

Regulatory Circular RG01-114

DATE: July 19, 2001

TO: Members and Member Organizations

FROM: Division of Regulatory Services  
Department of Market Monitoring

SUBJECT: Stock Buy-Ins

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The purpose of this Regulatory Circular is to address concerns expressed by members of the Exchange with respect to the issue of buy-ins, a forced repurchase of a short securities position.

KEY ISSUES

- **Buy-ins are often issued by firms attempting to meet possession and control requirements pursuant to the SEC Customer Protection Rule.**
- **When buy-in notices are received by NSCC, they are allocated to those NSCC members who have been short for the longest time period.**
- **The rules of the NYSE and AMEX dictate that the clearing firm that receives a buy-in notice is responsible for the execution of the buy-in trade, while NASD rules require the party issuing the buy-in notice to execute the buy-in.**
- **NASD rules require that the firm executing the buy-in must be prepared to defend the price at which it was executed relative to the existing market.**
- **Failure by a member or member organization to comply with applicable SRO buy-in rules may result in Exchange disciplinary proceedings and be deemed a violation of Exchange Rule 4.1 – Just and Equitable Principles of Trade and other applicable rules and regulations.**

DISCUSSION

**Reasons for a Buy-in**

The possibility of a buy-in exists whenever a market maker sells stock short which was not pre-borrowed, thereby failing to deliver, or when borrowed shares cannot be returned to the lender upon demand. While a market maker or specialist is exempt from pre-borrowing requirements in fulfilling market making obligations, the trader is not exempt from buy-ins.<sup>1</sup> Often the firm owed

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<sup>1</sup> See Regulatory Circular RG95-69.

the shares is forced to issue a buy-in as the SEC Customer Protection Rule mandates that clearing firms maintain possession and control of all fully paid customer securities. In order to meet possession and control requirements, a firm must attempt to obtain possession and control of customer securities by issuing a buy-in notice on fails over thirty days old. Although possession and control requirements are a primary reason for buy-ins, any purchasing party has the right to request and receive physical delivery of securities.

### **Buy-in Process**

Since the purpose of many buy-ins is to actually gain possession and control of the security, buy-in notices often are marked for guaranteed delivery. Additionally, whenever a firm issues an intention to buy-in, it receives the highest priority for stock deliveries in NSCC's net settlement processing. As a result, in only a small number of instances where an intention to buy-in is issued, does an actual buy-in take place. Upon proper notification from a failing to receive member, NSCC issues buy-in notices to sufficient short failing members to satisfy the buy-in, beginning with those NSCC members who have been short for the longest time period. An NSCC member will remain in its position on the chronological allocation chart at NSCC until such point in time when it no longer is short. Since it is the NSCC member, and not the CBOE market maker or specialist, who receives the buy-in notice, it is the responsibility of the clearing firms to be familiar with the rules governing the execution of buy-ins on the various securities exchanges and associations. Additionally, the clearing firms should have written procedures for both their internal allocation and notification of buy-ins to the account being bought in.

The firm responsible for executing the buy-in differs between markets. When a buy-in takes place on the AMEX or NYSE, the firm failing to deliver will be responsible for execution of the buy-in.<sup>2</sup> However, according to NASD rules, the firm owed the shares, or failing to receive, is responsible for the execution of the buy-in. **The NASD has rules requiring that the firm executing the buy-in must be prepared to defend the price at which it was executed relative to the existing market.**<sup>3</sup>

### **Member Complaints**

Members who wish to question the executed price of a buy-in trade are encouraged to speak with their clearing firms. Members who wish to lodge a formal complaint regarding the execution of a buy-in may forward a written complaint to the Exchange's Department of Market Monitoring ("Department"). If the broker-dealer effecting the buy-in is an Exchange member, the Department will investigate the matter. Where the broker-dealer is a non-member, the Department will forward the written complaint to the appropriate SRO for investigation.

**Failure by a member or member organization to comply with applicable SRO buy-in rules may result in Exchange disciplinary proceedings and be deemed a violation of Exchange Rule 4.1 – Just and Equitable Principles of Trade and other applicable rules and regulations.**

Questions regarding this Regulatory Circular should be directed to Rich Lewandowski at (312) 786-7183, or Douglas Beck at (312) 786-7959.

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<sup>2</sup> See AMEX Rule 783 and NYSE Rule 282.

<sup>3</sup> See NASD Rule 11810 (Uniform Practice Code) and NASD Rule 5379.