NEW YORK
1285 Avenue of the Americas
New York, NY 10019-6064
+1 212 373 3000

BEIJING
Unit 3601, Fortune Plaza Office
Tower A
No. 7 Dong Sanhuan Zhonglu
Chao Yang District, Beijing 100020
People's Republic of China
+86 10 5828 6300

HONG KONG
12th Fl., Hong Kong Club Building
3A Chater Road
Central Hong Kong
+852 2846 0300

LONDON
Alder Castle, 10 Noble Street
London EC2V 7JU
United Kingdom
+44 20 7367 1600

TOKYO
Fukoku Seimei Building, 2nd Floor
2-2, Uchisaiwaicho 2-chome
Chiyoda-ku, Tokyo 100-0011
Japan
+81 3 3597 8101

WASHINGTON, D.C.
2001 K Street NW
Washington, DC 20006-1047
+1 202 223 7300

WILMINGTON
Brandywine Building
1000 N. West Street, Suite 1200
Wilmington, DE 19801
+1 302 655 4410

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SEC Proposes New Large Trader Reporting System

On April 14, 2010, the SEC published for comment a proposal that would establish new reporting obligations for large market participants that conduct substantial securities trading activities. The proposed "large trader" reporting system is intended to enhance the SEC's ability to identify and track large traders and to promptly obtain information about, and assess the impact on the securities markets of, their trading activities.

Under the proposal, any trader falling under the definition of a "large trader" would be required to identify itself and make certain disclosures to the SEC. Under the proposed rule, a "large trader" would be defined as a person whose transactions in National Market System (NMS) securities equal or exceed:

- 2 million shares or $20 million during any calendar day, or
- 20 million shares or $200 million during any calendar month.

The SEC would assign a unique identification number to each large trader. The proposal would further require that a large trader provide to its registered broker-dealer the assigned identification number and identify all accounts over which it exercises investment discretion. Registered broker-dealers would be required to track and maintain trading data for each large trader and submit the data to the SEC upon request.

Background

In recent years, the U.S. securities markets have undergone a significant transformation with rapid technological advancements affecting the structure of the markets and trading strategies. Such technological advancements have allowed traders to employ sophisticated and electronic trading methods to swiftly conduct transactions in significant volumes. The SEC believes it is important to monitor large traders that conduct transactions in significant volumes because such traders appear to be playing an increasingly prominent role in the securities markets.

Currently, the SEC monitors trading activities by collecting transaction data from registered broker-dealers through the Electronic Blue Sheets ("EBS") system whereby, upon request from the SEC, registered broker-dealers are required to electronically submit trade information including the identity of the trader, the identity of the security, and the size and price of the transaction. Although the EBS system allows the SEC to aggregate transaction data for trades conducted through multiple accounts, the SEC believes it is insufficient to monitor the

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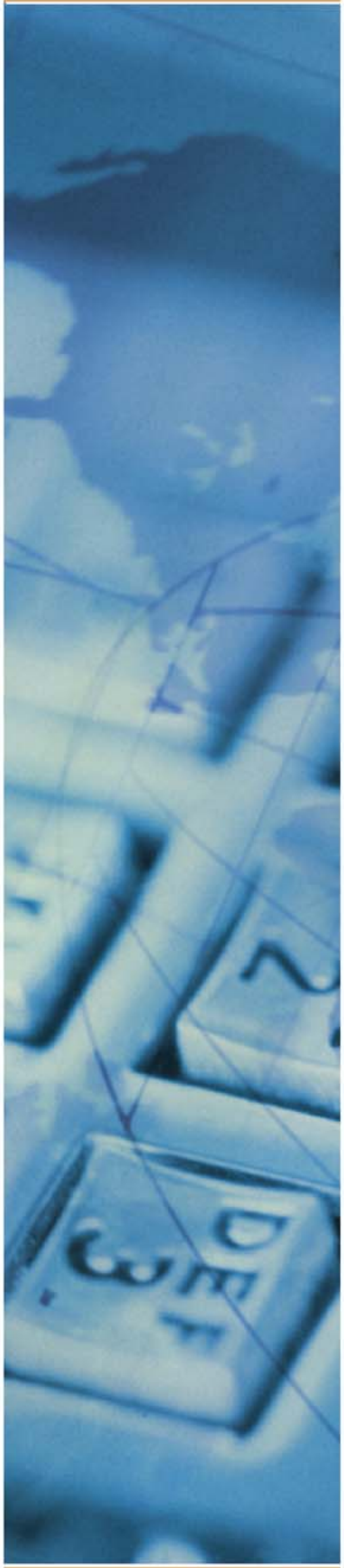

significantly increased levels of trading activities occurring in today's securities markets. Moreover, the current EBS system does not assign a specific deadline for broker-dealers to respond to any request from the SEC for data, which could result in a significant delay in collecting information relating to large trades.

To enhance its ability to collect trading information with respect to large trading activities, the SEC proposes to create a new large trader reporting system under Section 13(h) of the Securities Exchange Act of 1934.

The SEC Proposal

Identification of "Large Traders"

A "large trader" would be generally defined as any person who directly or indirectly exercises investment discretion to conduct trades in NMS securities that equal or exceed:

- within any calendar day, 2 million shares or a fair market value of $20 million, or
- within any calendar month, 20 million shares or a fair market value of $200 million.

In calculating the volume or fair market value of the trading activity level, equity securities underlying transactions in options or transactions in options on a group or index of equity securities would be required to be aggregated. Netting or offsetting between purchase and sale transactions would not be allowed. In other words, activity levels must be calculated based on a "gross up" approach.

In order to ensure certain small or otherwise infrequent trades are not burdened by the large trader reporting system, the SEC proposes to exclude the following from the proposed rule:

- any entry made to an account to record receipt or delivery of securities pursuant to the settlement of a transaction;
- any transaction that is part of an offering of securities (whether or not subject to registration under the Securities Act of 1933), except for an offering of securities effected through a national securities exchange;
- any transaction that is a gift;
- any transaction involving a distribution from a decedent's estate;
- any transaction effected pursuant to a court order or judgment;
- any transaction pursuant to a rollover of qualified plan or trust assets subject to Section 402(c)(1) of the Internal Revenue Code; and
- any transaction between an employer and employee as part of a benefit plan or compensatory arrangement.

SEC Filings by Large Traders

A large trader would be required to file a Form 13H with the SEC promptly after first effecting transactions that reach the prescribed trading activity level. The form would include information such as the identity of the large trader and its principal business, regulatory status and affiliated entities. The intent of the proposed rule is to focus on the parent entity controlling large traders to identify the primary institutions that conduct a large trading business. Accordingly, a large trader would also be required to disclose all accounts over which the large trader exercises investment discretion, directly or indirectly.

Once a Form 13H is filed, the SEC would assign the large trader a unique large trader identification number ("LTID"). The SEC would use LTIDs to sort through the trading data and analyze the activities of each large trader.

Upon the initial filing of a Form 13H, a large trader would thereafter be required to file the form annually 45 days after the end of each calendar year. The large trader would also be required to amend the form promptly following the end of each calendar quarter if the information contained therein becomes inaccurate during such quarter. If a large trader does not effect any transaction that reaches the prescribed activity level in a calendar year, the trader may file a Form 13H to claim inactive status and thereafter be relieved from the ongoing filing obligations.

Broker-Dealer Recordkeeping Requirements

Each large trader would be required to disclose the assigned LTID to its registered broker-dealers that effect securities transactions on its behalf. A large trader would also be required to identify all accounts held at each broker-dealer to which its LTID should be linked. In addition, each large trader would be required to disclose its LTID to all others with whom it collectively exercises investment discretion.

Each registered broker-dealer would be required to maintain transaction data with respect to accounts identified by the customers that have identified themselves as large traders (or if the registered broker-dealer is also a large trader, with respect to its own accounts). The data required would be largely similar to data required under the current EBS system — which include account number, type and symbol of security, and transaction price. Additionally, under the proposal, registered broker-dealers would be required to maintain data according to LTIDs and to keep record of transaction execution times. The transaction data would need to become available the morning after the transactions were effected, and broker-dealers would be required to retain such data for three years (for the first two years, in an accessible place).

Unidentified Large Traders

In addition to keeping records for identified large traders, registered broker-dealers would also be required to monitor whether any of their customers would meet the large trader threshold and maintain trade records for large unidentified traders that have not complied with the identification requirements discussed above. Broker-dealers would be required to maintain the name, address, date of the account opened and tax identification numbers for each such unidentified trader if they know or have a "reason to know" that the trader is a large trader.

A registered broker-dealer would not be deemed to know or have a "reason to know" that its customer is an unidentified large trader if (1) it does not have actual knowledge that the customer is a large trader, and (2) it established and maintained policies and procedures reasonably designed to ensure compliance with the proposed rules.

Broker-Dealer Reporting Requirements

Upon request from the SEC, registered broker-dealers would be required to submit the information maintained pursuant to the recordkeeping requirements described above before the close of business on the day specified in the SEC's request. The information would be

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transmitted to the SEC electronically based on the current EBS system format. Registered broker-dealers would only be required to report transactions that equal or exceed the reporting activity level generally defined as transactions in listed securities equal to or grater than 100 shares in a single account within a calendar day.

Implications

The SEC has stated that the proposed new large trader reporting system is the latest in its ongoing efforts to ensure that the markets are fair, transparent and efficient — other rules that have been proposed to this effect are a prohibition on marketable flash orders, disclosure requirements for dark pools of liquidity, and a ban on unfiltered access to markets. The current proposal is intended to strengthen the SEC's oversight of securities trading activities and to identify potentially manipulative and abusive practices.

Persons regularly trading in large volumes and registered broker-dealers should note that the current proposal, if adopted, would create a new reporting system under which they would be required to more closely manage, track and monitor their trading activities. In particular, registered broker-dealers should be aware that although the SEC would principally place the burden of compliance on large traders themselves, broker-dealers would also have an obligation to create a monitoring process to ensure compliance by their customers.

Comments

The SEC is seeking comments on all aspects of the proposed rule and the proposed large trader reporting system. The comments should be received by the SEC within 60 days of the publication of the proposal in the Federal Register.

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This alert is not intended to provide legal advice, and no legal or business decision should be based on its content. Any questions concerning the issues addressed in this alert may be directed to Mark S. Bergman (+44-207-367-1601), David S. Huntington ((212) 373-3124), Tong Yu (+81-3-3597-6306) or Akiko Okuma (+81-3-3597-6307).