

Regulatory Circular 95-29

DATE: April 1, 1995
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. In its study the Department spoke with various firms, exchanges, clearing corporations, and the NASD. The purpose of this circular is to summarize the results of this study. A more detailed description of its findings may be obtained from the Department.

The possibility of a buy-in exists whenever a market maker sells stock short which cannot be borrowed thereby failing to deliver, or when borrowed shares cannot be returned to the lender. Often the firm which is owed the shares is forced to issue the buy-in because the SEC Customer Protection Rule mandates that clearing firms maintain possession and control of all fully paid customer securities. As part of their continuous net settlement processing, stock clearing corporations allocate deliveries of stock against the oldest fail first, with the exception that whenever a firm issues an intent to buy-in it receives the highest priority for deliveries. As a result, in only a small fraction of instances where an intent to buy-in is issued, does an actual buy-in take place.

The firm responsible for executing the buy-in differs between markets. On the AMEX and NYSE the firm which is failing to deliver executes the buy-in. However, for trades on the Chicago Stock Exchange ("CHX") or over-the-counter trades, the firm that is owed the shares must execute the buy-in. CHX and NASD have 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.

The Department does not believe it is possible to exempt CBOE market makers from buy-ins. Stock specialists are not exempt and

if such as exemption were enacted the supply of borrowable stock would be severely restricted because lenders must have access to the shares which they have loaned. Members who question the price at which a buy-in was executed are encouraged to speak with their clearing firms.

A more thorough description of the Department's findings is available to members on request. Questions may be directed to Rich Lewandowski at 786-7183 or Steven O'Malley at 786-7925.