June 22, 2010

Via Electronic Filing

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

Re: Large Trader Reporting System, Rel. No. 34-61908; File No. S7-10-10

Dear Ms. Murphy:

The Investment Adviser Association (IAA)[1] appreciates the opportunity to comment on the Commission's proposed new Rule 13h-1 and Form 13H under Section 13(h) of the Securities Exchange Act of 1934 to establish a large trader reporting system.[2] The proposal is intended to assist the Commission in identifying and obtaining certain trading information about persons that conduct a substantial amount of trading activity in the US securities markets. The Commission proposes to use the large trader reporting system to analyze the effect of large trader activity on the securities markets, to reconstruct trading activity following periods of unusual market volatility, and to analyze significant market events for regulatory purposes.

We appreciate the Commission's desire to obtain relevant data to analyze trading activity in the US securities markets. The events of May 6 (during which the markets experienced a severe and rapid drop in prices) in addition to the volatile markets in 2008 have highlighted this need. Therefore, we support enhancing the Commission's ability to obtain access to useful and meaningful information about traders that conduct significant activity on the US securities markets both to detect and deter fraudulent and manipulative activity and other trading abuses and to analyze the securities markets and activities on the securities markets generally.

We have concerns, however, whether the large trader reporting system as currently contemplated in this proposal is the most effective means to collect data on trading activity on the US securities markets that would assist the Commission to better understand the causes of

[1] The IAA is a not-for-profit association that represents the interests of investment adviser firms that are registered with the SEC. For more information, please visit our web site: www.investmentadviser.org.

[2] Large Trader Reporting System, Rel. No. 34-61908 (Apr. 14, 2010) (Large Trader Proposing Release).

market volatility and to provide an appropriate regulatory response when necessary. We submit that the proposed requirement that parent companies aggregate the trading activity of all corporate affiliates (regardless of whether affiliates coordinate, or share information about, investment decisions) to determine whether the parent is a "large trader" and to tag all affiliate trading with the same large trader number would result in the Commission receiving inaccurate and potentially misleading trading information. We also believe that certain account information that appears to be required by proposed Form 13H may have the unintended result of disclosing information about investment advisory clients that are not necessary for purposes of obtaining information about large traders and that may raise privacy and other concerns. Moreover, some investment management firms do not have all of the requested account information and have various trading arrangements in place that otherwise would make compliance with the proposal extremely difficult and costly. Finally, we are concerned that the Commission may have greatly underestimated the compliance burden on investment managers, particularly with respect to firms with more complicated corporate structures.

By proposing the large trader reporting system, we understand that the Commission is seeking access to more information about large traders and their activities in the near-term before a consolidated audit trail becomes operational.[3] We believe, however, that the current proposal should be revised as suggested below so that the Commission can obtain useful and meaningful information and the burdens imposed on investment managers are minimized. We discuss each of our concerns below.

<u>The Commission Should Not Require Aggregation Among Affiliates that Do Not Share Information About Investment Decisions</u>

Proposed Rule 13h-1 would require large traders to identify themselves to the Commission on Form 13H. After the form is submitted, the Commission would issue a unique large trader identification (LTID) number to the large trader, which would in turn be provided to the large trader's registered broker-dealers. Registered broker-dealers would be required to maintain transaction records for each large trader and to report that information to the Commission on request.

The proposed rule would define a large trader as any person (including through other persons controlled by such person) that exercises investment discretion over one or more accounts and effects transactions for the purchase or sale of any NMS security for or on behalf or such accounts through one or more registered broker-dealers in an aggregate amount equal to or greater than the identifying activity level.[4] In the Large Trader Proposing Release,

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[3] The SEC recently has proposed a consolidated audit trail system that would allow the SEC to reconstruct trading activity and analyze suspicious trading behavior and unusual market events. *See* Consolidated Audit Trail, Rel. No. 34-62174 (May 26, 2010).

[4] Under the proposed rule, the "identifying activity level" is the threshold level of transaction activity at which a market participant would be considered a "large trader." The Commission proposes that the "identifying activity level" would mean aggregate transactions in NMS securities that are equal to or greater than: (1) during a calendar day, either two million shares or shares with a fair market value of $20 million; or (2) during a calendar month, either twenty million shares or shares with a fair market value of $200 million.

the Commission states that the proposed definition is intended to "push the identification requirement up the corporate hierarchy to the parent entity to identify the primary institutions that conduct a large trading activity." Specifically, the Commission appears to be proposing to require a parent company of subsidiaries that do not individually trade at a level that equals or exceeds the threshold to identify itself as a large trader if the subsidiaries collectively effect transactions that equal or exceed the threshold.[5] Under the proposed rule, if a parent company is deemed a large trader, affiliates would be required to identify all of the accounts held by their registered broker-dealers so that these accounts would be marked with the LTID number. On request from the Commission, broker-dealers would be required to provide transaction data based on the LTID number.

The Commission's proposal to require aggregation among affiliates is inappropriate with respect to investment adviser affiliates that do not share information. The proposal inherently assumes parental control and affiliate coordination when that is often not the case. For example, a parent company may have separately organized and operated investment management subsidiaries (both US and foreign) that manage different types of clients or may be a holding company of completely independent investment management firms. These advisers are independently registered with the Commission and make separate regulatory filings, such as Form ADV, Form 13F and Schedule 13G. Some investment advisers may be part of a financial holding company in which the parent company simply owns subsidiaries that operate independently.

Investment advisers are part of a wide range of business models and organizational structures. In many of these organizational structures, the investment adviser entities do not even share information about investment or trading decisions, much less coordinate such decisions.[6] Corporations have legitimate business reasons for separating their trading activity and have adopted policies and procedures long before this proposal to effectuate this practice in their corporate group. In fact, affiliates that do not share information about investment decisions have information barriers to ensure that voting and investment powers are exercised independently from parent and affiliated entities. These and other policies and procedures are typically in place to ensure that affiliates do not have access to any nonpublic information

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[5] *See* Large Trader Proposing Release, *supra* note 2 ("even if an individual employee, group, or subsidiary within a company would not effect transactions that equal or exceed the identifying activity threshold by itself, if collectively the ultimate parent company operates subsidiaries or controls individuals that together effect transactions that equal or exceed the identifying activity threshold, then the parent company would need to identify itself as a large trader").

[6] For example, a financial holding company may have: (1) a US registered adviser that manages institutional and mutual fund assets using fundamental strategies; (2) a US registered adviser that manages institutional, mutual fund and wrap account assets using quantitative strategies; (3) a US entity that is dually registered as an investment adviser and broker-dealer with retail brokerage and wrap fee accounts; (4) a French mutual fund company; and (5) a Korean joint venture that manages mutual fund assets. The holding company would not coordinate investment decisions, and none of the entities would share information about investment decisions. The proposed rule, however, would require the trading data of all the subsidiaries to be aggregated. Therefore, the Commission would receive misleading information regarding the trading activity of the "large trader" holding company because transaction data of all of the subsidiaries would have been consolidated.

regarding other affiliates and reflect the fact that there are legitimate reasons for disaggregating trading activity.

In these circumstances, transaction data that combine the trading activities of all of the affiliates would send confusing and unhelpful information to the Commission regarding the trading activity of a corporate group or of a "large trader." Transaction data that consolidate trading activity of affiliates that do not coordinate investment decisions or trading strategies or even share information about investment decisions would present at best an inaccurate, and at worst a misleading, picture to the Commission of the trading activity of a large trader. In other words, the data received from such a corporate group would be as meaningless as consolidated data of trading activity of investment managers located in a particular geographic area. This type of reporting may lead the Commission to view the transactions as being coordinated among affiliates in a group when that is clearly not the case and thus could thwart the Commission's goal to obtain information about coordinated trading activity and the executions of a large trader's investment decisions. Indeed, the Commission would have to disaggregate the information to conduct any meaningful investigation of market activity.

The proposed aggregation requirement also would impose significant burdens on parent companies to keep track of all of the brokerage accounts of their subsidiaries (which they would not do in the ordinary course of business) to file and amend Form 13H. In addition, a parent company would have to ensure that its affiliates tag all new brokerage accounts with the parent's LTID number. The ongoing tracking and monitoring by the parent company of trading activities of its affiliates would be a new and significant additional burden. As we discuss in more detail below, these types of organizations often do not have a common system for trading activity, and compliance with this rule would require implementation of new systems to collect, collate, and disseminate the information required by the proposed rule and form. The aggregation requirement also would impose a burden on affiliates that otherwise would not have to report because, for example, they are fixed income managers or funds of funds managers and only trade small amounts of NMS securities. Tagging the de minimis trades in NMS securities of these affiliates would provide no useful information to the Commission in obtaining data about the coordinated trading activity of a large trader and therefore would impose burden with no policy benefit.

We appreciate the Commission's concern that disaggregation may permit persons to evade the large trader identification requirement by allowing companies to divide their trading among subsidiaries. We believe, however, that a requirement to aggregate subsidiaries that individually would not trade at or above the threshold level is an overly broad approach to prevent some persons from deliberately avoiding being identified as a large trader.[7] In our view, the Commission can more narrowly tailor the proposal to recognize these variations in organizational structure among entities and permit disaggregation.

This concept of disaggregation among corporate affiliates has long been implemented in the context of Schedules 13D/13G, where the Commission has recognized that where the

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[7] Additional protection would be provided by the proposed prohibition on disaggregation of accounts that is intended to avoid the identification requirements of the proposed rule. *See* Proposed Rule 13h-1(c)(2).

"organizational structure of the parent and related entities are such that the voting and investment powers over the subject securities are exercised independently, attribution may not be required for the purposes of determining whether a filing threshold has been exceeded and the aggregate amount owned by the controlling persons."[8] We urge the Commission to take a similar approach for Rule 13h-1 and Form 13H.

Therefore, we request the Commission to add new Rule 13h-1(c)(3) permitting a parent company whose "organizational structure provides for voting and investment powers over securities to be exercised independently by its related entities to disaggregate trading activities of affiliates for purposes of determining whether a person is a large trader." We believe that where investment managers do not share information about investment decisions for business purposes, trading volume of such managers, even if affiliates, should not be required to be aggregated to determine whether the parent company is a large trader.

Under this scenario, only those affiliates that individually trade at or above the threshold level or affiliates that together (because of sharing of information regarding investment decisions) trade at or above the threshold level should be required to identify themselves as the large trader and be required to tag their brokerage accounts with the LTID number. We recommend that the Commission provide flexibility to permit the parent of one or more subsidiaries that are individually large traders to be deemed the large trader if the parent chooses. In such a case, those affiliates that do not qualify individually as large traders should not be required to tag accounts with their broker-dealers with a parent's or affiliate's LTID number for the reasons discussed above.

The Commission Should Not Require Disclosure of Account-Specific Information on Form 13H

Item 6 and Schedule 6 (List of Large Trader Accounts) of the proposed Form 13H imposes an obligation on a large trader to provide certain account information. Specifically, Item 2 of Schedule 6 would require, among others, information about the name of the registered broker-dealer that holds the account, the broker-dealer account number, and name of the account. In the Large Trader Proposing Release, the Commission states that it would use this information to cross-reference accounts and avoid double counting of transactions.

Information about Advisory Clients Should Not Be Required

As an initial matter, there is some confusion among market participants regarding the "account" for which the information should be provided. Because the text of the Large Trader Proposing Release refers to "information concerning accounts over which the large trader exercises investment discretion" and there is no definition of "accounts" in the proposed rule or form, some are concerned that the Commission is seeking information about the clients of a large trader. Information about a large trader's client is unnecessary for purposes of collecting information about the execution of a large trader's investment decisions. Although we understand that the Commission is not seeking this information, we seek confirmation that "account" for purposes of proposed Rule 13h-1 and Form 13H is the

[8] *Amendments to Beneficial Ownership Reporting Requirements*, Rel. No. 34-39538 (Jan. 12, 1998).

"brokerage" account and not the "account" of the client of the large trader. The Commission also should specifically state that it is not requesting any information about underlying clients of a large trader.

More problematic for investment managers, however, is that many advisers do not use omnibus or master brokerage accounts when trading for their clients and that client identifying information may be included in the brokerage account information. For example, some investment advisers use investment operation systems that include the investment adviser's client name and account number. Investment advisers also may trade on behalf of their clients through brokerage accounts held in the name of their clients. Wrap account programs also would involve trading through brokerage accounts in the name of the clients. In these circumstances, we are concerned that proposed Item 2 of Schedule 6 would require disclosure of the client's brokerage information and of client information. A requirement to disclose client information may raise numerous privacy issues, particularly with respect to transmission of confidential information from non-US jurisdictions such as the EU and Switzerland (which have strict data privacy laws). Client-specific information are not necessary for the Commission to determine the trading volume of a large trader investment manager, and a requirement to disclose client information could have harmful effects on the relationship between the investment manager and its clients. Therefore, we believe that client identification information should not be required on Form 13H.

Certain Brokerage Account Information May Not be Available or May be Burdensome to Include in Form 13H

We also believe that brokerage account information ("Broker-Dealer Account Number" and "Account Name" under Item 2 of Schedule 6 to Form 13H) should not be required in Form 13H because specific brokerage account information may not available in certain circumstances. Some investment managers may execute trades with broker-dealers with whom they have informal relationships but do not technically have "accounts." These investment managers do not have formal brokerage contracts with all of their broker-dealers and do not have account information to disclose.

In addition, there are some arrangements whereby investment advisers may, as part of their investment advisory services to defined contribution plans, provide transaction instructions on behalf of a plan participant to a defined contribution plan's record-keeper. In this situation, although the advisers may execute trades with broker-dealers, they do not technically maintain brokerage accounts with those broker-dealers. The advisers instead conduct transactions through the plan's record-keeper. Therefore, these advisers would not have any information about any brokerage accounts maintained by the plan's record-keeper and there would be no information available to the advisers to disclose on Form 13H.

Moreover, the specific brokerage account information may be extremely burdensome to produce in Form 13H because the number of "brokerage accounts" can range in the thousands and the brokers used can change.

For example, for wrap accounts, each wrap account client would have his or her own brokerage account through which a large trader may execute trades. Therefore, potentially thousands of wrap accounts may have to be provided on Form 13H, and the form would have to be updated each quarter for new wrap accounts. In addition, an adviser may trade away from the sponsoring broker so Form 13H would have to be amended with additional brokerage information about the brokerage accounts used to "trade away."

The list of brokers required to be disclosed also can change significantly each quarter. The brokers that will be used by an investment manager cannot be anticipated at the time of filing of the initial Form 13H or at the beginning of each calendar year. Although investment managers may have an approved list of brokers, they also may trade through other brokers occasionally for a particular type of security. Because of their best execution obligations, investment managers do not always use the same brokers. Therefore, investment managers would have to amend Form 13H each quarter to include the additional brokers that were used and the relevant account information. In a large corporate group, the parent company would have to keep track continuously of the brokerage information for all of its affiliates or have systems in place to ensure that their affiliates are amending their Form 13H quarterly.

Given these issues, we believe that tagging executions with the LTID number would sufficiently permit broker-dealers to provide the Commission with the appropriate transaction data.[9] At a minimum, we recommend that the Commission not require detailed listing of account numbers and names that would provide at best marginally useful information. If necessary, the Commission, under proposed Rule 13h-1(b)(4), would have the authority to request more detailed information from the large trader, including information regarding all "accounts" through which the large trader effects transactions.

<u>The Commission Greatly Underestimates the Compliance Burden of a Large Trader Reporting System</u>

In the Large Trader Proposing Release, the Commission states that the recordkeeping and reporting requirements have been designed to minimize costs. Specifically, the Commission estimates that it would take a large trader approximately 20 hours to calculate whether its trading activity qualifies it as a large trader, complete the initial Form 13H with all required information, obtain a LTID from the Commission, and inform its registered broker-dealers and other entities of its LTID and the accounts to which it applies. We believe that, particularly with respect to firms with more complicated corporate structures, the compliance burdens are much more significant and are not adequately reflected in the proposal. As

[9] This approach would be more consistent with the large trader reporting system that has been administered by the Commodity Futures Trading Commission (CFTC) for many decades. The CFTC's large trader reporting system mainly relies on the clearing members, futures commission merchants, and foreign brokers to file reports with the CFTC showing special accounts (*i.e.*, an account in which there is a reportable position) held with these brokers and clearing members. Individual traders are only required to report (Form 40) if they receive a special request from the CFTC, and parent firms do not need to aggregate the positions of their traders. This reporting system allows the CFTC to obtain adequate information about each individual trader and, based on the information provided, relate these separate traders to a single level of ownership as part of the CFTC staff analysis.

suggested below, the Commission should provide investment managers with a sufficient period of time to develop their systems to file as large traders.

In the Large Trader Proposing Release, the Commission states that it understands that "large traders currently maintain systems that capture their trading activity, and believes that these existing systems would be sufficient without further modification to enable a large trader to determine whether it effects transactions for the purchase or sale of any NMS security for or on behalf of accounts over which it exercises investment discretion in an aggregate amount equal to or greater than the identifying activity level."[10]

These systems assumptions underlying the Commission's estimate of the burden on certain large traders are not correct for all potential large traders. Many corporate groups maintain operational independence of their subsidiaries and each affiliate may employ its own individual system, which may not communicate with other affiliates. As a result, the process for gathering information would have to be done on a manual basis until a system can be developed. Gathering information across multiple affiliates (both US and non-US entities) manually will place a tremendous burden on investment managers.

Moreover, the lack of a system to capture trading activity across a corporate group is particularly true for investment advisers in a corporate group in which investment decisions are made independently and there are information barriers in place among the various affiliates and the parent company to prevent sharing of trading information. In these circumstances, neither the parent company nor any of its affiliates would have any "existing systems" that could be used or leveraged to comply with the requirements of the proposed rule and form. In fact, as we discussed in detail above, these corporate organizations have built structures to *prevent* sharing of trading information. As a result, the burden on these firms would be significant to develop a new system to aggregate trading activity and to communicate continuously new brokerage account information to include on Form 13H. At the same time, these firms would have to maintain information barriers to prevent sharing of non-public information about investment decisions to avoid triggering aggregation in other contexts such as Schedule 13D/13G or similar reporting requirements in foreign jurisdictions that permit disaggregation.[11]

Finally, there are numerous types of brokerage arrangements that investment managers employ to execute their trades that make other requirements in Form 13H burdensome.[12] By way of example, some investment managers have arrangements for certain strategies or

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[10] *See* Section IV Paperwork Reduction Act of the Large Trader Proposing Release, *supra* note 2.

[11] *See* EU Transparency Directive, 2004/109/EC (Articles 9.5, 12.4, 12.5, and 23).

[12] As discussed above, because an investment manager as a fiduciary is responsible for seeking best execution of client securities transactions, a manager may select among a wide range of brokers on a transaction-by-transaction basis or an investment style-by-style basis (*e.g.*, international equity or small cap). A manager cannot anticipate at the beginning of each year, or even each day, which broker (or which type of broker) it will choose to execute transactions. Therefore, investment advisers would be required to amend Form 13H to update the information regarding the brokers used each quarter.

accounts in which both affiliated and nonaffiliated subadvisers would be engaged to manage a portion of a client's account. In some instances, the nonaffiliated adviser may not have the back office capacity to place orders for execution of an investment decision and may request the operations group of the primary adviser to place the trade order on its behalf with the subadviser's broker. In these circumstances, the administrative personnel of the primary adviser would have to obtain the LTID number of the nonaffiliated subadviser (if it is a large trader) to provide to the broker. These types of arrangements may be common with multi-strategy accounts. In providing this illustration, we hope that the Commission recognizes that the proposal could unintentionally impose significant hardship on firms because of the variety of trading arrangements in which investment managers may engage.[13]

In recognition of these burdens, the Commission, at a minimum, should revise the effective date of a final rule from three months to one year after adoption to provide investment managers sufficient time to gather information and implement systems to provide the LTID number to their brokers and brokers of their subsidiaries, if any, and implement other systems that may be necessary within their corporate group. As discussed above, many investment managers in a corporate group would need to build systems to be able to gather the relevant data and file Form 13H.

<u>The Commission Should Modify the Frequency of Filings of Form 13H and Permit Electronic Filing of Form 13H</u>

The Commission proposes to require large traders to file the initial Form 13H promptly after effecting transactions that reach the threshold level. The Commission then would require an amended Form 13H promptly following the end of a calendar quarter if any of the information contained in the Form 13H become inaccurate for any reason. Regardless of whether any amended Form 13H was filed during the year, the Commission would require a large trader to file proposed Form 13H annually, within 45 days after the calendar year-end.

We do not believe the annual updating requirement is necessary if the Commission adopts the requirement to file an amended Form 13H following the end of the calendar quarter for any changes in the information. It is highly unlikely that the Commission would receive any new information from the annual Form 13H if large traders are required to file promptly changes during the last quarter. We suggest that the Commission eliminate the calendar-end filing requirement. We also recommend that the Commission provide a specific timeframe for amending Form 13H after the calendar quarter rather than adopting a "prompt" filing of changes standard. We believe 10 calendar days would be an appropriate timeframe.

We also support the Commission's proposal to require each large trader to file Form 13H electronically. The Commission notes that large traders might be required to file Form 13H in paper until such time an electronic filing system is operational and capable of receiving the form.[14] We would urge the Commission not to implement the requirement to

[13] We do not attempt in this letter to enumerate all the types of trading arrangements in existence today. If it would be helpful to the Commission and its staff, we would be pleased to provide additional examples.

[14] *See* Large Trader Proposing Release n. 80, *supra* note 2.

file Form 13H until the electronic filing system is operational. Even assuming the Commission's potentially low estimate that there would be 400 large traders subject to the proposed rule, the information submitted to the Commission could be voluminous. Without the ability to manage the information electronically, it would be difficult for the Commission to review these forms. We urge the Commission to implement the proposed rule and form when a system is in place to permit the Commission to receive the information electronically.

<u>The Commission Should Consider the Application of the Proposed Rule to Traders that Infrequently Trade at the Threshold Level</u>

In the Large Trader Proposing Release, the Commission requests comment on whether there should be a different measuring period for aggregating transactions to minimize the applicability of the rule to persons that effect one-time transactions greater than the identifying level. We believe that the Commission should consider the effect on traders that may trade at or above the threshold level infrequently. For example, the proposed Rule 13h-1 and Form 13H would appear to apply to investment advisers that provide investment advice to defined contribution plans. The transactions made on behalf of defined contribution plan participants may exceed the threshold activity level because of the number of participants in the plan. These transactions, however, usually occur at the beginning of an adviser's relationship with the plan and are unlikely to occur in subsequent periods. For these advisers, the identifying activity level typically would only be crossed when they obtain new clients at the plan level. Therefore, we request that the Commission consider ways to address the effect of the proposed rule on traders that infrequently cross the threshold level.

<u>The Commission Should Maintain Confidentiality of Information</u>

We applaud the Commission for proposing that the information that a large trader would be required to disclose on proposed Form 13H or provide in response to a Commission request would be exempt from disclosure under the Freedom of Information Act ("FOIA"). The Commission also states that any transaction information that a registered broker-dealer would report under the proposed rule would be exempt from disclosure under FOIA.

Investment managers are concerned that public disclosure of their significant trading activity may lead to professional traders attempting to take advantage of their investment strategy or others to front run their trades. We encourage the Commission to monitor the effect of the rule and form so that trading information about a large trader is not allowed to "leak," permitting professional traders to take advantage of an asset manager's strategies. We request that the Commission specifically caution in any adopting release that trading information should be treated as material non-public information and that dissemination by market intermediaries (*e.g.*, broker-dealers) of such information would be a breach of duty to their clients.

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The IAA strongly supports the Commission's efforts to obtain useful information about the US securities markets to ensure that the markets continue to be in the public interest and to protect investors. We are concerned that the proposed rule and form would result in the Commission obtaining information that may not be useful and potentially misleading while imposing significant burdens on investment managers. We appreciate the opportunity to provide our views on these issues and would be pleased to provide any additional information. Please contact the undersigned or Karen L. Barr, General Counsel, at (202) 293-4222 with any questions regarding these matters.

Respectfully submitted,

/s/ Jennifer S. Choi

Jennifer S. Choi
Associate General Counsel

cc: The Honorable Mary L. Shapiro, Chairman
The Honorable Kathleen L. Casey
The Honorable Elisse B. Walter
The Honorable Luis A. Aguilar
The Honorable Troy A. Paredes

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