

requirements of Section 17A(b)(3)(G) of the Act, which requires that the rules of a clearing agency provide that its members be appropriately disciplined for violation of any provision of the rules of the clearing agency by expulsion, suspension, limitation of activities, functions, and operations, fine, censure, or any other fitting sanction,<sup>15</sup> as well as Section 17A(b)(3)(H) which, among other things, requires that the rules of a clearing agency provide a fair procedure with respect to the disciplining of participants.<sup>16</sup>

In its filing, OCC requested that the Commission approve this proposed rule change on an accelerated basis for good cause shown. OCC cites as the reason for this request OCC's operation as a DCO, which is subject to regulation by the CFTC under the CEA. This rule change is being made according to regulations promulgated by the CFTC, which were previously subject to notice and comment. Not approving this request on an accelerated basis would have a significant impact on OCC's operations as a DCO.

The Commission finds good cause for approving the proposed rule change prior to the 30th day after the date of publication of notice in the **Federal Register** because the proposed rule change allows OCC to implement the regulations of another federal regulatory agency, the CFTC, in accordance with those regulations' effective date.

## V. Conclusion

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (SR-OCC-2012-06) is approved on an accelerated basis.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>17</sup>

**Elizabeth M. Murphy**,

*Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-66840; File No. SR-Phlx-2012-23]

### Self-Regulatory Organizations; NASDAQ OMX Phlx LLC; Order Approving Proposed Rule Change To Amend Registration, Qualification, and Continuing Education Requirements for Associated Persons

April 20, 2012.

#### I. Introduction

On February 16, 2012, NASDAQ OMX Phlx LLC ("Phlx" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup>, and Rule 19b-4<sup>2</sup> thereunder, a proposed rule change to amend and extend registration, qualification, and continuing education requirements for associated persons of members. The proposed rule change was published for comment in the **Federal Register** on March 7, 2012.<sup>3</sup> The Commission received no comment letters on the proposal. This order approves the proposed rule change.

#### II. Description of the Proposal

##### *Representative Registration*

Exchange Rule 604 applies to all member organizations and generally requires the Series 7 examination for Registered Representatives,<sup>4</sup> Principals,<sup>5</sup> off-floor traders<sup>6</sup> and persons compensated directly or indirectly for the solicitation or handling of business in securities who are not otherwise required to register with the Exchange by Rule 604(a).<sup>7</sup> Rule 604(f) provides that members and persons associated with member organizations who are registered with the Exchange for the purpose of trading NMS Stocks<sup>8</sup> through the facilities of the Exchange, which is the PSX platform, are subject to the provisions of Rule 604(g) and (h) governing principal and representative registration, respectively. Rule 604(h) is applicable today only to PSX users pursuant to Rule 604(f). The Exchange proposes to move the requirements in Rule 604, and expand on those

requirements, in proposed Rules 611, 612 and 613.

Rule 604(h) governs the registration of representatives with the Exchange. Specifically, Rule 604(h)(1) requires that all persons engaged or to be engaged in the investment banking or securities business<sup>9</sup> of a member organization who are to function as representatives be registered through WebCRD<sup>10</sup> in the category of registration appropriate to the function they will perform.<sup>11</sup> Before their registration can become effective, they must pass the Series 7 examination. The Exchange proposes to delete Rule 604 and adopt broader registration requirements in proposed Rule 613. Provisions contained in Rule 604(h) would be moved to Rule 613, Representative Registration, in substantially the same form, except with respect to trading floor personnel subject to Rule 620.

Proposed Rule 613(a) would require all persons engaged or to be engaged in the investment banking or securities business of a member organization who are to function as representatives to be registered through WebCRD as specified in Rule 613(e).<sup>12</sup> Trading floor personnel whose activities<sup>13</sup> are limited to the trading floor would continue to be required to register pursuant to Rule 620 and qualify by passing the Exchange's Trading Floor Qualification Examination.<sup>14</sup> In addition, amended Rule 620 would require all trading floor personnel, including clerks, interns, and any other associated persons of a member organization who are not required to register pursuant to Rule 620(a) to register on Form U4 through WebCRD. Thus, the same registration information would be available

<sup>9</sup> The term "investment banking or securities business" means the business, carried on by a broker or dealer, of underwriting or distributing issues of securities, or of purchasing securities and offering the same for sale as a dealer, or of purchasing and selling securities upon the order and for the account of others. See Rule 1(m). Of course, the federal securities laws may require broker-dealers to become members of the FINRA in order to perform some of these functions. See *e.g.*, 15 U.S.C. 78o(b)(8).

<sup>10</sup> WebCRD is FINRA's automated Central Registration Depository.

<sup>11</sup> Supplementary Material .04 of Rule 604.

<sup>12</sup> The requirement does not cover members whose activities are limited to the Exchange's options trading floor and who are registered pursuant to Rule 620(a), as well as associated persons whose activities are limited to the Exchange's options trading floor and are registered pursuant to Rule 620(b).

<sup>13</sup> These functions include handling and executing electronic and phoned-in orders on the trading floor, as well as providing markets, both verbally and electronically.

<sup>14</sup> Trading floor personnel, and members on the trading floor, would, however, be subject to new principal registration requirements, described below.

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See Securities Exchange Act Release No. 66497 (March 1, 2012) 77 FR 13668.

<sup>4</sup> See Rule 604(a).

<sup>5</sup> See Rule 604(g).

<sup>6</sup> See Rule 604(e).

<sup>7</sup> See Rule 604(d).

<sup>8</sup> See Rule 1(t).

<sup>15</sup> 15 U.S.C. 78q-1(b)(3)(G).

<sup>16</sup> 15 U.S.C. 78q-1(b)(3)(H).

<sup>17</sup> 17 CFR 200.30-3(a)(12).

electronically in WebCRD for trading floor members and associated persons as is available for persons registered as General Securities Representatives.

Currently, Supplementary Material .04 to Rule 604, Categories of Representative Registration—General Securities Representative, contains the basic requirement that each member and each person associated with a member organization who is included within the definition of a representative in Rule 1(cc) register with the Exchange as a General Securities Representative and pass the Series 7 examination before his registration may become effective. This provision is not changing and is similar to that of several other self-regulatory organizations (“SROs”).<sup>15</sup> The Exchange proposes to move the provisions of Rule 604(h) into Rule 613 and Supplementary Material .04 of Rule 604 into Rule 613(e) so that the “registered representative” categories and requirements would be located in one rule.

The Exchange also proposes Rule 613(f) which would adopt a limited category of representative registration, Proprietary Trader, and a qualifying examination for that category, the Series 56.<sup>16</sup> Members and associated persons engaged solely in proprietary trading, market making or effecting transactions on behalf of a broker-dealer account and who do not do business with the public may register as Proprietary Traders and pass the Series 56 examination, in lieu of registering as General Securities Representatives and passing the Series 7 examination. The Proprietary Trader category would include both Floor Brokers on the Exchange’s trading floor and persons performing brokerage functions off the trading floor (“upstairs”).<sup>17</sup>

The Exchange proposes to replace Rule 604 with Rule 613. Rule 613 would cover every person subject to registration as a representative, and unlike Rule 604, it is not limited to associated persons of member organizations for which the Exchange is

the designated examining authority (“DEA”). Furthermore, the proposed rules would extend the requirements currently set forth in Rule 604(h), which apply only to member organizations registered to use PSX,<sup>18</sup> to all member organizations. In addition, the language of Rule 613 more closely aligns with the rules of FINRA and NASDAQ, which should facilitate compliance by broker-dealers.

#### *Principal Registration*

Persons associated with a member organization who are actively engaged in the management of the member organization’s investment banking or securities business, including supervision, solicitation, conduct of business or training persons associated with a member organization for any of these functions are principals. Such persons include: Sole proprietors, officers, partners, managers of offices of supervisory jurisdiction,<sup>19</sup> and directors of corporations. Currently, principals of PSX member firms must register via Form U4 in Web CRD, and qualify by passing an appropriate examination, pursuant to Rule 604(g). The Exchange proposes to extend these principal requirements to cover all member organizations, including those that trade options. The more extensive principal requirements would be embodied in Rules 611 and 612, which would be substantially similar to Rule 604(g) and Supplementary Material .01–.03.

The Exchange also proposes to recognize two new categories of limited principal registration. First, the Exchange proposes to adopt Rule 612(d), which recognizes Registered Options Principals. Each member or person associated with a member organization who is included within the definition of principal, including any person designated as a Chief

Compliance Officer on Schedule A of Form BD of a member organization, may register as a Registered Options Principal and pass the Series 4 examination, instead of registering as a General Securities Principal and passing the Series 24 examination, if the person’s activities are limited solely to options. Specifically, a Registered Options Principal can only supervise the options activities of a member organization and must be registered pursuant to Exchange Rules as a General Securities Representative.

Second, the Exchange proposes to recognize the Proprietary Trader Principal category as a limited principal category in Rule 612(e). It would apply to persons whose supervisory responsibilities in the investment banking and securities business are limited to the activities of a member organization that involve proprietary trading, market making and effecting transactions on behalf of broker-dealers. It would require that the associated person register pursuant to Exchange Rules as a Proprietary Trader, qualify by passing the Series 24 examination, and not function in a principal capacity with responsibility over any area of business activity other than proprietary trading, market making and effecting transactions on behalf of broker-dealer accounts.<sup>20</sup> This category is in lieu of registration as a General Securities Principal, for which the prerequisite qualification examination is the Series 7. The qualification examination for the proposed new registration category of Proprietary Trader Principal is the Series 24, which is the same qualification required for registration as a General Securities Principal. However, the prerequisite examination for the Proprietary Trader Principal category is the Series 56. Phlx expects the Proprietary Trader Principal category to be available to Phlx member organizations in WebCRD shortly.

Both a Registered Options Principal and a Proprietary Trader Principal would count towards a firm’s two-principal requirement in Rule 611(e). If the member organization is involved in activity other than that permitted by these categories, however, an additional principal or principals would be required.

Two additional limited principal registration categories would also be available to all member organizations. Rule 604.02, titled Limited Principal—

<sup>18</sup> See Rule 604(f).

<sup>19</sup> The Exchange defined the term “office of supervisory jurisdiction” to mean any office of a member organization at which any one or more of the following functions take place: Order execution and/or market making; structuring of public offerings or private placements; maintaining custody of customers’ funds and/or securities; final acceptance (approval) of new accounts on behalf of the member organization; review and endorsement of customer orders; final approval of advertising or sales literature for use by persons associated with the member organization, pursuant to Rule 605, except for an office that solely conducts final approval of research reports; or responsibility for supervising the activities of persons associated with the member organization at one or more other branch offices of the member organization. This definition is drawn from NASD Rule 3010. The Exchange is adopting the reference to this term in order to cover these managers in the new principal registration requirement. The Exchange is not, at this time, adopting a comprehensive program with regard to such offices, such as that found in NASD Rule 3010. See proposed Rule 611(b).

<sup>20</sup> The Exchange worked with other exchanges and FINRA to develop this registration category. The Proprietary Trader Principal registration category is limited to those who supervise persons engaged only in activities covered by the proposed Proprietary Trader registration category.

<sup>15</sup> See e.g., BX Rules 1031 and 1032, NASDAQ Rules 1031 and 1032, and NASD Rules 1031 and 1032.

<sup>16</sup> The Exchange filed the Series 56 content outline with the Commission. See Securities Exchange Act Release No. 66645 (March 22, 2012), 77 FR 19042 (March 29, 2012). The Series 56 would also serve as a prerequisite for the Proprietary Trader principal registration category. The Series 24 would be the appropriate examination for the new principal registration category, as described below.

<sup>17</sup> This provision is the same as the provision in Chicago Board Options Exchange Incorporated (“CBOE”) rules, which requires that an individual Trading Permit Holder or associated person who effects transactions on behalf of a broker-dealer account register and pass the Series 56 examination. See CBOE Rule 3.6A, Interpretation and Policy .06.

Financial and Operations, requires each member organization of the Exchange that is subject to Rule 604(g) and that is operating pursuant to the provisions of Rule 15c3-1(a)(1)(ii), (a)(2)(i) or (a)(8) under the Act to designate as Limited Principal—Financial and Operations (“FINOP”) those persons associated with it, at least one of whom shall be its chief financial officer, who perform certain financial and operational duties, as specified in the rule. Each FINOP must register with the Exchange and pass the Series 27 examination. The Exchange proposes to move this provision to Rule 612(b) and extend it to cover trading floor members, in order to ensure that persons handling the financial affairs of a firm are properly registered and qualified, given the importance and complexity of the rules governing financial responsibility for broker-dealers.<sup>21</sup> Although the FINOP is a type of principal registration, because its scope is limited to financial matters, the FINOP does not count toward the two-principal requirement of Rule 611(e).

The Limited Principal—General Securities Sales Supervisor, currently in Rule 604.03, would be moved to Rule 612(c) and would also be available to all member organizations who have associated persons meeting its specific, limited requirements. Like the FINOP, the General Securities Sales Supervisor does not count toward satisfying the two-principal requirement of Rule 611.

#### Other Rule Modifications

In connection with strengthening its registration rules, the Exchange is proposing to reorganize and renumber its registration rules to better align with those of NASDAQ and FINRA.

In addition to the amendments discussed above, the Exchange proposes to renumber without change: Rule 604(i), Persons Exempt from Registration, to Rule 614 (and Rule 604(i)(2) to Rule 614(b)); and Rule 604(j), Waiver of Requirements, to Rule 615;<sup>22</sup> and Rule 604(g)(5), the general requirement to have a minimum of two principals with respect to each aspect of a member’s investment banking and securities business (except a proprietary trading firm with 25 or fewer

representatives, which is only required to have one) to Rule 611(e)(i).<sup>23</sup>

The Exchange proposes to consolidate electronic filing requirements in proposed Rule 616, Electronic Filing Requirements for Uniform Forms. Rule 616(a), WebCRD Filing, would require that forms filed pursuant to the Rule 600 Series be filed electronically through WebCRD. Similarly, Rule 616(b), Form U4 and U5 Filing Requirements, would require that initial filings and amendments of Forms U4 and U5 be submitted electronically.<sup>24</sup> In addition, every application for registration filed with the Exchange shall be kept current at all times by supplementary amendments via electronic filing or such other process as the Exchange may prescribe. The amendments shall be filed not later than 30 days after the applicant learns of the facts or circumstances giving rise to the need for the amendment.<sup>25</sup>

The Exchange also proposes to amend OFPA F-34 and EFPA A-7, both titled Failure to Timely Submit Amendments to Form U4, Form U5 and Form BD. These are the corollary minor rule plan provisions for Rule 623, which are being amended only to delete the reference to Rule 604 and add rule numbers 611–613 and 616.

The Exchange proposes to amend Rule 620, Trading Floor Registration, to specifically state the registration categories governed by the rule, to require all trading floor associated persons of member organizations to register via Form U4, to delete unnecessary language and to strengthen the time requirement. Specifically, the Exchange proposes to add to Rule 620(a), which requires Floor Brokers, Specialists and Registered Options Traders on an Exchange trading floor to register under “Member Exchange” (“ME”) via Form U4. The Exchange notes that this provision covers members operating on the trading floor and that such members are required to successfully complete the Exchange’s Trading Floor Qualification Examination. The Exchange also proposes to delete the reference in Rule 620(a) regarding updating Form U4

within a certain time period and include this requirement in Rule 616.

Rule 620(b) covers all trading floor personnel, such as clerks, interns, and other associated persons of member organizations who are not required to register under Rule 620(a) and requires them to register with the Exchange on a form supplied by the Exchange. The Exchange proposes to require these individuals to be registered on Form U4 in WebCRD. Accordingly, these associated persons will be subject to the comprehensive disclosure obligations of Form U4, which the Exchange believes is an important enhancement. The specific registration category will be “Floor Employee (“FE”)” under “Phlx,” which will be stated in the rule. The Exchange does not intend to require a qualification examination for non-member trading floor personnel at this time.<sup>26</sup>

The Exchange also proposes to amend Rule 620(b) to provide that following the termination of, or the initiation of a change in the status of any such personnel of a member organization who has been issued an Exchange access card and a trading floor badge, the appropriate Exchange form must be completed, approved and dated by a member organization principal, officer, or member of the member organization with authority to do so, and submitted to the appropriate Exchange department no later than 9:30 a.m. the next business day by the member organization employer. The Exchange proposes to strengthen this requirement by adding that such submission should occur *as soon as possible* but no later than 9:30 a.m. the next business day.

The Exchange proposes to codify an existing fingerprinting requirement into new paragraph (b) of Rule 623, Fingerprinting. This paragraph specifies that a member organization must promptly submit fingerprints on behalf of any person filing Form U4 pursuant to Rule 616, and the Exchange may make registration effective pending receipt of fingerprint information.

Finally, as a result of the expanded and amended registration requirements, additional persons will become subject to Continuing Education requirements in Rule 640.

<sup>21</sup> Although there must be a *minimum* of two Principals, *all* persons who engage in specified supervisory functions must be registered as Principals.

<sup>24</sup> As part of the member organization’s recordkeeping requirements, it must retain such records for a period of not less than three years, the first two years in an easily accessible place, and make such records available promptly upon request in accordance with Rule 17a-4 under the Act (17 CFR 240.17a-4).

<sup>25</sup> This rule is similar to NASDAQ Rule 1031(d)(3).

<sup>26</sup> The Exchange does not believe that the Series 7, Series 56 or its Trading Floor Qualification Examination is appropriate for the limited functions of a trading floor clerk because these persons are not members trading on the floor, and they are supervised by members. These persons do not execute transactions on the Exchange, but rather enter orders and report trades, for example, and perform related clerical functions. *See* Rule 1090.

<sup>21</sup> *See e.g.*, Phlx Rule 703.

<sup>22</sup> Rule 604(j) provides that the Exchange may, in exceptional cases and where good cause is shown, waive the applicable Qualification Examination and accept other standards as evidence of an applicant’s qualifications for registration. The Commission expects this waiver authority to be used sparingly, and that where used, the Exchange would keep records of waivers granted and reasons for so doing.

### III. Discussion and Commission Findings

The Commission believes that this proposed rule change is an important step towards harmonizing the registration, qualification and continuing education requirements across the SROs. In order to meet its obligations under Section 6(b)(1) of the Act<sup>27</sup> to enforce compliance by member firms<sup>28</sup> and their associated persons with the Act, the rules thereunder, and the Exchange's own rules, an exchange must have baseline registration and examination requirements for all persons conducting business on an exchange, as well as for those supervising the activity. In addition, an exchange should have continuing education requirements for registered persons to help ensure that members and persons associated with their members are up to date on the industry, including but not limited to amendments to the Exchange's rules and the securities laws, rules, and regulations that govern their activities.

The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.<sup>29</sup> Specifically, the Commission finds that the proposal is consistent with Section 6(b)(5) of the Act,<sup>30</sup> which requires, among other things, that the rules of a national securities exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to, and perfect the mechanism of, a free and open market and a national market system and, in general, to protect investors and the public interest. The Commission believes that the proposed rule change is also consistent with Section 6(c)(3)(B) of the Act,<sup>31</sup> which authorizes exchanges to prescribe standards of training, experience and competence for persons associated with exchange members, and gives exchanges the authority to bar a natural person from becoming a member or a person associated with a member, if the person

does not meet the standards of training, experience and competence prescribed in the rules of the exchange.

Phlx's proposed rule change requires all associated persons of member organizations engaged in a securities business on Phlx, as well as those who supervise, train or otherwise oversee those who do, to register with the Exchange via the Form U4, qualify by passing an appropriate examination, and comply with continuing education requirements. Phlx's requirements should help ensure that all associated persons who transact business on Phlx, including those engaged in proprietary trading, are subject to appropriate registration, qualification, and continuing education requirements. These requirements bolster the integrity of the Exchange by helping to ensure that all associated persons engaged in a securities business are, and will continue to be, properly trained and qualified to perform their functions, will be supervised, and can be identified by regulators.

Phlx is adding new limited principal registration categories which are recognized by other exchanges.<sup>32</sup> The Registered Option Principal will be restricted to supervising those persons exclusively involved in options activities, and the required examination, the Series 4, is focused on practices in and rules governing the options industry. The Proprietary Trader Principal category is corollary to the new Proprietary Trader Representative category discussed above and is recognized by many of the other exchanges.<sup>33</sup> Proprietary Trader Principals may supervise persons engaged in proprietary trading, market making and effecting transactions on behalf of broker-dealer accounts and must pass the Series 24 (General Securities Principal) examination.

In sum, under the proposed rule change, all Principals must register through WebCRD and pass appropriate prerequisite examinations, as well as principal examinations that reflect the enhanced responsibility entrusted to principals. In addition, Principals would be subject to the Exchange's continuing education requirements.

Phlx's proposed exceptions from the above-discussed general requirements are appropriate. Any member seeking an exception from the two principal requirement must provide evidence that conclusively indicates to the Exchange that only one principal is necessary. The Commission expects this authority to be

used sparingly, because such persons oversee the operations of member firms and provide the first line of defense in ensuring that member firms are complying with the rules of the exchange as well as the federal securities laws. In addition, Phlx may waive the qualification examination requirement in exceptional cases where the applicant has demonstrated that good cause exists to grant the waiver. The Commission also expects this authority to be used sparingly. The Commission notes that these exceptions are substantively the same as exceptions provided in similar rules at other SROs,<sup>34</sup> and it expects Phlx to keep records detailing the reasons for exceptions granted and waivers given.<sup>35</sup>

Phlx's proposed rule change will help ensure that all associated persons of members transacting business on the Exchange, as well as those who supervise, train or otherwise oversee those who do, will be registered with, and qualified by, the Exchange and will be subject to continuing education requirements. The Commission believes the proposal should enhance the Exchange's ability to ensure an effective supervisory structure for those conducting business on its facilities. The requirements apply broadly and should enhance the ability of Exchange members to comply with the Exchange's rules as well as with the federal securities laws.

Additionally, the Commission believes that the proposed rule change is consistent with the principles of Section 11A(a)(1)(22) of the Act in that it seeks to assure fair competition among brokers and dealers and among exchange markets. The Commission believes that the proposed rule change will promote uniformity of regulation across markets, thus reducing opportunities for regulatory arbitrage. Phlx's proposed rule change helps ensure that all persons conducting a securities business through Phlx are appropriately registered, qualified, and supervised, as is required under the Act.

### IV. Conclusion

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>36</sup> that the proposed rule change (SR-Phlx-2012-023), be, and hereby is, approved.

<sup>34</sup> See, e.g., FINRA Rule 1070(d) and NASDAQ Rule 1070(d).

<sup>35</sup> See Rule 17a-1(a) under the Act, 17 CFR 240.17a-1(a).

<sup>36</sup> 15 U.S.C. 78s(b)(2).

<sup>37</sup> 17 CFR 200.30-3(a)(12).

<sup>27</sup> Section 6 requires exchanges to have the ability to enforce compliance by their members and associated persons with the federal securities laws and with their own rules. 15 U.S.C. 78f(b)(1).

<sup>28</sup> Broker and dealers are required to supervise the activities of their associated persons. See Section 15(b)(4)(E) of the Act, 15 U.S.C. 78o(b)(4)(E).

<sup>29</sup> In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

<sup>30</sup> 15 U.S.C. 78f(b)(5).

<sup>31</sup> 15 U.S.C. 78f(c)(3)(B).

<sup>32</sup> See, e.g., CBOE Rule 9.2 and ISE Rule 601.

<sup>33</sup> See, e.g., CBOE Rule 3.6A and NASDAQ Rule 1032(c).

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>37</sup>

Elizabeth M. Murphy,  
Secretary.

[FR Doc. 2012-10027 Filed 4-25-12; 8:45 am]

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-66839]

### 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

April 20, 2012.

#### I. Introduction

On July 27, 2011, the Securities and Exchange Commission (“Commission”) adopted Rule 13h-1 under the Securities Exchange Act of 1934 (“Exchange Act”) concerning large trader reporting to assist the Commission in both identifying, and obtaining trading information on, market participants that conduct a substantial amount of trading activity, as measured by volume or market value, in U.S. securities (such persons are referred to as “large traders”).<sup>1</sup>

Pursuant to Exchange Act Section 13(h)(6) and Rule 13h-1(g) thereunder,<sup>2</sup> the Commission, by order, may exempt from the provisions of Rule 13h-1, upon specified terms and conditions or for stated periods, any person or class of persons or any transaction or class of transactions from the provisions of Rule 13h-1 to the extent that such exemption is consistent with the purposes of the Exchange Act.

Currently, the compliance date for the broker-dealer recordkeeping and reporting requirements of Rule 13h-1(d) and (e), respectively, as well as the requirement under Rule 13h-1(f) for broker-dealers to monitor their customers’ accounts for activity that may trigger the large trader identification requirements of Rule 13h-1, is April 30, 2012. As discussed below, the Commission is temporarily exempting registered broker-dealers from the requirements of new Rule 13h-1 by extending the April 30, 2012 compliance date to provide them with

additional time to comply with the recordkeeping, reporting, and monitoring requirements of the Rule.

Specifically, and as discussed more fully below, the Commission is extending the April 30, 2012 compliance date for registered broker-dealers to *May 1, 2013*, except for certain broker-dealers that: (1) Are large traders or (2) have large trader customers that are either broker-dealers or that trade through a “sponsored access” arrangement, for which the Commission is extending the compliance date to *November 30, 2012*.<sup>3</sup> The extension of the compliance date will allow broker-dealers additional time to develop, test, and implement enhancements to their recordkeeping and reporting systems as required under Rule 13h-1 and, for those broker-dealer requirements for which the compliance date has been extended to May 1, 2013, for the Commission to consider requests for relief from certain provisions of the Rule.

In addition, the Commission is exempting certain transactions from the definition of the term “transaction” provided in Rule 13h-1(a)(6), but for the sole purpose of determining whether a person is a large trader.

#### II. Broker-Dealer Recordkeeping and Reporting

##### A. Introduction

**Recordkeeping.** In addition to requiring large traders to register with the Commission by filing and periodically updating Form 13H, Rule 13h-1 requires certain broker-dealers to, among other things, maintain specified records of transactions that they effect, directly or indirectly, for large traders, and to report to the Commission, upon request of the Commission, such records in electronic format. Specifically, Rule 13h-1(d) requires broker-dealers to maintain records of the information specified in Rule 13h-1(d) for all transactions effected directly or indirectly by or through:

(i) An account such broker-dealer carries for a large trader or an Unidentified Large Trader,<sup>4</sup> or

<sup>3</sup> The effective date for Rule 13h-1 remains October 3, 2011. The compliance date for the requirement on large traders to identify to the Commission pursuant to Rule 13h-1(b) was December 1, 2011.

<sup>4</sup> The term “Unidentified Large Trader” means each person who has not complied with the identification requirements of paragraphs (b)(1) and (b)(2) of Rule 13h-1 that a registered broker-dealer knows or has reason to know is a large trader. See 17 CFR 240.13h-1(a)(9). For purposes of determining whether a registered broker-dealer has reason to know that a person is a large trader, a registered broker-dealer need take into account only

(ii) If the broker-dealer is a large trader, any proprietary or other account over which such broker-dealer exercises investment discretion.

(iii) Additionally, where a non-broker-dealer carries an account for a large trader or an Unidentified Large Trader, the broker-dealer effecting transactions directly or indirectly for such large trader or Unidentified Large Trader shall maintain records of all of the information required under the Rule for those transactions.

The information required to be maintained for large trader accounts includes the standard information currently captured pursuant to Rule 17a-25 and the Electronic Blue Sheets (“EBS”) system, plus two new fields that are unique to Rule 13h-1: (1) The time that the transaction was executed (“execution time”) <sup>5</sup> and (2) the large trader identification (“LTID”) number(s) associated with the account.<sup>6</sup>

**Reporting.** Rule 13h-1(e) requires every registered broker-dealer who is itself a large trader or carries an account for a large trader or an Unidentified Large Trader to report electronically to the Commission, at the Commission’s request, the required transaction information on such persons whose activity is equal to or greater than the reporting activity level.<sup>7</sup> In addition, the Rule provides that where a non-broker-dealer carries an account for a large trader or an Unidentified Large Trader, the broker-dealer effecting such transactions directly or indirectly for a large trader must electronically report such information, at the Commission’s request.

Broker-dealers are required to report information to the Commission upon request of the Commission.<sup>8</sup> Information must be reported to the Commission no later than the day and time specified in the Commission’s request for transaction information, which shall be no earlier than the open of business of

transactions in NMS securities effected by or through such broker-dealer. See *id.*

<sup>5</sup> See 17 CFR 240.13h-1(d)(2)(xii).

<sup>6</sup> See 17 CFR 240.13h-1(d)(2)(xiii).

<sup>7</sup> The reporting activity level is 100 shares. See 17 CFR 240.13h-1(a)(8). Accordingly, in response to a Commission request for EBS information, broker-dealers are required to report information for each account in which any large trader’s or Unidentified Large Trader’s activity amounts to at least 100 shares in the aggregate.

In response to a Commission request for transaction records, in addition to reporting information for any identified large trader (*i.e.*, a person for whom the broker-dealer has received an LTID number), the broker-dealer also should report records for each Unidentified Large Trader, as applicable, including any unique identifying number that the broker-dealer has assigned to such person.

<sup>8</sup> See 17 CFR 240.13h-1(e).

<sup>1</sup> See Securities Exchange Act Release No. 64976 (July 27, 2011), 76 FR 46960 (Aug. 3, 2011) (“Rule 13h-1 Adopting Release”). The effective date of Rule 13h-1 was October 3, 2011.

<sup>2</sup> See 15 U.S.C. 78m and 17 CFR 240.13h-1(g), respectively.