



SIDLEY AUSTIN LLP
1501 K STREET, N.W.
WASHINGTON, D.C. 20005

jbrigagliano@sidley.com
+1 202 736 8135

pmehta@sidley.com
+1 212 839 8526

AMERICA • ASIA PACIFIC • EUROPE

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By E-Mail

Ted Yu, Esq. Chief
Christina E. Chalk, Esq., Senior Special Counsel
Office of Mergers and Acquisitions
Division of Corporation Finance
U.S. Securities and Exchange Commission
100 F Street, N.E. Washington, D.C. 20549

Re: Request for No-Action Relief from Rule 14e-5 Related to Market-Making Activity

Dear Mr. Yu and Ms. Chalk:

We are writing on the behalf of BofA Securities, Inc. (“BofA”), a US registered broker-dealer, its affiliates, and its separately identifiable departments to request that staff (“Staff”) of the Securities and Exchange Commission’s (“SEC”) Division of Corporation Finance will not recommend enforcement action to the SEC pursuant to Rule 14e-5 under the Securities Exchange Act of 1934, as amended (the “Exchange Act”), in connection with equity derivatives market-making activity described herein.

I. Background

BofA, or an affiliate, may act as dealer manager or advisor in connection with a tender offer subject to Rule 14e-5 (the “Rule”) and hence BofA and its affiliates may acquire the status of “covered persons” under the Rule.¹ At the same time, BofA or one of its affiliates may also engage in equity derivatives market-making. As part of such market-making activity, BofA or

¹ “Covered person” means: (i) The offeror and its affiliates; (ii) the offeror's dealer-manager and its affiliates; (iii) any advisor to any of the persons specified in paragraph (c)(3)(i) and (ii) of Rule 14e-5, whose compensation is dependent on the completion of the offer; and (iv) any person acting, directly or indirectly, in concert with any of the persons otherwise specified as a “covered person” in connection with any purchase or arrangement to purchase any subject securities or any related securities.

an affiliate may seek to hedge its positions by purchasing or arranging to purchase securities that are “subject securities” or “related securities” under the Rule.²

In connection with a tender offer, the Rule generally prohibits a covered person from directly or indirectly purchasing or arranging to purchase any subject securities or any related securities except as part of such tender offer. A covered person may, however, engage in “basket transactions” under the exception provided for in subsection (b)(5) of the Rule. This exception allows purchases of a basket of securities containing a subject or related security by a covered person where (1) the purchase is in the ordinary course of business and not to facilitate the tender offer, (2) the basket contains 20 or more securities, and (3) covered and related securities do not comprise more than 5% of the value of the basket.³ From time to time BofA and its affiliates may avail themselves of the basket exception when hedging market-making positions.

In a 2008 no-action letter (the “2008 Letter”) issued under Rule 14e-5 to Morgan Stanley & Co.,⁴ the U.S. Securities and Exchange Commission’s (“SEC”) Division of Trading and Markets Staff indicated that they would not recommend enforcement action when a covered person traded subject or related securities to facilitate a range of hedging activities with respect to a merger arbitrage index where the number of underlying stocks in the index could fall below 20 or the weighting of a component stock could exceed 5%. In addition, the 2008 Letter allowed a market-maker hedging the index to purchase individual equity securities in certain circumstances, including when substitutions or additions were made to the individual component securities of such index. Such activity is not technically covered under the basket exception,⁵ but

² “Subject securities” are the securities or class of securities that are sought to be acquired in the transaction or that are otherwise the subject of the transaction. “Related securities” are securities that are immediately convertible into, exchangeable for, or exercisable for subject securities.

³ Hereinafter, the requirement that a basket contain more than 20 securities and be comprised of no more than 5% of covered or related securities will be referred to as the “5%/20 stock test.”

⁴ Letter from James A. Brigagliano, Division of Trading and Markets, Securities and Exchange Commission, to Peter Douglas, Davis Polk & Wardwell, re: MS&Co. OTC Swap Transactions Referencing a Merger Arbitrage Index (December 1, 2008), available at <https://www.sec.gov/divisions/marketreg/mr-noaction/2008/msandco120108-14e5.pdf>.

⁵ As stated in the 2008 Letter, trading activity in individual equity securities that are components of an index might not be viewed as a purchase of a “basket of securities” under Rule 14e-5(b)(5) and therefore might not meet the exception.

For example, in the case where an index administrator deleted one component from an index because an applicable merger transaction was completed and replaced it with the new component stock, one may read the basket exception as requiring a market participant (in order to avail itself of the basket exception) to sell all of the “old” index components and buy all of the “new” index components. However, such action would result in significant transaction costs and potentially cause price volatility in the

we understand the Staff issued relief based on its conclusion that the hedging activities described in the 2008 Letter did not present the opportunity for the type of abuse that the Rule is designed to prevent. As stated in the 2008 Letter, the relief was applicable to indexes with as few as 17 components and where subject or related securities comprised more than 5% of a given index. The relief was subject to the following additional conditions (the “Existing Additional Conditions”):⁶

1. The financial institution will maintain and enforce written policies and procedures reasonably designed to prevent the flow of information to or from the persons engaged in the hedging activities that might result in a violation of the federal securities laws and regulations with respect to any underlying stock in the index (including for these purposes any related security);
2. the hedging activities⁷ will be effected in the ordinary course of business and not for the purpose of facilitating any tender offer;
3. the underlying stocks or “related securities” acquired by the financial institution as a result of hedging activities will not be tendered in any tender offer;
4. the financial institution will not directly or indirectly enter into Derivative Transactions with an offeror in a tender offer (or any of such offeror's “covered persons”) and no such Derivative Transaction will be entered into with the purpose of facilitating any tender offer by the counterparty;

component stocks, and thus the terms of the 2008 Letter provided relief for hedging activity at the individual component level.

⁶ To facilitate application of the Existing Additional Conditions to the relief requested in this letter, we have paraphrased the Existing Additional Conditions, as specified in the Morgan Stanley & Co. letter, and replaced specific references to Morgan Stanley & Co. and/or its affiliates with generic references.

⁷ “Hedging activities” should be read as hedging activities with respect to over-the-counter swaps and options and exchange-listed options linked to an index (collectively, “Derivative Transactions”), with the goal of minimizing or eliminating a derivatives market-maker’s exposure to changes in the value of the index. These hedging activities would consist of, among other things, buying and selling the underlying stocks in the index (or securities that are immediately convertible into, exchangeable for, or exercisable for the underlying stocks) in the ordinary course of business to offset or minimize the exposure to the underlying stocks created by the Derivative Transactions pursuant to bona fide hedging activities, with the consequence that the hedging party may have a long or short physical position in the underlying stocks to hedge long or short exposure to the index.

5. the registration statements and other offer documents relating to any tender offer will disclose the possibility of, or the intention to make, purchases of the underlying stock or related securities outside the tender offer;

6. the financial institution will provide to the Division of Trading and Markets, upon request, a daily time-sequenced schedule of all hedging activities related to any underlying stock or related security, on a transaction-by-transaction basis, including:

(a) size, broker (if any), date and time of execution and price of purchase; and

(b) the exchange or other facility through which the purchase occurred;

7. upon request of the Division of Trading and Markets, the financial institution will transmit the information specified in paragraphs 6(a) and 6(b) to the Division of Trading and Markets at its offices in Washington, D.C. within 30 days of its request;

8. the financial institution will retain all documents and other information required to be maintained pursuant to the exemption for at least two years from the date of the termination of the relevant tender offer;

9. representatives of the financial institution will be made available (in person at the offices of the SEC in Washington, D.C. or by telephone) to respond to inquiries of the Division of Trading and Markets relating to the covered person's records; and

10. except as otherwise proposed herein, the financial institution will comply with Rule 14e-5.

The Staff provided similar relief prior to the 2008 Letter with respect to the Basket Opportunity Exchangeable Securities, or BOXES, product.⁸

⁸ Letter from James A. Brigagliano, Division of Trading and Markets, Securities and Exchange Commission, to Janet L Fisher, Cleary, Gottlieb, Steen & Hamilton, re: Biotech BOXES (March 19, 2002), available at <https://www.sec.gov/divisions/marketreg/mr-noaction/biotech031902.htm> ("BOXES Letter"). At the time the BOXES Letter was issued, the Division of Trading and Markets was called the Division of Market Regulation.

II. The Activity and Requested Relief

BofA requests that the Staff consider a more broadly applicable yet still narrowly tailored form of the relief provided in the 2008 Letter, to enable market makers such as BofA to service their customers in the current market – one in which equity indexes and the demand for index products are growing rapidly. Specifically, BofA requests that the Staff update the relief in the 2008 Letter to allow BofA and its affiliates, as covered persons under the Rule, to engage in hedging activities⁹ in connection with index-linked equity Derivative Transactions, where such activity would satisfy all of the Existing Additional Conditions, and where each underlying index would meet the following criteria (the “New Conditions”):

- i. such index would not be sponsored, administered or otherwise controlled by BofA or its affiliates;
- ii. at the time the Derivative Transaction is initiated or amended, such index would be comprised of at least 17 different equity securities (issued by at least 17 different issuers); and
- iii. at the time the Derivative Transaction is initiated or amended, no subject or related security would exceed 10% of the index.

Thus, the relief sought herein would be subject to both the Existing Additional Conditions and the New Conditions and would relate to any index product that met all such conditions.

The relief would assist BofA and its affiliates in hedging risks incurred in market making for the benefit of their customers. BofA believes that more general relief for third-party index hedging activity (to service customer orders) will facilitate orderly market-making activity and market efficiency, but will not thwart the underlying purposes of the Rule. BofA does not believe that the hedging activities described herein present opportunity for the type of tender offer-related abuse that the Rule is designed to prevent.

The relief requested here is consistent with the policies behind the basket exception to Rule 14e-5 requiring that any transaction in covered or related securities outside a tender offer relate to bona fide market activity. The activity in subject or related securities would be in connection with hedging of BofA’s market-making in Derivative Transactions. Moreover, the relief will only be available for hedging of index exposures where the indexes are broad-based and not under the sponsorship, administration, or control of BofA or its affiliates. BofA believes these limiting factors render such hedging activity an unlikely tool for facilitation or manipulation of tender offers.

Since the adoption of the 5%/20 stock test and the issuance of the 2008 Letter, the number of indexes and their variety have witnessed explosive growth. Financial journals have

⁹ For avoidance of doubt, the term “hedging activities” has the meaning described in footnote 7.

observed there are more than three million indexes world-wide and over 5,000 traded in the United States, and they vastly exceed the number of individual stocks.¹⁰ Much of this growth is attributable to investor-driven interest in passive investing strategies.

Unfortunately, hedging in such indexes may not always be possible for covered persons under the basket exception. Adjustments and rebalancings of indexes typically require market-makers to trade in single components or subsets of an index's components in order to maintain a closely aligned hedge position. Moving in and out of an entire index portfolio, in an effort to trade only in baskets of equity securities, remains impracticable.¹¹ In addition, there has been a recent increase in indexes created with a wide range of complex and targeted investment strategies.¹² Strategy-driven indexes generally tend to rebalance in more complicated ways, further pressuring the basket hedging model, which seems more appropriate for transactions involving static baskets.

Many indexes, though broad-based and frequently rebalanced, may permit 20 or fewer underlying stocks and/or exposures in excess of 5% (even when an index may contain many more than 20 underlying stocks).¹³ And even indexes that are generally intended to have more than 20 underlying stocks and 5% exposure caps may not rebalance frequently enough to prevent breaches in these limits during intervals between rebalancings or due to extraordinary events, and BofA has no ability to prevent these breaches in third-party indexes. As a result, financial institutions such as BofA often face the dilemma of either not servicing clients in tender offer transactions or not efficiently servicing clients in index-linked equity derivative transactions by having to price in higher hedging costs. BofA believes that such a result runs contrary to the interests of financial industry customers and undermines orderly and efficient markets. BofA's requested relief is essentially an application of previously understood guidance, as discussed above, albeit in the context of modern markets.

Finally, BofA notes that the Staff has previously issued similar Rule 14e-5 relief related to the basket exception where baskets contained fewer than 20 securities and a covered security

¹⁰ See e.g. <https://www.moneyobserver.com/news/there-are-now-70-times-more-stock-market-indices-listed-stocks-world>; <https://www.ft.com/content/9ad80998-fed5-11e7-9650-9c0ad2d7c5b5>; <https://www.investopedia.com/insights/introduction-to-stock-market-indices/>.

¹¹ See discussion in footnote 5.

¹² See <https://www.finra.org/investors/insights/etfs-what-you-need-know>.

¹³ For example, BofA sampled a subset of the population of over 200 new ETFs that were launched in 2019 and found that over 34 of these new ETFs track an index for which at least one component is weighted above 5%, and in many cases more than one component is weighted above 5%. Only 6 of these ETFs, however, track an index for which a component is weighted above 10%. All of the sampled ETFs track an index that contains more than 20 components.

comprised more than 5% of the basket.¹⁴ Allowing BofA's requested condition of relief that referenced indexes contain at least 17 different securities (of at least 17 different issuers) is similar to the relief granted in the BOXES Letter¹⁵ and substantially above the threshold utilized to mark indexes that are not narrow-based security indexes, under the Exchange Act.¹⁶ This is important because BofA believes that using a broad-based index to circumvent the purposes of Rule 14e-5 would be impractical and unrealistic. Further, the required condition that no subject or related security exceed 10% of the index ensures that no underlying index would reach the exposure thresholds set in the Exchange Act for a narrow-based securities index.¹⁷ BofA notes

¹⁴ See e.g. Letter from Ted Yu, Division of Corporate Finance, Securities and Exchange Commission to Ashley Bergus, American Century Investments, re: American Century ETF Trust Request for Exemptive Relief from Rule 14e-5 (December 12, 2019), available at <https://www.sec.gov/corpfin/american-century-etf-121219-14e5>.

¹⁵ The index in the BOXES Letter was comprised of 17 stocks, but this amount could fall to 15. See footnote 3 of the incoming request related to the BOXES Letter ("Morgan Stanley Dean Witter does not anticipate that the number of Underlying Stocks of the BTK Index will fall below 15 at any time. If the number of Underlying Stocks falls below 15, Morgan Stanley Dean Witter will consult with the Staff to determine whether the relief sought by this letter remains appropriate.")

¹⁶ Section 3(a)(55)(B) of the Exchange Act provide that an index is a "narrow-based security index" if, among other things, it meets one of the following four criteria:

- (i) the index has nine or fewer component securities;
- (ii) any component security of the index comprises more than 30 percent of the index's weighting;
- (iii) the five highest weighted component securities of the index in the aggregate comprise more than 60 percent of the index's weighting; or
- (iv) the lowest weighted component securities comprising, in the aggregate, 25 percent of the index's weighting have an aggregate dollar value of average daily trading volume of less than \$50,000,000 (or in the case of an index with 15 or more component securities, \$30,000,000), except that if there are two or more securities with equal weighting that could be included in the calculation of the lowest weighted component securities comprising, in the aggregate, 25 percent of the index's weighting, such securities shall be ranked from lowest to highest dollar value of average daily trading volume and shall be included in the calculation based on their ranking starting with the lowest ranked security.

BofA notes that, in certain contexts, the Commission has recognized that broad-based indexes are simply indexes that are not narrow-based. See Exchange Act Release No. 67453 (July 18, 2012), 77 FR 48208, 48272 (Aug. 13, 2012).

¹⁷ See Sections 3(a)(55)(B)(ii) and (iii) of the Exchange Act in note 16.

that the Staff previously granted Rule 14e-5 relief for baskets where component securities comprised 25% of the index and that the proposed threshold of 10% is far lower.¹⁸

III. Conclusion

The requested relief would apply only where a purchase of, or arrangement to purchase, a Rule 14e-5 subject or related security is for ordinary course hedging of third-party index exposures arising from equity derivatives market-making. In light of the growth of indexes, index products and the tighter regulatory standards on derivative market-makers, BofA believes updated, more general relief for index hedging activities is warranted, and BofA believes such relief would be consistent with the Rule's underlying policy objectives, including the manner in which such policy objectives apply to the Rule's basket exception and the 2008 Letter.

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We appreciate your consideration of this request. Please contact James Brigagliano (jbrigagliano@sidley.com or 202.736.8135) or Prabhat Mehta (pmehta@sidley.com or 212.839.8526) if you have any questions.

Sincerely,



James A. Brigagliano

¹⁸ Letter from James A. Brigagliano, Division of Trading and Markets, Securities and Exchange Commission, to Claire P. McGrath, The American Stock Exchange, re: Exemptive Relief for Exchange Traded Funds, (August 17, 2001), available at <https://www.sec.gov/divisions/marketreg/mr-noaction/etifclassrelief081701-msr.pdf>.