

**Securities Industry Association**

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June 19, 1997

Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, DC 20549
Attn.: Larry E. Bergmann, Esq.
Associate Director
Division of Market Regulation

Re: Request for Exemption Regarding Rule 10b-13 Basket Trading

Dear Mr. Bergmann:

On behalf of the Securities Industry Association ("SIA")¹ and its member firms, SIA's Capital Markets Committee (the "Committee") hereby requests an exemption from Rule 10b-13 under the Securities Exchange Act of 1934 (the "Exchange Act") for transactions in baskets of securities during a tender or exchange offer when the operation of Rule 10b-13 would otherwise prohibit a broker-dealer acting as a dealer manager in the tender or exchange offer from purchasing or arranging the purchase of one or more of the securities that comprise the basket (collectively, "Basket Component Stocks").

In August 1991, the Commission issued a letter to the SIA (the "1991 Letter")² granting an exemption from Rules 10b-6, 10b-7, 10b-8 and 10b-13 under the Exchange Act (collectively, the "Trading Rules") for transactions in Basket Component Stocks provided that specified conditions were met. The conditions set forth in the 1991 Letter applicable to Rule 10b-13 transactions are as follows:

The purchase of the Basket Component Stock must be part of a contemporaneous purchase of a basket of stocks that is based on a standardized domestic or foreign index comprised of at least 40 stocks. A "standardized index" is one that has a derivative instrument that trades on a national securities exchange registered under the Exchange Act or a board of trade registered as a contract market with the Commodity Futures Trading Commission.

- The basket of stocks purchased must, at a minimum comprise: (a) 75 percent of the weighted capitalization or weighted security value reflected in the capitalization-weighted or price-weighted index, respectively; (b) 75 percent of the securities underlying the index; or (c) 375 securities.
- The quantity of the Basket Component Stock purchased in any transaction must not exceed the greater of (a) twice the relative weighting of the Basket Component Stock in the applicable index, or (b) 500 shares.

- No bids, offers, purchases or sales may be made for the purpose of creating actual, or apparent, active trading in or raising or depressing the price of the Basket Component Stock. ³

Many SIA members, including firms represented on the Committee, are actively engaged in effecting transactions on a regular basis in baskets of securities. Many of these baskets relate to an underlying index of securities that meets the requirements of the 1991 Letter, and the Basket Component Stocks that are subject to Rule 10b-13 typically have a weight in such baskets such that transactions in those stocks meet the other requirements for the exemption. However, a large and increasing portion of the basket transactions effected by member firms are customized and do not necessarily relate to any underlying index. Nevertheless, in our view the risk of manipulation or abuse posed by most non-standard baskets is extremely low and could readily be addressed by standards that are more flexible than the exemption criteria in the 1991 Letter.

The Commission recognized that an exemption for a broader class of basket transactions is appropriate in the context of the Trading Rules other than Rule 10b-13 when it adopted Regulation M. In adopting this regulation, the Commission stated that it represented the "culmination of a comprehensive review by the Commission of its anti-manipulation regulation of securities offerings."⁴ As part of this review, the Commission reconsidered the conditions set forth in the 1991 Letter and determined that they were too restrictive. Under Rule 101(b)(6) of Regulation M, transactions by distribution participants in baskets of securities are exempt if: (i) the basket consists of twenty (20) or more securities; and (ii) the covered security does not comprise more than five percent (5%) of the value of the basket. In addition, Rule 101(b)(6) permits distribution participants to engage in transactions involving adjustments to a basket of securities related to a standardized index in the ordinary course of business as a result of a change in the composition of the standardized index. ⁵ Thus, the criteria adopted for exempt basket securities transactions in Regulation M are both much less restrictive than the conditions in the 1991 Letter and considerably easier for broker-dealers to administer and satisfy. The conditions imposed by Rule 101(b)(6) are hereinafter referred to as the "Basket Conditions."

In adopting Rule 101(b)(6), the Commission noted that "the 5%/20 stock standard allows trading in most basket transactions while ensuring that such transactions are not easily used to influence the price of a security."⁶ The Commission further noted that "the inclusion of the 20 stock criterion provides an objective indication of the *bona fide* nature of the basket transaction."⁷ We concur with these determinations and believe that these considerations apply with equal force in assessing the appropriateness of exempting transactions in Basket Component Stocks under Rule 10b-13.

If, as the Commission has concluded, a person's interest in a Basket Component Stock that complies with the Basket Conditions is too remote to afford that person the opportunity to use the transaction in the basket of securities as a mechanism by which to manipulate the value of the Basket Stock, it appears that the person's pecuniary interest in any Basket Component Stock is also too remote to justify subjecting the transaction to Rule 10b-13. In the 1991 Letter, the Commission concluded that the same manipulative and related concerns applied with equal force to Rule 10b-13 and the other Trading Rules. We believe that the factors underlying the Commission's decision to relax the 1991 Letter's conditions through adoption of Regulation M's Basket Conditions are equally applicable to the provision of relief under Rule 10b-13.

In adopting the revised conditions for baskets in Rule 101(b)(6) of Regulation M, the Commission apparently concluded that the first two conditions noted above in the 1991 Letter were unnecessary to ensure the bona fide nature of the basket. The Commission has determined that the 20 security criterion fulfills this objective. Those two conditions, together with the other Basket Conditions, apparently were intended to ensure that the subject equity securities represent a small percentage of the basket, regardless of whether the basket relates to a standardized index. Again, as noted above, the Commission has determined that the 5%/20 security standard of Rule 101(b)(6) addresses this issue. Accordingly, we believe that Rule 101(b)(6) effectively preserves the protections sought to be achieved in the 1991 Letter.

Finally, from a policy perspective, we believe Rule 101(b)(6) of Regulation M and Rule 10b-13 should continue to be applied consistently. Having two different standards will require member firms to implement two different sets of procedures and will increase the risk of unintended mistakes in application. Furthermore, the Basket Conditions in Rule 101(b)(6) are much simpler and more straightforward than the conditions in the 1991 Letter and are therefore easier to apply.

For the reasons discussed above, we respectfully request that the staff grant an exemption to Rule 10b-13 for purchases of Basket Component Stocks in basket transactions that meet the Basket Conditions of Rule 101(b)(6) of Regulation M.

We appreciate your attention to our request. If you or any member of the Commission or the staff have any questions concerning the foregoing, please contact Mark A. Egert, SIA's Vice President and Associate General and Staff Adviser to the Capital Markets Committee, at 212-618-0508, or the undersigned, at 212-761-6686.

Very truly yours,

Ralph Pellecchio, Chairman
Capital Markets Committee

Footnotes

1 The Securities Industry Association is the trade association representing over 750 securities firms headquartered in the United States and Canada. Its members include securities organizations of virtually all types -- investment banks, brokers, dealers and mutual fund companies, as well as other firms functioning on the floors of the exchanges. SIA members are active on all exchange markets, in the over-the-counter market and in all phases of corporate and public finance. Collectively they provide investors with a full spectrum of securities and investment services and account for approximately 90% of the securities business being done in North America.

2 Basket Trading During Distributions Letter [1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,752 (August 6, 1991).

3 Certain additional conditions were included in the 1991 Letter with respect to the other Trading Rules, most notably limiting the availability of the exemption during a period beginning

in the final hour of trading on the principal market for the Basket Component Stock and ending upon commencement of a distribution subject to Rule 10b-6, 10b-7 or 10b-8.

4 Release No. 34-38067, [1996-97 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,871 (December 20, 1996) (footnote omitted) (the "Release").

5 The adjustment exception does not apply to customized baskets unless the adjustment itself qualifies under the 5%/20 stock standard. See Release, at p. 88,836.

6Id.

7Id.