

Regulatory Circular 97-70

DATE: June 8, 1997
TO: The Membership
FROM: Department of Financial Compliance
RE: Stock Buy-Ins

In response to concerns expressed by members of the Exchange, the Department of Financial Compliance recently conducted a study into the issue of buy-ins, a forced repurchase of a short securities position. In its study the Department spoke with representatives of various exchanges and the National Securities Clearing Corporation ("NSCC"). The purpose of this circular is to summarize the results of this study.

The study revealed the following, which are explained in detail below:

- Buy-ins are most 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 CBOE, NYSE, and AMEX dictate that the clearing firm who 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.

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.** Often the firm owed 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.

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 CBOE, AMEX or NYSE, the firm failing to deliver will be responsible for execution of the buy-in. 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. Members who wish to question the executed price of a buy-in trade are encouraged to speak with their clearing firms.

Questions and Additional Information

This issue of buy-ins was also previously addressed in Regulatory Circular RG 95-29. Questions may be directed to Kevin Devlin at 786-7232 or Doug Beck at 786-7959.