



February 27, 2003

Mr. Jonathan G. Katz  
Secretary  
U.S. Securities and Exchange Commission  
450 Fifth Street, N.W.  
Washington, D.C. 20549-0609

Re: File No. S7-50-02; Rule 10b-18 and Purchases of Certain Equity  
Securities by the Issuer and Others

Dear Mr. Katz,

The Securities Industry Association (“SIA”)<sup>1</sup> is pleased to offer its comments in response to the proposed amendments to Rule 10b-18 under the Securities Exchange Act of 1934 (“Exchange Act”) concerning issuer repurchases of common stock. Rule 10b-18 provides issuers with a safe harbor from liability for manipulation when they repurchase their common stock in the market in accordance with the rule’s manner, time, price, and volume conditions. These conditions are intended to minimize the market impact of issuer repurchase transactions.

The Securities and Exchange Commission (“SEC” or “Commission”) has proposed to revise Rule 10b-18 to reflect market developments since the rule’s adoption. SIA applauds the efforts of the SEC to simplify and update the safe harbor. SIA shares the Commission’s belief that repurchases provide economic benefits to investors, issuers and the marketplace. At the same time, SIA agrees with the SEC that it is appropriate to place some limitations on repurchase activity so as not to permit an issuer to unduly influence the price of the issuer’s stock.

SIA’s principal objections to the proposed amendments are with the provision that would eliminate the block exception and the provision that would require disclosure of the broker-dealer used to effect issuer repurchases. The effect of eliminating the block exception will be to reduce overall issuer repurchase activity and therefore the available

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<sup>1</sup> The Securities Industry Association brings together the shared interests of nearly 700 securities firms to accomplish common goals. SIA member firms (including investment banks, broker-dealers, and mutual fund companies) are active in all U.S. and foreign markets and in all phases of corporate and public finance. The U.S. securities industry manages the accounts of nearly 80 million investors directly and indirectly through corporate, thrift, and pension plans, and generates \$358 billion of revenue. Securities firms employ approximately 760,000 individuals in the United States. (More information about SIA is available on its home page: <http://www.sia.com>.)

liquidity in the market for the shares of the stock. The SEC claims that the block exception negates the volume limitation and undermines its purpose, but does not explain how the limitation serves the goal of anti-manipulation and to what extent that goal has or has not been met under the status quo. While supportive of many of the new disclosure provisions, SIA strongly objects to the provision requiring disclosure of the identity of the broker-dealer that is used to effect issuer repurchases. The Discussion section of the release offers no reason why this disclosure is relevant, particularly to an investor. Moreover, knowledge that a particular broker is involved in a buyback on behalf of an issuer is likely to provide certain market participants with an informational advantage and contribute to volatility in the market for the security. SIA addresses these and other concerns in more detail below.

#### **A. Volume of Purchases**

SIA commends the SEC for reviewing Rule 10b-18 and the block exception in light of the changes in the securities markets, particularly in trading volumes. SIA strongly disagrees, however, with the SEC's conclusion that the existing block exception should be removed. SIA does not believe, as the SEC suggests, that this exception negates the original volume limitation and undermines its purpose. The existing block exception substantially benefits our securities markets by allowing a sufficient level of issuer repurchase activity, which in turn provides liquidity for those securities and prevents excessive volatility in the trading of those shares.

Small issuers would be hit particularly hard by the removal of the exception. Without the exception, buybacks of these issuers would be subject to volume restrictions, which would tend to be low relative to block sizes given their lower trading volumes. The net effect will be to deny already illiquid markets the benefit of the liquidity that issuer repurchases can provide.

Although it is true that allowing block trades to be included in the calculation of volume restrictions would increase the amount of shares that could be bought, it will not provide liquidity at the time a block is for sale in the marketplace. In fact, elimination of the exception for block purchases will prevent issuers from reacting to unsettled market conditions when liquidity would be most needed. The benefit of including blocks in the calculation is likely to be negligible for those stocks that do not see a lot of block activity.

SIA notes that the Discussion section of the release does not provide sufficient information on the concerns that removal of the block exception would address. SIA notes that large block transactions take place frequently without disclosure and without negative impact. Firms do not believe that blocks, *per se*, pose a risk of manipulation. More information from the SEC supporting the need for a reduced level of buy-backs, particularly on how it would serve the goal of anti-manipulation, should be made public in order for the public and the securities industry to be able to comment before any proposed change that would decrease market liquidity is adopted. In addition, SIA notes that the SEC has other tools to combat anti-manipulation and fraud, such as Regulation M

and Rule 10b-5. These regulations already prescribe when issuers cannot be in the market, and SIA believes that another layer of rulemaking in this area is unnecessary.

## **B. Disclosure Requirements**

SIA supports the SEC's overall goal to provide greater disclosure to investors. SIA, however, recognizes that any new disclosure proposal must strike a balance between what is truly necessary and beneficial disclosure for the investor and the potential harm to the markets of such disclosure, such as in decreased efficiency or liquidity. Congress noted the importance of achieving this balance when it passed the National Securities Markets Improvement Act of 1996. This Act included amendments to Section 2 of the Securities Act of 1933 and Section 3 of the Exchange Act that call for the SEC, whenever it is engaged in rulemaking and is required to consider or determine whether an action is necessary or appropriate in the public interest, to also consider "in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation."

### **1. Disclosure of Broker-Dealers**

SIA strongly objects to the proposed requirement that the identity of the broker-dealer used to effect issuer repurchases be disclosed. SIA believes that this type of disclosure would seriously compromise shareholder value, negatively impact the efficiency of our markets, and provide no benefits to the investing public.

SIA notes that the Discussion section of the release offers no reason why this disclosure is relevant or beneficial to public investors. On the other hand, knowledge that a particular broker is involved in a buy-back on behalf of an issuer would give an inequitable advantage to market professionals who could anticipate issuer repurchase activity based on the presence or activity of the issuer's broker and thus be in a position to trade ahead of the issuer. Tipping off the market to relationships between brokers and issuers and the strategies employed by the broker on the issuer's behalf would undercut the issuer's goals in repurchasing shares and make such purchases more difficult to execute. This is contrary to the overriding tenant of Rule 10b-18 -- that repurchases be done with as little impact on share price as possible.

This informational advantage would only serve to contribute to volatility, decreased efficiency, and reduced liquidity in the market for the security. Brokers are particularly concerned about revealing their proprietary strategies as they are in an extremely competitive business and are judged on the basis of their ability to get a repurchase done at minimal cost and volatility. Public awareness of the broker-dealer routinely involved in the execution of a particular buy-back could result in "gaming" by market participants. In addition, some firms pointed out that, even if they are not in the process of repurchasing an issuers' shares, others might think that they are based on prior disclosure, act on that assumption, and thus create unnecessary volatility in the shares.

Overall, firms support disclosure that allows average investors and their brokers to have enough information about an issuer's market activity to invest, but not disclosure that would enable some market professionals to trade to the disadvantage of the issuer and its shareholders. The proposed disclosure would violate firms' confidentiality with their clients, and negatively impact shareholder value and the securities markets. If the SEC believes that this type of disclosure is important to their surveillance and enforcement programs, SIA recommends that the name of the executing broker-dealer be disclosed solely to the SEC and otherwise be kept confidential and not disclosed to the public.

## **2. Disclosure of Repurchases Outside of the Safe Harbor**

SIA questions the benefit of the SEC's proposal to require companies and their affiliates to disclose repurchases outside of the safe harbor. SIA believes that such information has little or no value to investors. Indeed, some firms believe that, if investors did see this type of disclosure, they might mistakenly think that it has negative connotations when it does not. If manipulation is suspected, the SEC already has the tools necessary to investigate such purchases. As an alternative, some firms suggest that this type of information be reported to the SEC only and not be made available to the public.

## **3. Disclosure of When Companies Plan to Repurchase Securities**

SIA believes that the SEC's proposed disclosure of when companies plan to start repurchasing their securities is also unnecessary, and simply divulges a firm's trading strategy without providing any real benefit to investors. Once again, the SEC already has the ability to investigate instances of suspected manipulation or fraud in this area. Firms suggest again that, if the SEC needs this type of information, it should be reported to the SEC only and not be made available to the public.

## **C. Price of Purchases**

The SEC proposes a price condition that limits issuers to repurchasing their securities at a purchase price that does not exceed the highest independent bid or the last independent transaction price, whichever is higher, quoted or reported in the consolidated system. In light of decimalization and the resulting increase in the number of potential price points, SIA believes that it is important that firms have as much flexibility as possible in this area. SIA recommends that the price reference remain the same as it is currently: no higher than the highest independent bid or the last independent sale, whichever is higher. The SEC asked whether Rule 10b-18 bids and purchases should be limited to the highest independent bid. Limiting the price reference to the bid test only will restrict a broker-dealer's ability to "take offers" based on last sale price. Such purchases should not be considered destabilizing because the company/affiliate is not leading the market, but merely following it. SIA disagrees with the SEC's assertion that such purchases allow the issuer to influence the market. In fact, in a fast moving market

where automatic executions occur rapidly, a static bid would have the effect of unfairly restricting the purchaser's ability to access offered liquidity.

SIA also recommends that the SEC exempt passive pricing models from the proposed pricing restriction. SIA believes that automated trading systems, such as those utilizing VWAP or mid-point NBBO passive pricing algorithms, pose little risk of manipulation and should be exempted from the restriction. In using these mechanisms, the companies/affiliates relinquish control over the timing and pricing of the executions (so there is no intent to manipulate) and the nature of the pricing is objective (representing benchmarks that are based on independent market forces and are identifiable to all market participants).

#### **D. Time of Purchases**

SIA seeks further guidance from the SEC on the applicability of the safe harbor to after-hours trading sessions. The SEC's proposed amendments to the rule's timing restriction suggest that the safe harbor is not available after 6:30 p.m. ("after the termination period in which the last sale prices are reported in the consolidated system"); however, the "After-Hours Trading" discussion in the proposal states that the safe harbor would only be available for off-hours trading sessions such as the NYSE Crossing Sessions. It is not clear whether the after-hours OTC session (4:00-6:30 p.m.) falls within or outside of the safe harbor. In addition, SIA seeks clarity on whether the restrictions would renew for the after-hours session; in other words, whether the opening trade and the last ten minutes (actively traded) or 30 minutes (all others) would apply in the session independently.

Several firms commented that the proposal enabling issuers to purchase their securities up to the last ten minutes of trading is a beneficial change and will provide issuers with the ability to repurchase during this period of enhanced liquidity.

#### **E. Eligible Securities**

SIA member firms do not believe that the rule should apply to securities other than common equity. The rule works particularly well with common equities because there is such transparent pricing with these securities.

SIA firms do recommend, however, that the existing inconsistencies between the Rule 10b-18 definition of common equity and the NYSE definition of equity securities be resolved. Harmonization in these definitions would be beneficial to all.

#### **Conclusion**

SIA believes that the Rule 10b-18 safe harbor has had a successful track record of adding liquidity, in the form of issuer buying power, to the marketplace while preventing that buying interest from manipulating the price of the security. It is commendable that

the SEC is seeking to keep its rule and safe harbor current, but changing a regulation that has by all measures served its purpose well should only be made upon persuasive proof of its shortcomings. SIA believes the block exception has served the purpose of providing additional liquidity to the market without any demonstrable increase in manipulative activity and thus should be retained. With this change, along with the elimination of the broker-dealer disclosure provision, the retention of the current means with which to calculate price, and the other suggestions included herein, SIA would be pleased to support the rule change.

We respect the Commission's need for information about how its rule is working, and would welcome the opportunity to have SEC staff visit with our firms to see how corporate buy-backs are executed.

We thank you for the opportunity to present our views. If you have any questions or would like to discuss these issues further, please contact Scott Kursman, Vice President and Associate General Counsel, at 212-608-1500 ([skursman@sia.com](mailto:skursman@sia.com)), or Ann Vlcek, Vice President and Associate General Counsel, at 202-296-9410 ([avlcek@sia.com](mailto:avlcek@sia.com)).

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