

## Chapter Six

# ISSUER REPURCHASE ACTIVITY

### A. Introduction

In the wake of the October market break, approximately 650 issuers publicly announced plans to make open market purchases of their common stock. Previously, between January 1, 1987 and October 16, 1987, approximately 350 issuers had announced stock repurchase programs. Many of these issuers initiated or continued their repurchase activities during the week of October 19-23. This section discusses the market impact of issuer repurchase activity on the stocks in the S&P 500, and the operation of Rule 10b-18 under the Exchange Act. <sup>1/</sup>

### B. Rule 10b-18

Many issuers conduct repurchase programs pursuant to Rule 10b-18 ("Rule") under the Exchange Act, which provides that an issuer (and certain related persons) will not incur liability under the anti-manipulation provisions of Sections 9(a)(2) or 10(b) (and Rule 10b-5 thereunder) of the Exchange Act if purchases of the issuer's common stock are effected in compliance with the limitations contained in the Rule.

When the Rule was adopted in 1982, <sup>2/</sup> the Commission recognized that issuer repurchase programs are seldom undertaken with improper intent, that they may frequently be of substantial economic benefit to investors, and that undue restriction of such programs is not in the interest of investors, issuers, or the marketplace. The Commission stressed that Rule 10b-18 is not the exclusive means by which issuers can make repurchases without manipulating the market.

The conditions of Rule 10b-18 pertain to four areas: volume, timing, price, and manner of purchases. The volume limitation is designed to prevent an issuer from dominating the market for its securities through substantial purchasing activity. Specifically, the Rule provides that an issuer may effect daily purchases of up to 25 percent of the trading volume in its shares, defined as the average daily trading volume over the preceding four weeks. Purchases of blocks, as defined in the Rule, <sup>3/</sup> are excepted from the volume condition although all other conditions apply. Thus, an issuer may comply with the volume condition if it purchases up to 25 percent of the trading volume and, in addition, purchases one or more blocks.

The timing conditions specify those periods during which the issuer may bid for or purchase its own stock. The issuer's purchase may not be the opening purchase reported in the consolidated system; nor may the purchases be made during the last

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<sup>1/</sup> 17 CFR Sec. 240.10b-18.

<sup>2/</sup> Securities Exchange Act Release No. 19244 (November 17, 1982), 47 FR 53333.

<sup>3/</sup> A "block" is defined essentially as a quantity of stock that has a purchase price of \$200,000 or more, or is at least 5000 shares and has a purchase price of at least \$50,000. Rule 10b-18(a)(14).

half-hour before the close of trading. Purchases of a reported security <sup>4/</sup> or exchange-traded security at the opening or close of a trading day generally are thought to be significant indicia of the current market value of the security since they tend to forecast the direction of trading and to suggest the strength of demand. Thus, the exclusion of opening purchases was designed to prevent the issuer from setting the character of the day's trading through such transactions. Likewise, the exclusion of bids and purchases near the close was designed to prevent the issuer from creating or sustaining a high bid or transaction price at or near the close.

The price conditions specify the highest price an issuer may pay for its common stock. The maximum price will depend on whether the common stock is a reported security, an exchange-traded security, a NASDAQ security, or other security, and on whether the transaction is effected on an exchange or not. The price limitations were designed to prevent an issuer from effecting transactions at prices that lead the market. Instead, an issuer must pay a price determined by independent market forces.

Finally, the manner of purchase conditions require that an issuer make purchases from or through not more than one broker or dealer on any given day. The single broker-dealer limitation was designed to prevent the manipulative practice of creating the appearance of widespread interest and trading activity in the security through the use of several broker-dealers. The Rule permits issuer purchases, however, from any number of broker-dealers in transactions that are not solicited by the issuer.

### C. Commission Staff Activity

From October 20 through November 20, the Commission received and responded to over 350 telephone calls from issuers and broker-dealers or their legal counsel concerning repurchase programs. One of the most frequently asked questions was whether the Commission had waived the Rule's restriction on purchases during the last half hour of trading or in other respects, as had been suggested in newspaper reports. Callers were advised that, although none of the provisions of the Rule had been waived or rescinded, issuer repurchases could continue to be made pursuant to the safe harbor provisions of the Rule or outside the Rule so long as the issuer did not engage in manipulative practices. Callers were also advised that the staff recognized that there are many valid reasons for issuer repurchasing activity, and that it was understandable that many issuers wished to actively purchase their stock (including cautiously purchasing outside certain parameters of the Rule) during the week of October 19 because of a belief that the stock was priced at an attractive level. An experienced staff member was designated to respond to questions on repurchase programs, and she counseled a large number of callers on the application of the Rule's provisions in various contexts. The questions presented to the staff reflected a concern about market developments, and an interest in effecting repurchase programs for various legitimate corporate purposes, and providing additional liquidity in the marketplace.

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<sup>4/</sup> *I.e.*, any security for which last sale information is available, including NASDAQ-NMS securities.

## D. Analysis of Repurchase Activity

### 1. Introduction

The staff undertook to determine the extent of S&P 500 issuer repurchase activity during the week of October 19-23, and whether the repurchase programs affected the market performance of the companies' common stock. During the week, 158 (31.6%) of the S&P 500 companies either had ongoing common stock repurchase programs (101) and/or announced new or accelerated programs (78), as reflected below. Of the 158 companies, 129 made purchases on one or more days during the week. The staff found that issuer repurchase activity was substantial, particularly toward the end of the week. Moreover, the purchases had a positive effect on the overall price performance of the securities of these issuers during that week. Additionally, announcements of repurchase programs appeared to have a short-term positive effect on market price.

### 2. Repurchase Volume <sup>2/</sup>

Table 6-1 shows the market participation of S&P 500 companies during the week. Daily issuer purchases accounted for 2.80% to 9.36% of total S&P 500 trading volume. Table 6-2 reflects the breakdown between new and ongoing repurchase programs.

Table 6-1  
S&P 500 COMPANY REPURCHASING ACTIVITY  
October 19-23, 1987

<u>DATE</u>	<u>* COMPANIES PURCHASING</u>	<u>* SHARES PURCHASED (million)</u>	<u>% NYSE S&amp;P 500 VOLUME</u>	<u>% NYSE VOLUME</u>
10-19	56	11.84	2.80	1.95
10-20	91	21.94	5.14	3.57
10-21	87	15.44	4.94	3.41
10-22	109	25.02	8.86	6.33
10-23	103	16.15	9.36	6.52
TOTAL	129*	90.39	5.59	3.90

\* Total reflects the number of companies that made purchases on one or more days of the week.

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<sup>2/</sup> The analysis compared issuer repurchase activity to consolidated volume which is generally higher than the volume of a security on the primary market for its shares.

Table 6-2

S&P 500 ISSUER REPURCHASING ACTIVITY  
October 19-23, 1987

DATE	ONGOING PROGRAMS			Program Announcements*	NEW PROGRAMS			CUMULATIVE PROGRAMS (ONGOING & NEW)		
	No. of Ongoing Programs	No. of Companies Buying	Shares Repurch. (million)		No. of New Programs	No. of Companies Buying	Shares Repurch. (million)	Cumulative Programs	No. of Companies Buying	Shares Repurch. (million)
10/19	101	54	10.25	2	2	2	1.59	103	56	11.84
10/20	103	76	18.86	31	21	15	3.08	124	91	21.94
10/21	124	76	12.32	22	18	11	3.12	142	87	15.44
10/22	142	99	23.91	16	11	10	1.11	153	109	25.02
10/23	153	101	15.81	7	5	2	.34	158	103	16.15
10/19-23	—	—	81.15	78	57	—	9.24	158	129**	90.39

\* Announcements of new or accelerated ongoing programs. After the date of announcement, a new program is treated as an ongoing program.

\*\* 129 different companies purchased on one or more days.

During the period October 19-20, 93 S&P 500 companies made purchases of their shares, and their purchases ranged from 60.1% to 0.2% of the week's trading volume for the individual company's shares, with a median of 12.5%. Nineteen companies accounted for 25% or more of their volume. During the period October 19-23, 129 S&P 500 companies made purchases of their shares, ranging from 80.5% to 0.4% of their trading volume, with a median of 12.9%. Thirty companies accounted for 25% or more of their volume. The repurchasing activity is even more substantial if the number of shares purchased is compared to the trading volume on and after the day that the company began purchasing. Using this measure, the 129 companies purchased between 82.5% and 0.5% of their trading volume, with a median of 18.7%, and 47 companies accounted for 25% or more of their trading volume. Eleven companies accounted for more than 50% of their trading volume.

### 3. Price Performance

We also analyzed the price performance of S&P 500 companies with ongoing and new repurchase programs. The analyses are divided into two time periods, October 19-20, and October 19-23. All S&P 500 companies were categorized by whether or not they purchased their common stock during these periods. In order to ascertain the effect of the announcement of a repurchase program, the price performance of the S&P 500 companies that made repurchase program announcements during the period and either purchased or did not purchase their shares was also analyzed.

#### a. The Effect of Repurchases

Tables 6-3(A) and (B) show that during October 19-20, the market price of companies that repurchased their shares decreased 17.5%, or 2.1% less than companies that did not repurchase their shares; and, in the period October 19-23, the market price of repurchasing companies' common stock decreased 15%, or 1.5% less than the market price of nonpurchasing companies. This suggests that company repurchases ameliorated the price decline of their common stock.

Tables 6-3(A) and (B) also contain the repurchasing companies' market performance adjusted for the beta values <sup>6/</sup> of the individual securities, and show

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<sup>6/</sup> Beta values are a measure of the relative price volatility of an individual stock compared with the overall market. By adjusting price movements of the individual S&P 500 stocks for their beta values, the market volatility component of the price movements of the individual stocks is eliminated. The S&P 500 stocks generally moved consistently with their beta values during the week of October 19.

In Tables 6-3(A) and (B) the beta-adjusted price performance of the purchasing and non-purchasing firms is reported as compared to the movement of the S&P 500 index. Note that the average beta adjusted performance of all 500 of the S&P 500 stocks is positive over this period (1.2% in Table 6-3(A) and 1% in Table 6-3(B)). One would expect that the beta-adjusted performance of all 500 firms in the S&P 500 would be zero when compared to the movement of the S&P 500. There are two reasons for this seemingly anomalous result. First, the betas used in these calculations were obtained from Value Line and average 1.0 in comparison to the Value Line index, not necessarily the S&P 500 index. In addition, the S&P 500 index is value weighted while these calculations are equal weighted. Thus,

similar results. Specifically, in the October 19-20 period, the adjusted market price of repurchasing companies' common stock rose 3.2%, or 2.4% more than the market price of nonpurchasing companies. For the October 19-23 period, repurchasing companies' adjusted market price rose 2.7%, or 2.3% more than the market price of nonpurchasing companies.

The 11 companies that purchased more than 50% of their trading volume outperformed all purchasing companies as a group and those companies that purchased less than 50% as follows:

<u>Percentage of Trading Volume Purchased</u>	<u>Average Percentage Price Change <sup>7/</sup></u>	<u>Number of Companies</u>
Over 50%	-13.0	11
Under 50%	-15.2	118
Overall	-15.0	129

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larger firms have a greater impact on the S&P 500 index than they have on these samples where each firm's price movement is equally weighted. However, these characteristics of the beta adjustment for market movements do not affect the comparison between the price performance of purchasing and non-purchasing firms.

<sup>7/</sup> Difference in means is statistically significant at the 75% level of confidence. In most studies in business and economics, a confidence level of 95% is thought most appropriate. The Division presents some data in this chapter with confidence levels below this level solely to provide the reader with additional information on the effect of purchases and announcements.

Table 6-3(A)

PRICE PERFORMANCE OF  
ALL S&P 500 COMPANIES  
October 19-20

	Percentage Price Change		Number of Companies
	Mean	Median	
Purchasers	-17.5	-17.7	93
Non-Purchasers	-19.6	-19.1	407
Overall	-19.2	-18.9	500

(Difference in means is statistically significant at  
the 99% level of confidence)

BETA ADJUSTED  
PRICE PERFORMANCE OF  
ALL S&P 500 COMPANIES  
October 19-20

	Percentage Price Change		Number of Companies
	Mean	Median	
Purchasers	3.2	3.3	93
Non-Purchasers	0.8	2.2	407
Overall	1.2	2.3	500

(Difference in means is statistically significant at  
the 99% level of confidence)

Table 6-3(B)

PRICE PERFORMANCE OF  
ALL S&P 500 COMPANIES  
October 19-23

	Percentage Price Change		Number of Companies
	Mean	Median	
Purchasers	-15.0	-15.8	129
Non-Purchasers	-16.5	-16.8	371
Overall	-16.1	-16.3	500

(Difference in means is statistically significant at  
the 95% level of confidence)

BETA ADJUSTED  
PRICE PERFORMANCE OF  
ALL S&P 500 COMPANIES  
October 19-23

	Percentage Price Change		Number of Companies
	Mean	Median	
Purchasers	2.7	2.8	129
Non-Purchasers	0.4	1.4	371
Overall	1.0	1.7	500

(Difference in means is statistically significant at  
the 99.5% level of confidence)



### b. The Effect of Announcements <sup>8/</sup>

The staff also analyzed whether the announcement of a new or accelerated repurchase program had a separate price impact. We first compared the price performance of companies that made an announcement with companies that did not make an announcement. This comparison, however, did not indicate any clear price impact from the announcement. <sup>9/</sup>

We separately compared the average percentage price change of the individual stocks and the S&P 500 index between the price on the hour prior to announcement (T) and the price two hours later (T+2). <sup>10/</sup> Table 6-4 shows that the price of companies that made announcements rose by an average of 3.27%, whereas the S&P 500 index rose by an average of 1.82%. Accordingly, the price of announcing companies outperformed the S&P index by 79.7%. If one company that made an announcement but had an abnormally large negative percentage price change is eliminated from the group, the percentage positive price change for announcing companies is even greater, as reflected in Table 6-4. Moreover, it is interesting to note that the index itself moved positively in the hour after corporate repurchase announcements.

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<sup>8/</sup> The only announcements included in this study were those that were reported in the financial press. Companies that purchased during the week but did not make a reported announcement during the week were treated as having ongoing repurchase programs only.

Eight companies made repurchase program announcements between 11 a.m. and 1 p.m. on October 20 (the actual announcement times were between 11:59 a.m. and 12:58 p.m.).

<sup>9/</sup> See Tables 6-5 to 6-12 at the end of this chapter.

<sup>10/</sup> Where an announcement was made in the last hour of trading or after the close of trading, the T+2 time was 11:00 a.m. on the next trading day.

Table 6-4  
**EFFECT OF REPURCHASE PLAN  
 ANNOUNCEMENTS ON SHARE PRICES**  
October 19-23, 1987

	Average Percentage Price Change (2 hour period)	Number of Companies
Announcing Companies	3.27 <u>11/</u> (3.84) <u>12/</u>	78 (77)
S&P 500 Index	1.82 (1.92)	500 (499)

#### **E. Broker-Dealer Survey**

To gain additional perspective on repurchase programs and the operation of Rule 10b-18, the staff surveyed 13 brokerage firms that appeared to be active in the execution of repurchase programs. This section summarizes the responses to the survey.

The brokers stated that they offered their services to issuers announcing new or accelerated repurchase programs, and that new repurchase programs generally did not begin until October 20 or 21.

The brokers reported that the vast majority of repurchases were made within the parameters of Rule 10b-18, and that the Rule had worked satisfactorily during the week. The major exception occurred with respect to the timing restrictions: a number of brokers purchased during the last half-hour of trading, and one broker made two opening purchases. It is also clear that the treatment of blocks under the Rule was very significant and many issuers purchased a large number of blocks. Some issuers bought only 25% of the trading volume, as contemplated by the Rule; other issuers purchased the 25% and blocks; and others purchased only blocks.

#### **F. Summary**

Stock repurchases by many S&P 500 companies represented a significant proportion of the trading volume in their shares during October 19-23. The Division found that these purchases appeared to be made for legitimate business purposes based generally on the perception by issuers that their securities had become substantially undervalued. Purchasing activity had a favorable impact on price performance, and the effect of the announcement of a repurchase program appeared to have a short-term

11/ Difference in means is statistically significant at the 90% level of confidence.

12/ Difference in means is statistically significant at the 97.5% level of confidence. Numbers in parentheses reflect the exclusion of one company that had an abnormal negative percentage change for the 2 hour period.

positive effect. The substantial purchasing level of a number of S&P 500 companies (11 companies purchased over 50% of their trading volume) does, however, raise concerns about market domination.

While most issuers apparently followed all but the time requirements in Rule 10b-18, the treatment of blocks under the Rule may effectively negate the volume restriction for many securities. As a result, a number of issuers were the predominant buy market force in their securities after they commenced their repurchase activity. It is not clear that this was a situation envisioned by the Commission when Rule 10b-18 was adopted. Accordingly, the staff expects to continue its review of the impact of issuer repurchases during the market break, and review the need for amendments to Rule 10b-18.

Table 6-5

PRICE PERFORMANCE OF S&P 500 COMPANIES  
 THAT DID NOT MAKE ANY PURCHASES  
 October 19-20

Non-Purchasing Companies	Percentage Price Change		Number of Companies
	Mean	Median	
Announced	-19.5	-18.7	9
Did Not Announce	-19.6	-19.2	398
Overall	-19.6	-19.1	407

(Difference in means is not statistically significant)

Table 6-6

PRICE PERFORMANCE OF S&P 500 COMPANIES  
 THAT DID NOT MAKE ANY PURCHASES  
 October 19-23

Non-Purchasing Companies	Percentage Price Change		Number of Companies
	Mean	Median	
Announced	-17.9	-21.3	18
Did Not Announce	-16.4	-16.3	353
Overall	-16.5	-16.8	371

(Difference in means is statistically significant at  
 the 60% level of confidence)

Table 6-7

PRICE PERFORMANCE OF S&P 500 COMPANIES  
 THAT MADE PURCHASES OF THEIR SHARES  
 October 19-20

Purchasing Companies	Percentage Price Change		Number of Companies
	Mean	Median	
Announced	-17.1	-16.9	27
Ongoing Programs	-17.7	-18.4	66
Overall	-17.5	-17.7	93

(Difference in means is statistically significant at  
 the 60% level of confidence)

Table 6-8

PRICE PERFORMANCE OF S&P 500 COMPANIES  
 THAT MADE PURCHASES OF THEIR SHARES  
 October 19-23

Purchasing Companies	Percentage Price Change		Number of Companies
	Mean	Median	
Announced	-16.0	-16.9	60
Ongoing Programs	-14.2	-15.7	69
Overall	-15.0	-15.8	129

(Difference in means is statistically significant at  
 the 75% level of confidence)

Table 6-9

BETA ADJUSTED  
 PRICE PERFORMANCE OF S&P 500 COMPANIES  
 THAT DID NOT MAKE ANY PURCHASES  
 October 19-20

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Non-Purchasing Companies	Percentage Price Change		Number of Companies
	Mean	Median	
Announced	3.1	5.1	9
Did Not Announce	0.7	2.1	398
Overall	0.8	2.2	407

(Difference in means is statistically significant at  
 the 90% level of confidence)

Table 6-10

BETA ADJUSTED  
 PRICE PERFORMANCE OF S&P 500 COMPANIES  
 THAT DID NOT MAKE ANY PURCHASES  
 October 19-23

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Non-Purchasing Companies	Percentage Price Change		Number of Companies
	Mean	Median	
Announced	-1.1	-2.5	18
Did Not Announce	0.5	1.5	353
Overall	0.4	1.4	371

(Difference in means is statistically significant at  
 the 75% level of confidence)

Table 6-11

BETA ADJUSTED  
 PRICE PERFORMANCE OF S&P 500 COMPANIES  
 THAT MADE PURCHASES OF THEIR SHARES  
 October 19-20

Purchasing Companies	Percentage Price Change		Number of Companies
	Mean	Median	
Announced	4.3	6.1	27
Ongoing Programs	2.7	2.9	66
Overall	3.2	3.3	93

(Difference in means is statistically significant at  
 the 75% level of confidence)

Table 6-12

BETA ADJUSTED  
 PRICE PERFORMANCE OF S&P 500 COMPANIES  
 THAT MADE PURCHASES OF THEIR SHARES  
 October 19-23

Purchasing Companies	Percentage Price Change		Number of Companies
	Mean	Median	
Announced	2.5	2.5	60
Ongoing Programs	2.8	3.1	69
Overall	2.7	2.8	129

(Difference in means is not statistically significant)

