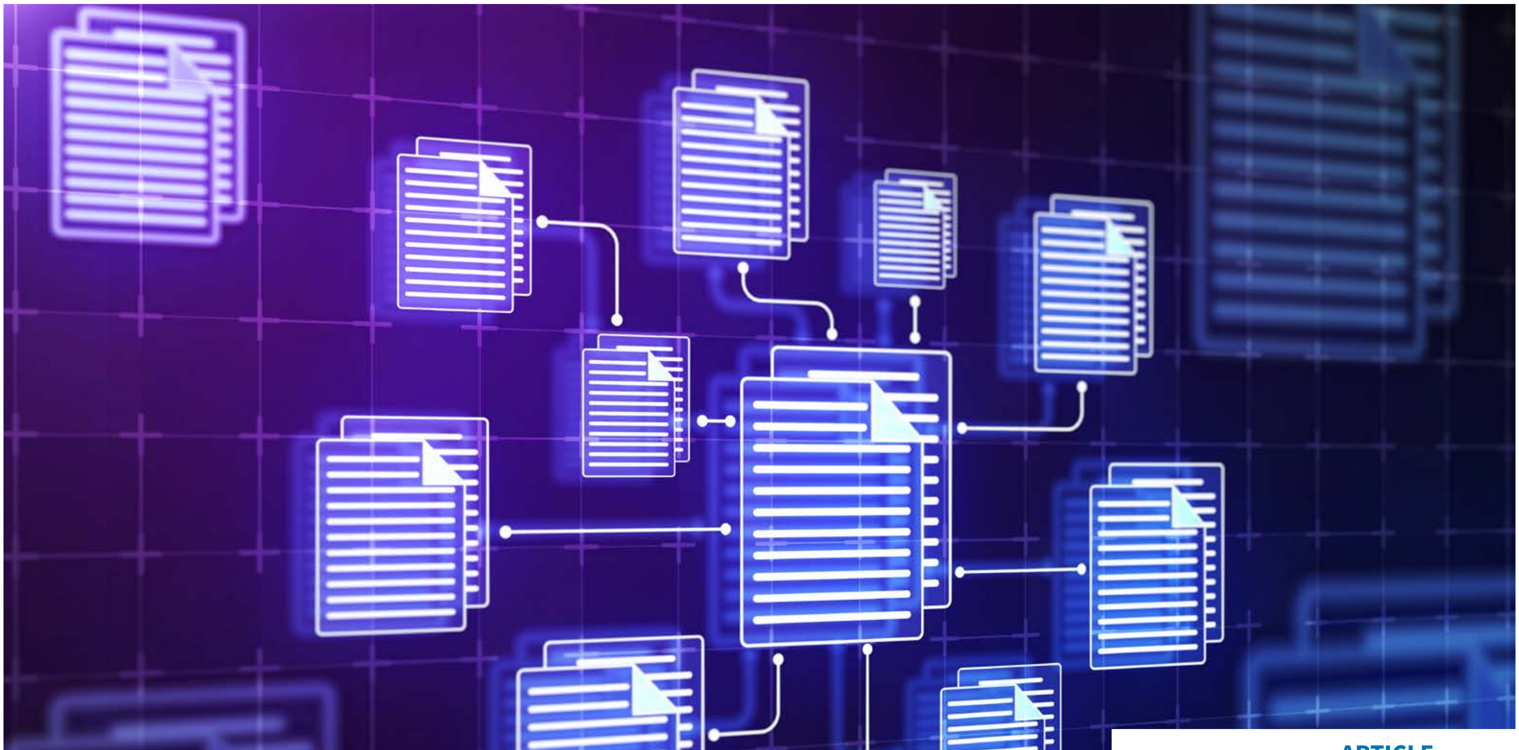

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# Large Trader Rule Continues to Challenge the Industry and Drive Regulatory Scrutiny

The Exchange Act Rule 13h-1 (“Large Trader Rule”) was enacted more than 10 years ago; even so, the Securities & Exchange Commission (“SEC”) and the Financial Industry Regulatory Authority (“FINRA”) continue to highlight the importance of market participants’ compliance with the Large Trader Rule following implementation of the Consolidated Audit Trail (“CAT”) in April 2021.

While the SEC and FINRA are the primary enforcers of the Large Trader Rule, other self-regulated organizations such as the New York Stock Exchange and Chicago Board Options Exchange have access to Large Trader ID (“LTID”) data through the Electronic Blue Sheet (“EBS”) and CAT platforms. As regulators increasingly rely upon data scientists and algorithmic programs to perform market analyses, there has been uniform adoption of zero tolerance for reporting inaccurate data; pristine and accurate reporting is the norm and will continue to be the minimum expectation.

Regulators are closely examining and enforcing firms’ adherence to Rule 13h-1 in both regular compliance examination modules as well as specific “for cause” enforcement examinations. It is anticipated that market participant compliance with Rule 13h-1 will ultimately include testing/sampling of data submissions (EBS and CAT) as well as periodic reviews of respective operational/supervisory policies and procedures.

Beyond the investigative uses for EBS and CAT data, the regulatory community plans to utilize this data, including LTID, for market reconstruction, market structure/volatility reviews, and statistical analyses.

The primary requirements of the Large Trader Rule are:

— The Large Trader rule mandates broker-dealers (“BDs”) to onboard, maintain, and report accurate information with respect to Large Traders. A Large Trader is a person or entity that (1) exercises investment discretion over one or more accounts and (2) effects transactions in NMS securities that in aggregate equal or exceed (a) two million shares or $20 million during any calendar day or (b) 20 million shares or $200 million during any calendar month.

— LTIDs are expected to be tracked, stored, and applied accurately throughout the broker-dealers’ trading systems used for EBS and CAT reporting.

— The Large Trader Rule includes a Safe Harbor provision for broker-dealers that protects against record-keeping and reporting violations. To trigger safe harbor, the provision requires broker-dealers to conduct reasonably designed monitoring to detect Large Traders who have failed to provide an LTID to the Firm. “Reasonably designed” is defined as including each of the following components:

 1. Determine whether an individual or entity exercised transactions that triggered either trading threshold in accounts carried at the broker-dealer.
 2. Assign qualifying individuals or entities an Unknown LTID (“ULTID”) if no LTID has been provided.
 3. Notify individuals or entities of their potential reporting obligations according to the rule.

## Best Practices for Compliance

Despite the rule’s simplistic language, compliance with Rule 13h-1 can pose significant challenges for broker-dealers, often leading to non-compliance. To mitigate risk of regulatory action, broker-dealers should ensure their current operations include each of the following components:

— Established governance structure to provide oversight and ensure accurate tracking and reporting of LTIDs, including an identification of resources.

— Formalized documentation that clearly define procedures for each step in an LTID’s lifecycle: onboarding new clients, linking to relevant accounts, maintaining accurate records, monitoring transactions, identification of unknown Large Traders, notification to clients, and reporting on EBS/CAT reports.

— Centralized repository for storing Large Trader-related data.

— Automated process that replicates all updates to downstream systems that process and report LTIDs.

— Implemented supervisory procedures for quality management and identification of potential errors.

— Routine procedures for applying Unidentified LTIDs (“ULTIDs”) for clients who have not provided a documented LTID for qualify trading behavior; procedure for coordinating with and contacting clients when a ULTID is applied (including retention of notifications provided to qualify for Safe Harbor provision).

## FTI CONSULTING'S OFFERINGS

We have the expertise to assist market participants facing uncertainty with the Large Trader Rule. Specifically, FTI's interdisciplinary team, drawn from its Broker-Dealer and Data & Analytics practices, have together developed direct client experience with the following:

- Document and assess existing procedures, controls, governance, and operations; perform current state assessment and provide process improvement recommendations.
- Evaluate current allocation of LTIDs to known large traders and remediate identified errors.
- Analyze trading activity of known LTID errors and conduct impact assessments.
- Assess operational processes for appending LTIDs to relevant transactional activity based on client-to-account relationships.
- Review and evaluate broker-dealer surveillance processes for identification and tagging of Unidentified Large Traders with appropriate identifiers and outreach processes for client notification.
- Coordinate with internal and external legal counsel responding to regulatory inquiries and investigations involving both EBS and CAT submissions.


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