTIDs;
- The executing broker is the best source for execution fill details that are reported to the consolidated tape and should be considered the “carrying broker” for such purposes;

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- The SEC should clarify that executing brokers are obligated to capture, store and accurately transmit execution fill details to the SEC or to their clearing broker pursuant to Rule 13h-1; and
- If execution fill details are transmitted by the executing brokers to the clearing broker of the executing broker, the clearing broker would act as a conduit to report the execution fill details and would have no regulatory liability for reporting inaccurate information received from the executing broker or for failing to report information that it does not receive from the executing broker.

There are various legal mechanisms that could be used for issuing this interpretive guidance. First, the definition of “carrying broker” as used in Rule 13h-1 could be expanded to include the executing broker, or the clearing broker for the executing broker, solely for the purpose of reporting execution fill details and the average price executions details with which such execution fill details are associated. Similarly, the definition could be narrowed with respect to ascribing responsibility for the reporting of execution fill details as it applies to prime brokers and to clearing brokers that are not also acting as executing brokers for such trades. Alternatively, the SEC could provide no-action relief for clearing brokers (other than clearing brokers for executing brokers) and prime brokers that do not have direct access to execution fill details such that they would not be subject to liability under Rule 13h-1 for the failure to report execution times. Finally, an obligation could be imposed on the executing broker through an interpretation in a FAQ that, in accordance with Rule 17a-25, executing brokers, or the clearing brokers for executing brokers, must provide execution times for large traders upon request by the SEC.<sup>9</sup> In a related issue, where the clearing broker for the executing broker provides execution fill details and is acting merely as a conduit, the SEC could provide no-action relief that the clearing broker would not be subject to enforcement for submitting inaccurate execution fill details that it does not have a means of verifying directly or for failing to report execution fill details that it has not received from the executing broker.

The SEC staff requested that SIFMA’s proposed solutions provide the SEC with a central point of contact for all of the elements of large trader reporting. SIFMA has considered this request and, for the reasons described below, believes that it is neither practical nor appropriate to implement Phase II in such a way that a single broker-dealer would be able to report all of the large trader information required by Rule 13h-1 to the SEC. This approach would place an extraordinary burden on the industry, while also requiring a protracted and costly industry-wide developmental effort. The existing prime broker regulatory structure<sup>10</sup> is designed for trades to settle and compare via DTC ID on

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<sup>9</sup> We note that Question 75 in NASD Notice to Members 06-33 requires executing firms to pass on to their clearing brokers all of the information that the clearing brokers need to make their electronic blue sheets submissions complete.

<sup>10</sup> Please refer to Appendix A for a further explanation of the prime brokerage system.

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an aggregated basis.<sup>11</sup> Changing this approach would require the creation of systems to convey information from the executing broker to the carrying broker, capture the information at the carrying broker and link the information to the appropriate large traders on an ongoing basis for all executions. Under this approach, the data flow between firms would increase exponentially, since all execution fill details would have to be conveyed, captured and sorted. Any such arrangement could not be implemented without significant time and cost in cases where there are multiple brokers in the chain of a transaction.

We also note that the costs to the industry associated with such single point of contact approach, if it could be implemented, would far exceed the benefits to the SEC of having one point of contact for large trader information. This is particularly true when the development and implementation of this solution would quickly become redundant when the consolidated audit trail (the “CAT”) is instituted.

## **V. Phase II Proposed Solutions**

We describe in greater detail below why we believe that our recommendation, which involves multiple points of contact for obtaining all of the necessary elements in the trades, is workable and would accomplish the goals of large trader reporting. We also provide a specific recommendation for the unique problems associated with average price transactions.

### **A. SIFMA Recommendation for Obtaining Execution Fill Details**

For trades that involve more than one registered broker-dealer in the chain of the transaction (*e.g.*, all trades depicted in the examples in Appendix B, other than that which is depicted by Example 1 in that Appendix B), SIFMA recommends that the SEC request the LTID (and sub-account allocations, if applicable) for customer accounts from the carrying broker for the large trader, as well as the identification of the executing broker for the trade, but not request the execution fill details associated with those trades from the carrying broker.<sup>12</sup> The SEC would then make a separate request to the executing

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<sup>11</sup> To alter long-standing clearance settlement practices to include the execution fill level would dramatically explode trade reconciliation volumes, introduce complexities and significantly increase operational risk. Without costly technology builds, quality-testing, and additional human capital, the exponential increase in trade reconciliation volumes would strain existing capacities of legacy systems, likely increasing reconciliation trade breaks and significantly disrupting the orderly settlement of trades. Brokers and the Omgeo Trade Suite System would face immediate capacity issues and trade reporting systems for a substantial percentage of external client base would need to be updated.

<sup>12</sup> We note that Question 79 in NASD Notice to Members 06-33 recognized that, for transactions in which a firm is acting only as a clearing broker, as with prime brokerage, and where clearing occurs on an aggregated basis and not at the individual execution level, a clearing broker or prime broker need only report in its electronic blue sheet submission transactions showing the trade data that it was given and, for aggregated trades where the underlying transactions are of different types, then the clearing broker or prime broker should leave those fields blank. Thus, imposing a requirement for such brokers to provide execution times for aggregated trades under Rule 13h-1 would be a significant departure from current practice.

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broker, or the clearing broker for non-self-clearing executing brokers, for the individual trades and execution times associated with the particular trades.<sup>13</sup> In connection with this recommendation, we also request that the SEC confirm that the daisy chain (as described in Example 4 of the Appendix) ends at the point where a transaction is executed with a counterparty and reported to the tape.

Although this approach would impose a slightly greater burden on the SEC (*i.e.*, in most cases, two requests instead of one), it would require the least amount of re-engineering trade flows that exist in the market today, and would minimize the tremendous cost (both in economic terms and in allocation of human resources that would have to be taken away from other critical items) to the industry of developing and implementing the necessary technological changes. In addition, the timeline for implementing this arrangement would be significantly shorter than would be required to implement any approach that would rely on a single point of contact for reporting.

This solution also may provide benefits to the SEC in obtaining crucial information by allowing the SEC to formulate requests in different ways and provide multiple access points to this data to the SEC. If the SEC is looking for information about a particular large trader, it can start with the carrying broker for the large trader and then track back to the execution times. If the SEC is looking for information regarding particular executions in the market, it can start with the executing brokers and track back to the individual large traders through the carrying brokers.

The challenges associated with Phase II and SIFMA's proposed solutions can be demonstrated through a few specific examples. We briefly identify these examples below and refer you to Appendix B of this letter for a detailed depiction of representative trade flows. Each of the trade flows indicates which entity in the chain would have the relevant information required by the SEC, and the appropriate contact points recommended by SIFMA for the SEC to obtain that information. These are illustrative examples only; in fact, there could be numerous variations on these example trade flows.

- Example 1 establishes the baseline scenario in which a large trader places an order with a self-clearing executing broker. This scenario does not raise significant implementation issues because the self-clearing executing broker has direct access to the LTID and execution fill details.<sup>14</sup> Accordingly, the SEC could obtain LTIDs and execution fill details from the self-clearing executing broker.

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<sup>13</sup> Because the executing broker may not currently report via the electronic blue sheets and, therefore, may not have the capability to do so for large trader execution fill details, the SEC could instead request the information from the clearing broker for the executing broker, while imposing a duty on the executing broker either to provide the execution fill details to the SEC or to provide them to its clearing broker, as well as impose a duty on the clearing broker for the executing broker to report to the SEC execution fill details provided to it by the executing broker. *See also* Note 10 *supra*.

<sup>14</sup> Some development may still be necessary for this solution, since many firms do not currently connect the information in the order management system with the information in the clearance and settlement systems.

- Examples 2(a) and 2(b) depict scenarios where there is an executing broker and one or more prime brokers involved, the difference between the two scenarios being whether the executing broker is self-clearing or utilizes a separate clearing broker. Although each prime broker is a “carrying broker” for the large trader under Rule 13h-1 as currently interpreted by the SEC with respect to an average price allocated portion of the daily trading activities of the large trader, only the executing broker or its clearing firm will have the execution fill details. The prime broker does not collect this information in practice. In this situation, the SEC could obtain the execution fill details from the clearing firms for the executing brokers and obtain the LTIDs and sub-account average price allocation details from the prime brokers.
- Example 3(a) depicts a scenario in which there are separate executing and clearing firms. Although the carrying broker for the large trader has a duty to report, the clearing broker for the executing broker is the only entity that has the execution times. On the other hand, the carrying broker for the large trader would be the only source of the LTIDs for specific client account allocations. In this situation, the SEC could obtain the execution fill details from the self-clearing executing broker and obtain the sub-account allocations and LTIDs from the large trader’s carrying broker. Example 3(b) shows what happens when an introducing broker is involved. Here, the SEC can obtain the LTIDs and execution fill details from the large trader’s carrying broker.
- Example 4 demonstrates the case of a “daisy chain” transaction, which involves a chain of two or more executing brokers and clearing brokers. This example further illustrates the split in the availability of information when there are multiple participants in the chain of execution. In this example, the SEC could obtain the execution fill details from the self-clearing executing broker (to the extent that they are reported back by the “BD1” in the chain of the transaction) and otherwise obtain the remainder of the execution fill details from “BD2” in the chain of the transaction. The SEC could then obtain the sub-account allocations and LTIDs from the large trader’s carrying broker.

#### **B. Many-to-Many Average Price Transactions**

The issues described above in Section III become much more complicated for average price transactions for multiple accounts that are aggregated in average price accounts and then executed in multiple transactions (“**many-to-many transactions**”). The solutions that we set forth in the examples in Appendix B seek to address these issues by providing a means by which the SEC can obtain the execution fill details and large trader LTID data. Requiring the specific execution fill details to be reported by a single carrying broker is not practicable and would require extensive re-engineering of trade flows that exist in the market today. Therefore, even if the SEC does not grant the relief requested above, SIFMA recommends that relief be provided for many-to-many average price trades such that the execution time should not be required to be reported by the carrying broker.

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The provision of execution fill details from a single point in the context of average price transactions involving multiple accounts and multiple broker dealers would ultimately require significant changes to the manner in which information is communicated among market participants, which is something that the SEC has expressly recognized in adopting CAT. Attempting to create this type of linkage outside of CAT would be unduly burdensome on the industry and inefficient in light of the current development of the CAT. We also note that, in proposing the CAT plan, the SROs have suggested a daisy chain approach under which each of the reporting broker-dealers and SROs convey sufficient information to link with the next firm in the chain, but that the CAT would be responsible for determining and recreating the entire chain of the order. This significant undertaking to link the different portions of the transaction chain should be left solely to the CAT, rather than the SEC requiring the development on a firm-by-firm basis for Rule 13h-1.

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SIFMA supports the goals of Rule 13h-1 and appreciates the opportunity to work with the SEC staff in implementing Rule 13h-1. We look forward to hearing from you regarding the above-described implementation issues and our recommendations for Phase II.

If you have any comments or questions, please do not hesitate to contact me at (202) 962-7383. You can also contact our outside counsel, Jerry Citera and Ashley Harris at Davis Polk & Wardwell, at (212) 450-4881 and (212) 450-4780, respectively.

Respectfully submitted,



Theodore R. Lazo  
Managing Director and  
Associate General Counsel

cc: The Honorable Elisse B. Walter, Chairman  
The Honorable Luis A. Aguilar, Commissioner  
The Honorable Troy A. Paredes, Commissioner  
The Honorable Daniel M. Gallagher, Commissioner  
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### Description of the Prime Brokerage Process

Prime brokerage is a system developed by full-service firms to facilitate the clearance and settlement of securities trades for substantial retail and institutional investors who are active market participants. Prime brokerage involves three distinct parties: the prime broker, the executing broker (for itself or as clearing broker for another executing broker), and the customer. The prime broker is a registered broker-dealer that clears and finances the customer trades executed by one or more other registered broker-dealers (“**executing broker**”) at the behest of the customer. Each of the executing brokers receives a letter from the prime broker setting forth the terms on which they agree to clear and carry each trade placed by the customer with the executing broker where the customer directs delivery of money or securities to be made to or by the prime broker.

The customer maintains its funds and securities in an account with the prime broker. Orders placed with the executing broker are effected through an account with the executing broker in the name of the prime broker for the benefit of the customer. When a customer places a trade order (“**trade date**”), the executing broker buys or sells securities in accordance with the customer's instructions. On trade date, the customer notifies the prime broker of the trade performed by the executing broker. The transaction is recorded in a customer account with the prime broker. At the same time, the prime broker records the transaction in a "fail-to-receive/deliver" account with the executing broker.

The executing broker confirms the transaction with the prime broker.<sup>1</sup> The prime broker then will affirm the trade if the information it received from the customer matches successfully with the information received from the executing broker and meets the credit or margin requirements for the customer's account. The trade may then be submitted to the National Securities Clearing Corporation for clearance and settlement following normal settlement procedures. The prime broker then settles with the customer in the normal way. Disaffirmed and DKed trades are treated as customer transactions on the books of the executing broker. Since the trade could be disaffirmed or DKed by the prime broker, the executing broker is compelled to fulfill its compliance responsibilities with respect to the particular transaction and customer.

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<sup>1</sup> The current industry practice is to confirm such transactions through the Omgeo Trade Suite System.

# Large Trader Flows

**For Discussion Purposes Only**

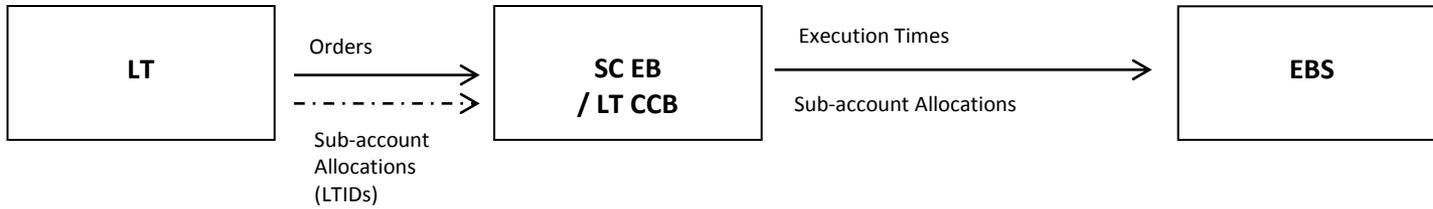
Illustrative trade flows are shown in the following slides. SIFMA's Recommendations for where the SEC would obtain Rule 13h-1 reporting information are in the green boxes on the bottom right-hand side of each page.

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1.

**Legend:**  
LT = Large Trader  
SC EB = Self-Clearing Executing Broker  
EBS = Electronic Blue Sheets  
IB = Introducing Broker  
EB = Executing Broker  
EB CB: Executing Broker Clearing Broker  
BD1 / BD 2 = Self-Executing Routing Brokers  
LT CCB = Large Trader Carrying Clearing Broker  
PB = Prime Broker

**Example 1. Self-clearing firm**

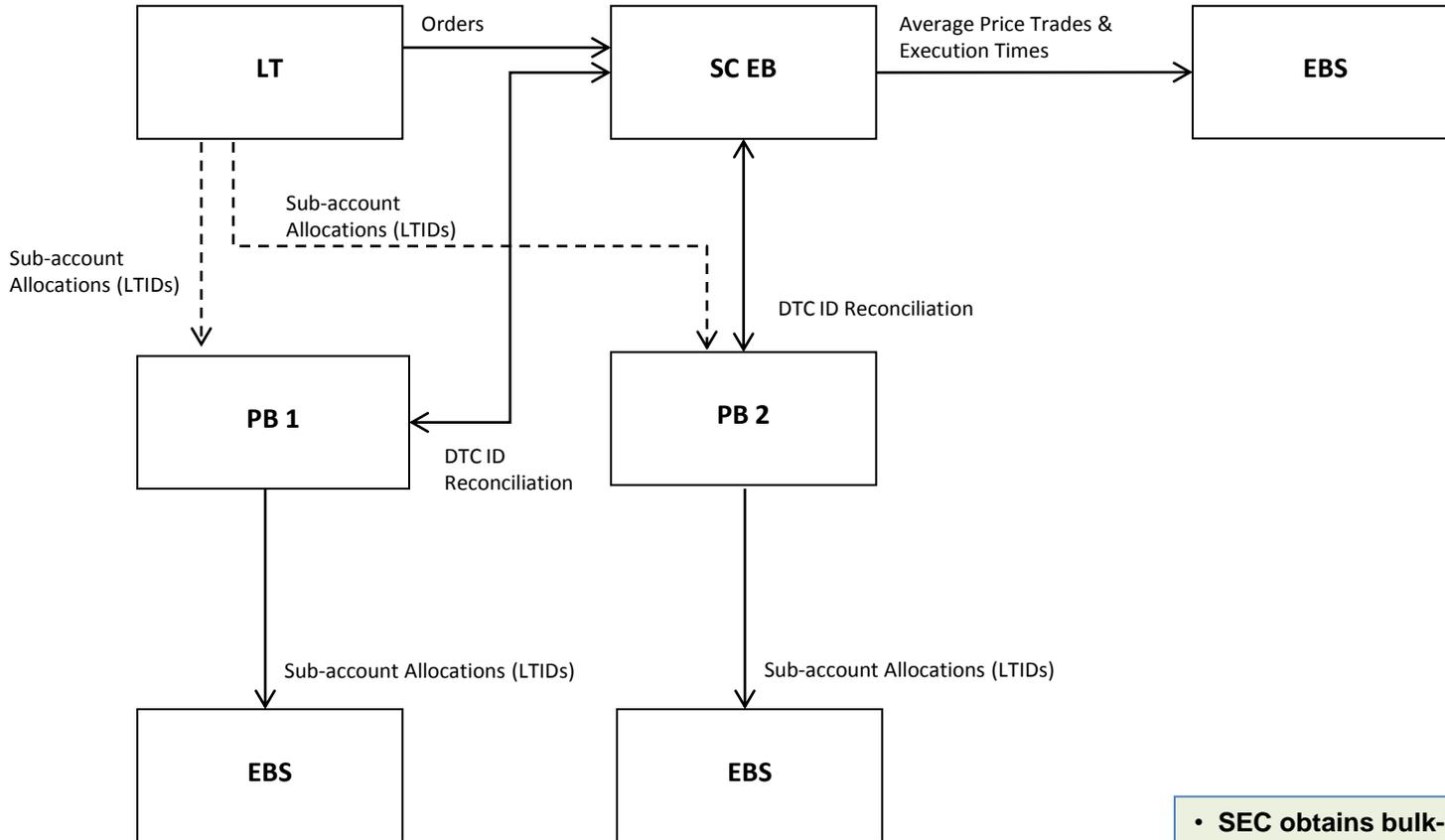


- SEC obtains the LTIDs on the sub-account allocations and the execution times from the SC EB / LT CCB.

# 2a.

## Example 2a. Separate executing broker/ Multi prime broker

**Legend:**  
LT = Large Trader  
SC EB = Self-Clearing Executing Broker  
EBS = Electronic Blue Sheets  
IB = Introducing Broker  
EB = Executing Broker  
EB CB: Executing Broker Clearing Broker  
BD1 / BD 2 = Self-Executing Routing Brokers  
LT CCB = Large Trader Carrying Clearing Broker  
PB = Prime Broker

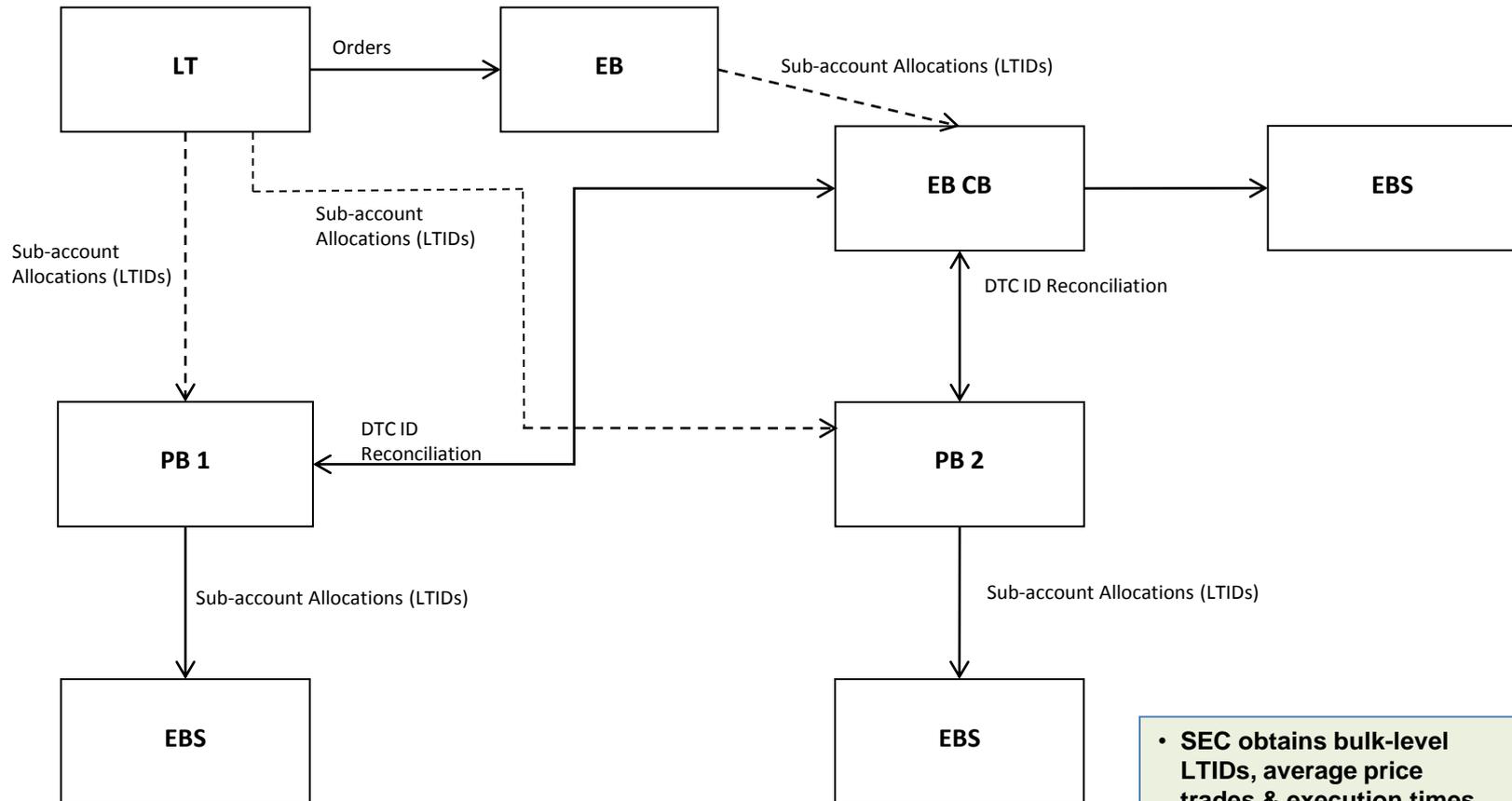


- SEC obtains bulk-level LTIDs, average price trades and execution times from the SC EB.
- SEC obtains sub-account allocations and LTIDs from PB 1 and PB 2.

## 2b.

### Example 2b. Separate executing broker/prime broker and clearing broker

**Legend:**  
LT = Large Trader  
SC EB = Self-Clearing Executing Broker  
EBS = Electronic Blue Sheets  
IB = Introducing Broker  
EB = Executing Broker  
EB CB: Executing Broker Clearing Broker  
BD1 / BD 2 = Self-Executing Routing Brokers  
LT CCB = Large Trader Carrying Clearing Broker  
PB = Prime Broker

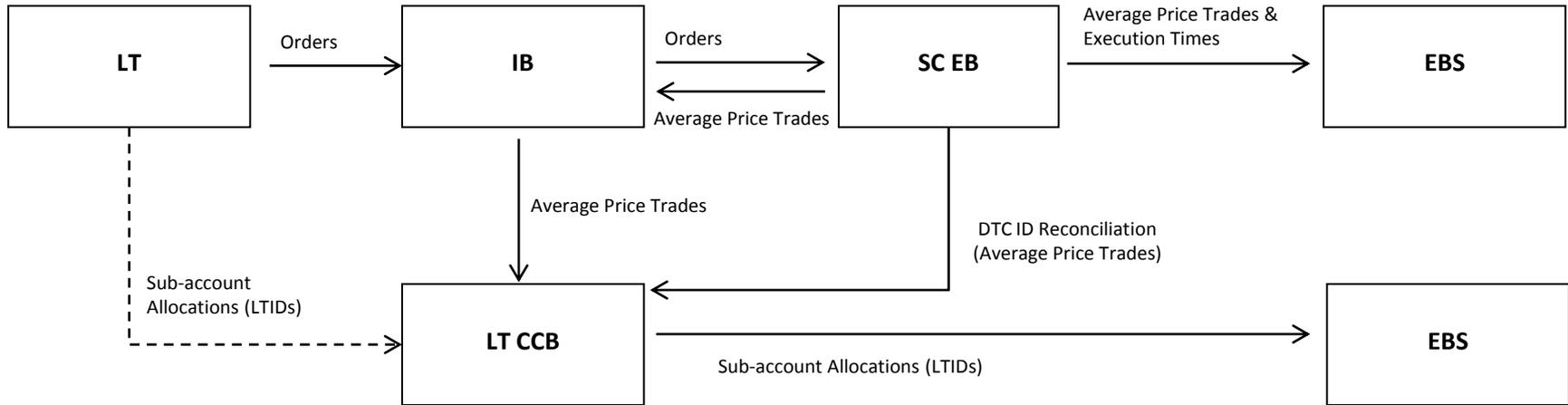


- SEC obtains bulk-level LTIDs, average price trades & execution times from the EB CB.
- SEC obtains sub-account allocations and LTIDs from PB 1 and PB 2

### 3a.

**Example 3a. Introducing broker flow (where the executing broker has the execution times and the clearing broker has the LTIDs)**

**Legend:**  
 LT = Large Trader  
 SC EB = Self-Clearing Executing Broker  
 EBS = Electronic Blue Sheets  
 IB = Introducing Broker  
 EB = Executing Broker  
 EB CB: Executing Broker Clearing Broker  
 BD1 / BD 2 = Self-Executing Routing Brokers  
 LT CCB = Large Trader Carrying Clearing Broker  
 PB = Prime Broker



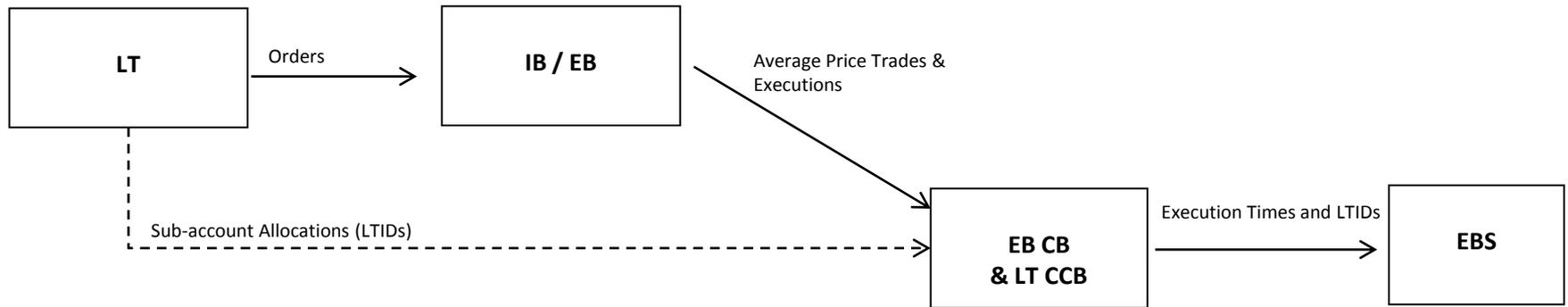
- SEC obtains bulk-level LTIDs, average price trades & execution times from the SC EB.\*
- SEC obtains sub-account allocations and LTIDs from the LT CCB.

\* If bulk LTIDs are not conveyed by the IB to the SC EB, then the Electronic Blue Sheet will contain the MPID of the IB.

3b.

**Example 3b. Institutional client routes an order to an executing broker that has the same clearing broker as the large trader (Dedicated custody account)**

**Legend:**  
LT = Large Trader  
SC EB = Self-Clearing Executing Broker  
EBS = Electronic Blue Sheets  
IB = Introducing Broker  
EB = Executing Broker  
EB CB: Executing Broker Clearing Broker  
BD1 / BD 2 = Self-Executing Routing Brokers  
LT CCB = Large Trader Carrying Clearing Broker  
PB = Prime Broker

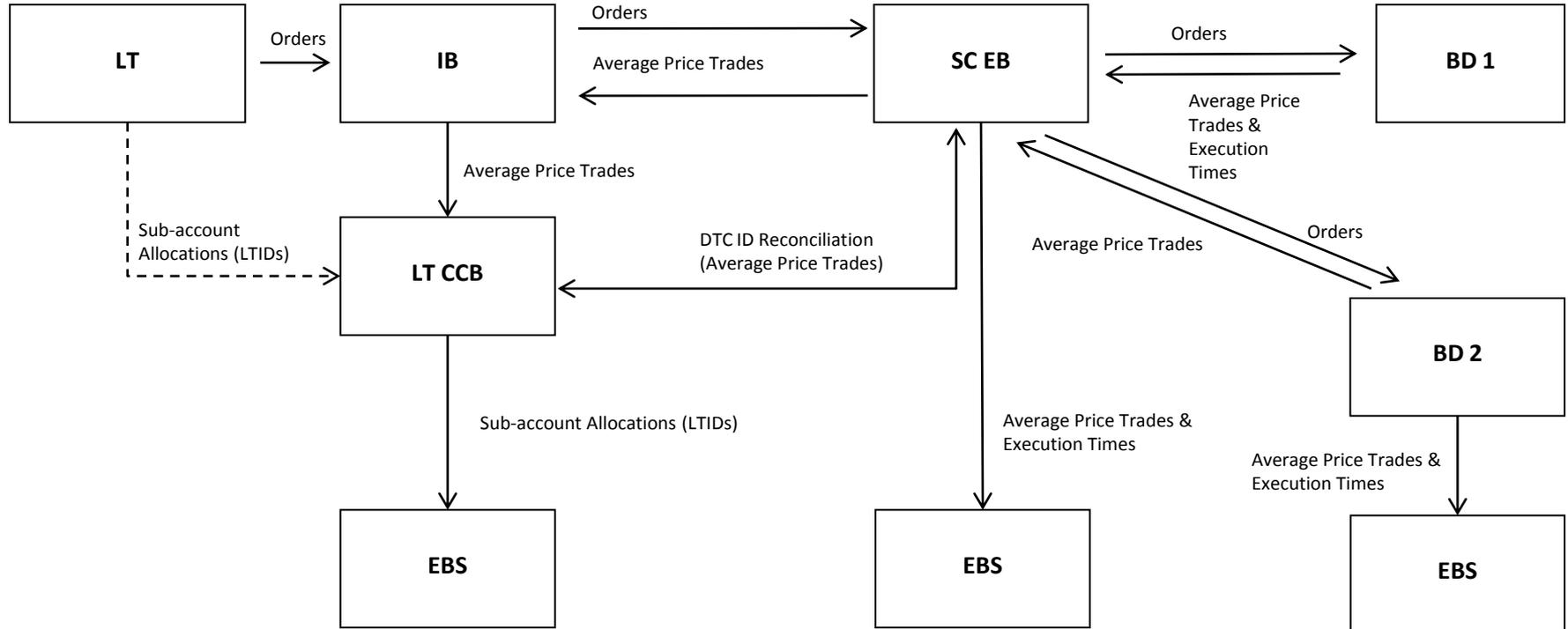


• SEC obtains LTIDs and execution times from the LT CCB.

# 4.

## Example 4. Daisy Chain – Involving a chain of two or more executing brokers/clearing firms

**Legend:**  
 LT = Large Trader  
 SC EB = Self-Clearing Executing Broker  
 EBS = Electronic Blue Sheets  
 IB = Introducing Broker  
 EB = Executing Broker  
 EB CB: Executing Broker Clearing Broker  
 BD1 / BD 2 = Self-Executing Routing Brokers  
 LT CCB = Large Trader Carrying Clearing Broker  
 PB = Prime Broker



- **SEC obtains some of the execution times from the SC EB (i.e., those reported back by BD 1).**
- **SEC obtains the remainder of the execution times from BD 2 (BD 2 does not report back execution times to SC EB).**
- **SEC obtains sub-account allocations and LTIDs from the LT CCB.**