



DIVISION OF
MARKET REGULATION

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

February 14, 1994

Raymond J. Hennessy
Vice President
Member Firm Regulation
New York Stock Exchange, Inc.
20 Broad Street, 21st Floor
New York, New York 10005

Dear Mr. Hennessy:

The New York Stock Exchange, Inc. and other industry representatives have raised concerns with respect to the procedure to be followed when recalling and buying-in loaned corporate securities. In this regard, some broker-dealers engaging in these activities experience difficulties in complying with subparagraph (d)(1) of Rule 15c3-3 under the Securities Exchange Act of 1934 ("Act").¹ An elective procedure for broker-dealers to follow when recalling or buying-in loaned corporate securities of like kind and quantity as those originally loaned has been proposed. In connection with this proposal, the views of the Division of Market Regulation ("Division") regarding the applicability of Section 15(c)(3) of the Act² and Rule 15c3-3 thereunder have been requested.

I. BACKGROUND

Rule 15c3-3 requires that broker-dealers promptly obtain and thereafter maintain the physical possession or control of fully-paid and excess margin securities carried by them for the account of customers.³ Paragraph (d) of the rule requires broker-dealers to make a daily determination, based on its books and records, of the quantity of customer fully-paid and excess margin securities both in the possession or control of the broker-dealer and outside the possession or control of the broker-dealer.⁴

If, upon such daily determination, the broker-dealer's books and records reveal that it has not obtained possession or control

¹ 17 C.F.R. § 240.15c3-3(d)(1).

² 15 U.S.C. § 78o(c)(3).

³ 17 C.F.R. § 240.15c3-3(b)(1).

⁴ 17 C.F.R. § 240.15c3-3(d).

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If, upon such daily determination, the broker-dealer's books and records reveal that it has not obtained possession or control of all customer fully-paid and excess margin securities (the amount of such securities not in the possession or control of the broker-dealer is referred to as the "deficit"), and if that broker-dealer has loaned securities of the same issue and class to another broker-dealer, the lending broker-dealer, must issue instructions for the return of the loaned securities. The broker-dealer must issue the recall instructions no later than the business day following the day on which the determination of the deficit is made and must have possession or control of the securities within five business day following the date of the issuance of the recall instructions.⁵

The broker-dealer would be in violation of Rule 15c3-3 if the loaned securities are not returned to the broker-dealer by the fifth business day following the date of issuance of the recall instructions and if all other efforts (e.g., attempts to borrow securities) by such broker-dealer to fulfill its possession or control requirement have been unsuccessful.⁶ The broker-dealer then must take prompt action, such as purchasing securities of like kind and quantity ("buying-in"), in order to remedy the violation.

II. DESCRIPTION OF PROPOSED ELECTIVE PROCEDURES

Currently, there are no formalized rules regarding recall of loaned securities and buy-ins. Accordingly, some broker-dealers have experienced difficulties in complying with paragraph (d)(1) of the Rule 15c-3. In view of the lack of formalized rules, you have proposed the schedule set forth below as an elective procedure to be followed by broker-dealers when recalling loaned corporate securities or buying-in corporate securities of like kind and quantity as those originally loaned.

Deficit Determination Day

If a broker dealer who has loaned securities ("lender") determines that it has a deficit and if the lender has securities of the same issue and class as those constituting the deficit loaned to another broker-dealer ("original borrower"), the lender, on the day

⁵ 17 C.F.R. § 240.15c3-3(d)(1).

⁶ Id.

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the deficit is determined, must undertake the necessary steps to borrow securities to fulfill its possession or control requirement.

Notification Day

No later than 11:30 a.m. New York Time ("NYT") on the business day following the Deficit Determination Day ("Notification Day" or "N"), a lender, whose attempts to cover a deficit by borrowing securities have been unsuccessful and who, therefore, continues to have a deficit, must send notification to the original borrower that the securities must be returned ("recall notification").

The recall notification shall inform the original borrower that after 2:30 p.m. NYT on the fifth business day following the date of issuance of the recall notification ("N+5"), the lender will execute a buy-in for securities of like kind and quantity as those originally loaned unless the lender receives from the original borrower either: (i) proof of purchase of securities of like kind and quantity as those originally loaned by 2:30 p.m. NYT on N+5, or (ii) the loaned securities by 2:30 p.m. NYT on N+5.

On Notification Day, if the original borrower does not have the borrowed securities immediately available, it must begin attempts to borrow securities of like kind and quantity as those originally borrowed to return them to the lender.

If the original borrower is lending the securities to another broker-dealer ("secondary borrower"), it may re-transmit the recall notification to such secondary borrower no later than the close of business NYT of the Notification Day. However, re-transmittal to or by any secondary borrower shall not cause a change in the schedule for notices of purchase, returns of loaned securities or buy-ins as set by the original lender. Evidence of a re-transmitted recall notification does not relieve the original borrower or any secondary borrower from its responsibility to return to the lender the loaned securities or securities of like kind and quantity as those originally borrowed. The original borrower must continue attempts to borrow securities to return to the lender. Any secondary borrower that does not have the securities immediately

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available to it must begin attempts to borrow securities to return to the original borrower.

**First, Second and Third Business Day after Notification Day
("N+1," "N+2" and "N+3")**

All secondary borrowers must continue attempts to borrow securities to return to the lender the loaned securities or securities of like kind and quantity as those originally borrowed.

Fourth Business Day after Notification Day ("N+4")

If the deficit still exists, the lender must send to the original borrower notice that it still requires the return of the securities ("reaffirmed-recall notification"). The reaffirmed-recall notification shall constitute final notice to the original borrower that if the lender has not received the proof of purchase of securities or the securities by 2:30 p.m. NYT on N+5, the lender will purchase on behalf of the original borrower securities of like kind and quantity as those originally borrowed.

If the securities are still due from a secondary borrower, the original borrower must re-transmit the reaffirmed-recall notification to the secondary borrower no later than the close of business NYT on N+4. The re-transmitted, reaffirmed-recall notification must be accompanied by a notice informing the secondary borrower that it must return the securities or provide proof of purchase of the securities in sufficient time for the original borrower to fulfill its obligation to the lender.

If the lender fails to send a reaffirmed-recall notification on N+4, it will be understood by the original borrower that the lender has resolved the deficit and no longer requires the return of the securities.

Fifth Business Day after Notification Day ("N+5")

If the lender has not received the proof of purchase of securities or the securities by 2:30 p.m. NYT, the lender will execute a buy-in of securities of like kind and quantity as those originally borrowed, in accordance with the rules and procedures of the

principal exchange or market in which the securities are traded.

A lender executing a buy-in of securities of like kind and quantity as those originally borrowed must provide the original borrower with written confirmation of purchase no later than the close of business on the execution date of the buy-in. Such notice shall disclose any difference between the price of securities purchased in the buy-in transaction and the value of the original borrower's collateral held by the lender.

Should the lender be unable, due to market conditions, to execute a buy-in for all or any part of the securities, the lender shall notify the original borrower that it will attempt to execute on a daily basis any amount remaining undelivered. Any subsequent deliveries shall require prior permission from the lender. If a re-transmitted notice has been issued to secondary borrowers for these situations, the original borrower must provide identical information within the prescribed time frames.

Notes

Generally, if these procedures are followed, the lender should have a deficit no longer than ten business days from notification date. Should the lender's buy-in trade fail on settlement date, the lender must obtain possession or control of the securities in accordance with paragraph (d)(2) of the rule.

If the lender receives a proof of purchase of securities it shall not execute the buy-in on N+5. However, if the securities remain undelivered at 2:30 p.m. NYT on the first business day following the settlement date indicated in the proof of purchase, the lender may buy-in the securities (without any further notice of intent to the borrower) in accordance with the established procedures of the principal exchange or market in which the securities are traded.

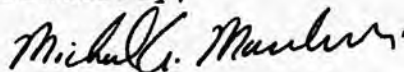
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III. CONCLUSION

The Division will not recommend to the Securities and Exchange Commission that enforcement action be taken for violations of the possession or control requirement of rule 15c3-3 as to any registered broker-dealer acting as a lender that has issued in a timely manner instructions for the return of loaned corporate securities, and has not received the loaned securities within five business days after the date of issuance of the recall instructions so long as that broker-dealer adheres to the elective procedure set forth in this letter.

This is a position of the Division's staff concerning enforcement action with regard to certain aspects of Section 15(c)(3) of the Act and Rule 15c3-3 thereunder, and does not represent any legal conclusion on this matter. This position is based solely on the description made to the Division as set forth above. Any factual variations might require a different conclusion. This position may be withdrawn or modified if the Division determines that such action is necessary in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the securities laws.

Sincerely,



Michael A. Macchiaroli
Associate Director