



<b>Regulatory Information Circular</b>			
<b>Circular Number:</b>	2006-02	<b>Contact:</b>	Katherine Simmons
<b>Date:</b>	January 25, 2006	<b>Telephone:</b>	212/897-0233

### **Subject: Proposed Rule Change Notice – NYSE Margin Rules**

Pursuant to ISE Rule 1202(a), which states that Members must elect to be bound by the initial and maintenance margin requirements of either the CBOE or the NYSE as the same may be in effect from time to time, this Regulatory Information Circular informs Members of a proposed rule change to the NYSE's Rule 431 ("Margin Requirements") and Rule 726 ("Delivery of Options Disclosure Document and Prospectus") published by the Securities and Exchange Commission, attached.

In the January 23, 2006 *Federal Register*, the Commission published a notice of filing of a proposed rule change by the NYSE (SR-NYSE-2005-93) that would expand the scope of products that are eligible for treatment under the SEC's approved Portfolio Margin Pilot Program (the "Pilot"). The proposed rule change also includes amendments to the Options Disclosure Document to include SEC approved products under the Pilot (Securities Exchange Act Release No. 34-53126 (January 13, 2006)).

Please contact me with any questions.

amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing also will be available for inspection and copying at the principal offices of NASD. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-NASD-2005-144 and should be submitted on or before February 13, 2006.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>6</sup>

Nancy M. Morris,  
Secretary.

[FR Doc. E6-663 Filed 1-20-06; 8:45 am]

BILLING CODE 8010-01-P

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-53126; File No. SR-NYSE-2005-93]

### Self-Regulatory Organizations; New York Stock Exchange, Inc; Notice of Filing of Proposed Rule Change to Rule 431 ("Margin Requirements") and Rule 726 ("Delivery of Options Disclosure Document and Prospectus") To Expand the Products Eligible for Customer Portfolio Margining and Cross-Margining

January 13, 2006.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the "Exchange Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on December 29, 2005, the New York Stock Exchange, Inc. ("NYSE" or the "Exchange") filed with the Securities and Exchange Commission (the "Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Exchange. The Commission is publishing this notice to

solicit comments on the proposed rule change from interested persons.

#### I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The NYSE is filing with the Commission proposed amendments to NYSE Rule 431 ("Margin Requirements") that would expand the scope of products that are eligible for treatment as part of the Commission's approved Portfolio Margin Pilot Program (the "Pilot").<sup>3</sup> Amendments to Rule 726 ("Options Disclosure Document") also are proposed to include the Commission approved products on the disclosure document required to be furnished to customers pursuant to this rule. The text of the proposed rule change is below. Additions are in italics. Deletions are in brackets.

\* \* \* \* \*

#### Margin Requirements

Rule 431. (a) through (f) unchanged.

#### Portfolio Margin and Cross-Margin [for Index Options]

(g) As an alternative to the ["strategy" based] "strategy-based" margin requirements set forth in sections [paragraphs] (a) through (f) of this Rule, member organizations may elect to apply the portfolio margin requirements set forth in this section (g) to [margin for] (1) listed, broad-based U.S. index options, index warrants and underlying instruments and (2) listed security futures contracts<sup>4</sup> and listed single stock options, (See section (g)(6)(C)(1)). [(as defined below) in accordance with the portfolio margin requirements set forth in this Rule.]

In addition, member organizations, provided they are a Futures Commission Merchant ("FCM") and are either a clearing member of a futures clearing organization or have an affiliate that is a clearing member of a futures clearing organization, are permitted under this

<sup>3</sup> See Securities Exchange Act Release No. 52031 (July 14, 2005), 70 FR 42130 (July 21, 2005), (SR-NYSE-2002-19). On July 14, 2005, the Commission approved on a Pilot Basis expiring July 31, 2007, amendments to Exchange Rule 431 to permit the use of a prescribed risk-based margin requirement ("portfolio margin") for certain specified products as an alternative to the strategy based margin requirements currently required in section (a) through (f) of the Rule. Amendments to Rule 726 were also approved to require disclosure to, and written acknowledgement from, customers in connection with the use of portfolio margin. See NYSE Information Memo 05-56, dated August 18, 2005 for additional information.

<sup>4</sup> For purposes of this section of the Rule, the term "security future" utilizes the definition at section 3(a)(55) of the Exchange Act, excluding narrow-based security indices.

section (g) to combine an eligible participant's [a customer's] related instruments [(] as defined in section (g)(2)(C), [below) and] with listed, broad-based U.S. index options, index warrants and underlying instruments and compute a margin requirement for such combined products [(("cross margin"")] on a portfolio margin basis[.](("cross-margin"). Member organizations must confine cross-margin positions to a portfolio margin account dedicated exclusively to cross-margining.

The portfolio margin and cross-margining provisions of this Rule shall not apply to Individual Retirement Accounts ("IRAs").

(1) Member organizations must [will be expected to] monitor the risk of portfolio margin accounts and maintain a written risk analysis methodology for assessing the potential risk to the member organization's capital over a specified range of possible market movements of positions maintained in such accounts. The risk analysis methodology shall specify the computations to be made, the frequency of computations, the records to be reviewed and maintained, and the person(s) [position(s)] within the organization responsible for the risk function. This risk analysis methodology shall be made available to the Exchange upon request. In performing the risk analysis of portfolio margin accounts required by this Rule, each member organization shall include the following in the written risk analysis methodology:

(A) Procedures and guidelines for the determination, review and approval of credit limits to each eligible participant, [customer,] and across all eligible participants, [customers,] utilizing a portfolio margin account.

(B) Procedures and guidelines for monitoring credit risk exposure to the member organization, including intraday credit risk, related to portfolio margin accounts.

(C) Procedures and guidelines for the use of stress testing of portfolio margin accounts in order to monitor market risk exposure from individual accounts and in the aggregate.

(D) Procedures providing for the regular review and testing of these risk analysis procedures by an independent unit such as internal audit or other comparable group.

(2) Definitions.—For purposes of this section [paragraph] (g), the following terms shall have the meanings specified below:

(A) The term "listed option" [shall] means any option traded on a registered national securities exchange or

<sup>6</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

automated facility of a registered national securities association.

(B) [(F)] The term “underlying instrument” means long and short positions in an exchange traded fund or other fund product registered under the Investment Company Act of 1940, that holds the same securities, and in the same proportion, as contained in a broad-based index on which options are listed. The term “underlying instrument” shall not be deemed to include[,] futures contracts, options on futures contracts, underlying stock baskets, or unlisted instruments.

(C) [(E)] The term “related instrument” within an option class or product group means futures contracts and options on futures contracts covering the same underlying instrument.

(D) [(B)] The term “options class” refers to all options contracts covering the same underlying instrument.

(E) [(C)] The term “portfolio” means any eligible product, as defined in section (g)(6)(C)(1), [options of the same options class] grouped with their underlying instruments and related instruments.

(F) [(D)] The term “option series” relates to listed options and means all option contracts of the same type (either a call or a put) and exercise style, covering the same underlying instrument with the same exercise price, expiration date, and number of underlying units.

(G) The term “product group” means two or more portfolios of the same type (see table in section [sub-paragraph] (g)(2) [(H)] (I) below) for which it has been determined by Rule 15c3-1a under the Securities Exchange Act of 1934 that a percentage of offsetting profits may be applied to losses at the same valuation point.

(H) For purposes of portfolio margin and cross-margin the term “equity”, as defined in section (a)(4) of this Rule, includes the market value of any long or short option positions held in an eligible participant's account.

(I) [(H)] The term “theoretical gains and losses” means the gain and loss in the value of individual eligible products [option series] and related instruments at 10 equidistant intervals (valuation points) ranging from an assumed movement (both up and down) in the current market value of the underlying instrument. The magnitude of the

valuation point range shall be as follows:<sup>5 6</sup>

Portfolio type	Up/down market move (high & low valuation points)
Listed Security Futures Contract and Listed Single Stock Option .....	+/- 15%
Non-High Capitalization, Broad-based U.S. Market Index Option .....	+/- 10%
High Capitalization, Broad-based U.S. Market Index Option .....	+6%/- 8%

(3) Approved Theoretical Pricing Models.—Theoretical pricing models must be approved by a Designated Examining Authority and reviewed by the Securities and Exchange Commission (“The Commission”) in order to qualify. Currently, the theoretical model utilized by [The] the Options Clearing Corporation (“[The] OCC”)[.] is the only model qualified pursuant to [The] the Commission's Net Capital Rule. All member organizations [participating in the pilot program] shall obtain their theoretical values from [The] the OCC.

(4) Eligible Participants.—The application of the portfolio margin provisions of this section [paragraph] (g), including cross-margining, is limited to the following:

(A) any broker or dealer registered pursuant to Section 15 of the Securities Exchange Act of 1934;

(B) any member of a national futures exchange to the extent that listed index options hedge the member's index futures; and

(C) any other person or entity not included in sections (g)(4)(A) and [through] (g)(4)(B) above that has or establishes, and maintains, equity of at least five [5] million dollars. For purposes of this equity requirement, all securities and futures accounts carried by the member organization for the same eligible participant [customer] may be combined provided ownership across the accounts is identical. A guarantee pursuant to section [paragraph] (f)(4) of this Rule is not permitted for purposes of the minimum equity requirement. For those accounts that are solely limited to listed security

<sup>5</sup> In accordance with section [sub-paragraph] (b)(1)(i)(B) of Rule 15c3-1a (Appendix A to Rule 15c3-1) under the Securities Exchange Act of 1934, 17 CFR 240.15c3-1a(b)(1)(i)(B).

<sup>6</sup> See footnote above.

<sup>7</sup> For purposes of this Rule, the term “related instruments,” within an option class or product means futures contracts and options on futures contracts covering the same underlying instrument.

futures contracts and listed single stock options, the five million dollar equity requirement shall be waived.

(5) Opening of Accounts.

(A) Member organizations must notify and receive approval from the Exchange prior to establishing a portfolio margin or cross-margin methodology for eligible participants.

(B) [(A)] Only eligible participants [customers] that have been approved for options transactions and approved to engage in uncovered short option contracts pursuant to Exchange Rule 721, are permitted to utilize a portfolio margin account.

(C) [(B)] On or before the date of the initial transaction in a portfolio margin account, a member organization shall:

(1) [(i)] furnish the eligible participant [customer] with a special written disclosure statement describing the nature and risks of portfolio margining and cross-margining which includes an acknowledgement for all portfolio margin account owners to sign, and an additional acknowledgement for owners that also engage in cross-margining to sign, attesting that they have read and understood the disclosure statement, and agree to the terms under which a portfolio margin account and the cross-margin account respectively, are provided (see Exchange Rule 726 (d)), and (2) [(ii)] obtain the signed acknowledgement(s) noted above from the eligible participant [customer] (both of which are required for cross-margining eligible participants [customers]) and record the date of receipt.

(6) Establishing Account and Eligible Positions.

(A) [(1)] Portfolio Margin Account. For purposes of applying the portfolio margin requirements [provided] prescribed in this [paragraph] section (g), member organizations are to establish and utilize a specific securities margin account, or sub-account of a margin account, clearly identified as a portfolio margin account that is separate from any other securities account carried for an eligible participant [a customer].

(B) [(2)] Cross-Margin Account. For purposes of combining related instruments [and] with listed, broad-based U.S. index options, index warrants, and underlying instruments, and applying the portfolio margin requirements, member[s] organizations are to establish [and utilize a portfolio margin account, clearly identified as] a cross-margin account[,] that is separate from any other securities account or portfolio margin account carried for an eligible participant. [a customer.]

A margin deficit in either the portfolio margin account or the cross-margin account of an *eligible participant* [a customer] may not be considered as satisfied by excess equity in the other account. Funds and/or securities must be transferred to the deficient account and a written record created and maintained.

(C) [(A)] Portfolio Margin Account—Eligible [Positions] Products

(1) For *eligible participants* as described in sections (g)(4)(A) through (g)(4)(C), [(i) A] a transaction in, or transfer of, [a listed, broad-based U.S. index option or index warrant] an *eligible product* may be effected in the portfolio margin account. *Eligible products under this section consist of:*

(i) a listed, broad-based U.S. index option or index warrant and underlying instrument.

(ii) a listed security futures contract or listed single stock option.

(2) [(ii)] A transaction in, or transfer of, an underlying instrument may be effected in the portfolio margin account provided a position in an offsetting listed, broad-based U.S. index option or index warrant is in the account or is established in the account on the same day.

(3) A transaction in, or transfer of, a listed security futures contract or listed single stock option may also be effected in the portfolio margin account.

(4) Any long position or any short position in any *eligible product* that is no longer part of a hedge strategy must be transferred from the portfolio margin account to the appropriate securities account within ten business days, subject to any applicable margin requirement, unless the position becomes part of a hedge strategy again. Member organizations must monitor portfolio margin accounts for possible abuse of this provision.

[(iii)] If, in the portfolio margin account, the listed, broad-based U.S. index option or index warrant position offsetting an underlying instrument position ceases to exist and is not replaced within ten business days, the underlying instrument position must be transferred to a regular margin account, subject to initial Regulation T and margined according to the other provisions of this Rule. Member organizations will be expected to monitor portfolio margin accounts for possible abuse of this provision.

(iv) In the event that fully paid for long options and/or index warrants are the only positions contained within a portfolio margin account, such long positions must be transferred to a securities account other than a portfolio margin account or cross-margin account

within 10 business days, subject to the margin required, unless the status of the account changes such that it is no longer composed solely of fully paid for long options and/or index warrants.]

(D)[(B)] Cross-Margin Account—

Eligible [Positions] Products

(1) For *eligible participants*, as described in sections (g)(4)(A) through (g)(4)(C), a transaction in, or transfer of, an *eligible product* may be effected in the cross-margin account.

(2) [(i)] A transaction in, or transfer of, a related instrument may be effected in the cross-margin account provided a position in an offsetting *eligible product* [listed, U.S. broad-based index option, index warrant or underlying instrument] is in the account or is established in the account on the same day.

(3) Any long position or any short position in any *eligible product* that is no longer part of a hedge strategy must be transferred from the cross-margin account to the appropriate securities account or futures account within ten business days, subject to any applicable margin requirement, unless the position becomes part of a hedge strategy again. Member organizations must monitor cross-margin accounts for possible abuse of this provision.

[(ii)] If the listed, U.S. broad-based index option, index warrant or underlying instrument position offsetting a related instrument ceases to exist and is not replaced within ten business days, the related instrument position must be transferred to a futures account and margined accordingly. Member organizations will be expected to monitor cross-margin accounts for possible abuse of this provision.

[(iii)] In the event that fully paid for long options and/or index warrants (securities) are the only positions contained within a cross-margin account, such long positions must be transferred to a securities account other than a portfolio margin account or cross margin account within 10 business days, subject to the margin required, unless the status of the account changes such that it is no longer composed solely of fully paid for long options and/or index warrants.]

(7) Initial and Maintenance Margin Required.—The amount of margin required under this section [paragraph] (g) for each portfolio shall be the greater of:

(A) the amount for any of the 10 equidistant valuation points representing the largest theoretical loss as calculated pursuant to section [paragraph] (g)(8) below, or

(B) \$.375 for each *contract* [listed index option] and related instrument multiplied by the contract's or

instrument's multiplier, not to exceed the market value in the case of long positions in *eligible products*. [listed options and options on futures contracts.]

(C) Account guarantees pursuant to section [paragraph] (f)(4) of this Rule are not permitted for purposes of meeting initial and maintenance margin requirements.

(8) Method of Calculation.

(A) Long and short *contracts*, [positions in listed options,] including underlying instruments and related instruments, are to be grouped [by option class; each option class group being] as a "portfolio." [.] Each portfolio is categorized as one of the portfolio types specified in section [sub-paragraph] (g)(2)(I) [(H)] above.

(B) For each portfolio, theoretical gains and losses are calculated for each position as specified in section [sub-paragraph] (g)(2)(I) [(H)] above. For purposes of determining the theoretical gains and losses at each valuation point, member organizations shall obtain and utilize the theoretical values of *eligible products* as described in this section [a listed index option, underlying instrument or related instrument] rendered by an *approved* [a] theoretical pricing model. [that, in accordance with sub-paragraph (b)(1)(i)(B) of Rule 15c3-1a under the Securities Exchange Act of 1934, qualifies for purposes of determining the amount to be deducted in computing net capital under a portfolio based methodology.]

(C) Offsets. Within each portfolio, theoretical gains and losses may be netted fully at each valuation point.

Offsets between portfolios within *eligible product groups*, as described in section (g)(2)(I), [the High Capitalization, Broad-based Index Option product group and the Non-High Capitalization, Broad-based Index Option product group] may then be applied as permitted by Rule 15c3-1a under the Securities Exchange Act of 1934.

(D) After applying the [Offsets] *offsets* above, the sum of the greatest loss from each portfolio is computed to arrive at the total margin required for the account (subject to the per contract minimum).

(9) *Portfolio Margin Minimum Equity Call* [Equity Deficiency] .—

(A) If, at any time, the equity in the portfolio margin or cross-margin account of an *eligible participant*, as described in section (g)(4)(C), declines below the [5] five million dollar minimum equity required, [under sub-paragraph (4)(D) of this paragraph (g)] and is not restored to at least [5] five million dollars within three [(3)] business days (T+3) by a deposit of

funds and/or securities, [;] member organizations are prohibited from accepting opening orders starting on T+4, except that opening orders entered for the purpose of hedging existing positions may be accepted if the result would be to lower margin requirements. This prohibition shall remain in effect until equity of five [5] million dollars is established. *For those accounts that are solely limited to security futures contracts and single stock options, the five million dollar equity requirement shall be waived.*

(B) Member organizations will not be permitted to deduct any portfolio margin minimum equity call amount from Net Capital in lieu of collecting the minimum equity required.

(10) [(11)] Portfolio Margin Maintenance Call [Additional Margin. —]

(A) If at any time, the equity in the [any] portfolio margin or cross-margin account of an eligible participant, as described in sections (g)(4)(A) through (g)(4)(C), is less than the margin required, the eligible participant [customer] may deposit additional margin or establish a hedge to meet the margin requirement within [one] three business days [(T+1)] (T+3). During the three business day period, member organizations are prohibited from accepting opening orders, except that opening orders entered for the purpose of hedging existing positions may be accepted if the result would be to lower margin requirements. In the event an eligible participant [a customer] fails to hedge existing positions or deposit additional margin within [one] three business days, the member organization must liquidate positions in an amount sufficient to, at a minimum, lower the total margin required to an amount less than or equal to the account equity. [Paragraph (f)(7) of this Rule—Practice of Meeting Regulation T Margin Calls by Liquidation Prohibited shall not apply to portfolio margin accounts. However, member organizations will be expected to monitor portfolio margin and cross-margin accounts for possible abuse of this provision.]

(B) If the portfolio margin maintenance call is not met by the close of business T+1, member organizations will be required to deduct from Net Capital the amount of the call until such time the call is satisfied.

(C) Member organizations will not be permitted to deduct any portfolio margin maintenance call amount from Net Capital in lieu of collecting the margin required.

(11) [(10)] Determination of Value for Margin Purposes.—For the purposes of this section [paragraph] (g), all eligible

products [listed index options] and related instrument positions shall be valued at current market prices. Account equity for the purposes of this section [paragraph] (g) shall be calculated separately for each portfolio margin or cross-margin account. [by adding the current market value of all long positions, subtracting the current market value of all short positions, and adding the credit (or subtracting the debit) balance in the account.]

(12) Net Capital Treatment of Portfolio Margin and Cross-Margin Accounts.

(A) No member organization that requires margin in any eligible participant [customer] account pursuant to section [paragraph] (g) of this Rule shall permit [gross] the aggregate eligible participant [customer] portfolio margin and cross-margin initial and maintenance requirements to exceed [1,000 percent] ten times [of] its net capital for any period exceeding three business days. The member organization shall, beginning on the fourth business day, cease opening new portfolio margin and cross-margin accounts until compliance is achieved.

(B) If, at any time, a member organization's [gross] aggregate eligible participant [customer] portfolio margin and cross-margin requirements exceed [1,000 percent] ten times [of] its net capital, the member organization shall immediately transmit telegraphic or facsimile notice of such deficiency to the principal office of the Securities and Exchange Commission in Washington, DC, [450 Fifth Street, NW., Washington, DC 20549; to] the district or regional office of the Securities and Exchange Commission for the district or region in which the member organization maintains its principal place of business; and to the New York Stock Exchange. [its Designated Examining Authority.]

(13) Day Trading Requirements.—The requirements of section [sub-paragraph] (f)(8)(B) of this Rule—Day-Trading shall not apply to portfolio margin accounts or [including] cross-margin accounts.

(14) Cross-Margin Accounts—Requirements to Liquidate

(A) A member is required immediately either to liquidate, or transfer to another broker-dealer eligible to carry cross-margin accounts, all eligible participant [customer] cross-margin accounts that contain positions eligible for cross-margining [in futures and/or options on futures] if the member is:

(1) [(i)] insolvent as defined in section 101 of title 11 of the United States Code, or is unable to meet its obligations as they mature;

(2) [(ii)] the subject of a proceeding pending in any court or before any agency of the United States or any State in which a receiver, trustee, or liquidator for such debtor has been appointed;

(3) [(iii)] not in compliance with applicable requirements under the Securities Exchange Act of 1934 or rules of the Securities and Exchange Commission or any self-regulatory organization with respect to financial responsibility or hypothecation of eligible participant's [customer's] securities; or

(4) [(iv)] unable to make such computations as may be necessary to establish compliance with such financial responsibility or hypothecation rules.

(B) Nothing in this section [paragraph] (14) shall be construed as limiting or restricting in any way the exercise of any right of a registered clearing agency to liquidate or cause the liquidation of positions in accordance with its by-laws and rules.

\* \* \* \* \*

#### Delivery of Options Disclosure Document and Prospectus

Rule 726 (a) through (c) unchanged.

#### Portfolio Margining and Cross-Margining Disclosure Statement and Acknowledgement

(d) The special written disclosure statement describing the nature and risks of portfolio margining and cross-margining, and acknowledgement for an eligible participant [customer] signature, required by Rule 431(g)(5)(B) shall be in a format prescribed by the Exchange or in a format developed by the member organization, provided it contains substantially similar information as in the prescribed Exchange format and has received the prior written approval of the Exchange.

#### Sample Portfolio Margining and Cross-Margining Risk Disclosure Statement To Satisfy Requirements of Exchange Rule 431(g)

##### Overview of Portfolio Margining

1. Portfolio margining is a margin methodology that sets margin requirements for an account based on the greatest projected net loss of all positions in a "product class" or "product group" as determined by an options pricing model using multiple pricing scenarios. These pricing scenarios are designed to measure the theoretical loss of the positions given changes in both the underlying price and implied volatility inputs to the model. Portfolio margining is currently

limited to product classes and groups of index products relating to *listed*, broad-based market indexes, *listed security futures contracts* and *listed single stock options*.

2. The goal of portfolio margining is to set levels of margin that more precisely reflects actual net risk. The *eligible participant* [customer] benefits from portfolio margining in that margin requirements calculated on net risk are generally lower than alternative "position" or "strategy" based methodologies for determining margin requirements. Lower margin requirements allow the customer more leverage in an account.

#### Customers Eligible for Portfolio Margining

3. To be eligible for portfolio margining, customers (other than broker-dealers) must meet the basic standards for having an options account that is approved for uncovered writing and must have and maintain at all times account net equity of not less than [\$5] *five million dollars*, aggregated across all accounts under identical ownership at the clearing broker. [The] *This* identical ownership requirement excludes accounts held by the same customer in different capacities (e.g., as a trustee and as an individual) and accounts where ownership is overlapping but not identical (e.g., individual accounts and joint accounts). *For those accounts that are solely limited to listed security futures contracts and listed single stock options, the five million dollar equity requirement shall be waived.*

#### Positions Eligible for a Portfolio Margin Account

4. All positions in *listed security futures contracts, listed single stock options, listed, broad-based U.S. market index options* [and] *index warrants*, [listed on a national securities exchange, and] *exchange traded funds* and other products registered under the Investment Company Act of 1940 that are managed to track the same index that underlies permitted index options, are eligible for a portfolio margin account.

#### Special Rules for Portfolio Margin Accounts

5. A portfolio margin account may be either a separate account or a sub-account of a customer's *standard* [regular] margin account. In the case of a sub-account, equity in the *standard* [regular] account will be available to satisfy any margin requirement in the portfolio margin sub-account without transfer to the sub-account.

6. A portfolio margin account or sub-account will be subject to a minimum margin requirement of \$.375 multiplied by the *contract's* [index] multiplier for every *contract* [option contract or index warrant] carried long or short in the account. No minimum margin is required in the case of eligible exchange traded funds or other eligible fund products.

7. Margin calls in the portfolio margin account or sub-account, regardless of whether due to new commitments or the effect of adverse market [moves] *movements* on existing positions, must be met within [one] *three* business days. Any shortfall in aggregate net equity across accounts must be met within three business days. Failure to meet a *portfolio margin maintenance* call when due will result in immediate liquidation of positions to the extent necessary to reduce the margin requirement. Failure to meet [an] *a minimum* equity call prior to the end of the third business day will result in a prohibition on entering any opening orders, with the exception of opening orders that hedge existing positions, beginning on the fourth business day and continuing until such time as the minimum equity requirement is satisfied.

8. A position in an exchange traded index fund or other eligible fund product may not be established in a portfolio margin account unless there exists, or there is established on the same day, an offsetting position in securities options, or other eligible securities. *The position(s)* [Exchange traded index funds and/or other eligible funds] will be transferred out of the portfolio margin account and into a *standard* [regular] securities account subject to *any applicable margin requirement* [initial Regulation T and NYSE Rule 431 margin] if the offsetting securities options, other eligible securities and/or related instruments no longer remain in the account for ten business days.

9. When a broker-dealer carries a *standard* [regular] cash account or margin account for a customer, the broker-dealer is limited by rules of the Securities and Exchange Commission and of The Options Clearing Corporation ("OCC") to the extent to which the broker-dealer may permit OCC to have a lien against long option positions in those accounts. In contrast, OCC will have a lien against all long option positions that are carried by a broker-dealer in a portfolio margin account, and this could, under certain circumstances, result in greater losses to a customer having long option positions in such an account in the event of the insolvency of the customer's broker.

Accordingly, to the extent that a customer does not borrow against long option positions in a portfolio margin account or have margin requirements in the account against which the long option can be credited, there is no advantage to carrying the long options in a portfolio margin account and the customer should consider carrying them in an account other than a portfolio margin account.

#### Special Risks of Portfolio Margin Accounts

10. Portfolio margining generally permits greater leverage in an account, and greater leverage creates greater losses in the event of adverse market movements.

11. Because the time limit for meeting margin calls is shorter than in a *standard* [regular] margin account, there is increased risk that a customer's portfolio margin account will be liquidated involuntarily, possibly causing losses to the customer.

12. Because portfolio margin requirements are determined using sophisticated mathematical calculations and theoretical values that must be calculated from market data, it may be more difficult for customers to predict the size of future margin calls in a portfolio margin account. This is particularly true in the case of customers who do not have access to specialized software necessary to make such calculations or who do not receive theoretical values calculated and distributed periodically by The Options Clearing Corporation.

13. For the reasons noted above, a customer that carries long options positions in a portfolio margin account could, under certain circumstances, be less likely to recover the full value of those positions in the event of the insolvency of the carrying broker.

14. Trading of securities index products in a portfolio margin account is generally subject to all the risks of trading those same products in a *standard* [regular] securities margin account. Customers should be thoroughly familiar with the risk disclosure materials applicable to those products, including the booklet entitled "Characteristics and Risks of Standardized Options".

15. Customers should consult with their tax advisers to be certain that they are familiar with the tax treatment of transactions in securities *options* [index] and *futures* products.

16. The descriptions in this disclosure statement relating to eligibility requirements for portfolio margin accounts, and minimum equity and margin requirements for those accounts,

are minimums imposed under Exchange rules. Time frames within which margin and equity calls must be met are maximums imposed under Exchange rules. Broker-dealers may impose their own more stringent requirements.

#### Overview Of Cross-Margining

17. In a cross-margin account, [With cross-margining,] index futures, [and] options on index futures are combined with offsetting positions in securities index options and underlying instruments, for the purpose of computing a margin requirement based on the net risk. This generally produces lower margin requirements than if the related instruments<sup>7</sup> and securities products are viewed separately, thus providing more leverage in the account.

18. Cross-margining must be *effected* [done] in a portfolio margin account type. A separate portfolio margin account must be established exclusively for cross-margining.

19. *Cross-margining is achieved when* [When] index futures and options on futures are combined with offsetting positions in index options and underlying instruments in a dedicated account, and a portfolio margining methodology is applied to them. [Cross-margining is achieved.]

#### Customers Eligible for Cross-Margining

20. The eligibility requirements for cross-margining are generally the same as for portfolio margining. [Accordingly,] [and] any customer eligible for portfolio margining is eligible for cross-margining.

21. Members of futures exchanges on which cross-margining eligible index contracts are traded are also permitted to carry positions in cross-margin accounts without regard to the minimum aggregate account equity.

#### Positions Eligible for Cross-Margining

22. All securities products eligible for portfolio margining are also eligible for cross-margining.

23. All broad-based U.S. listed market index futures and options on index futures traded on a designated contract market subject to the jurisdiction of the Commodity Futures Trading Commission ("CFTC") are eligible for cross-margining.

#### Special Rules for Cross-Margining

24. Cross-margining must be conducted in a portfolio margin account type. A separate portfolio margin account must be established exclusively

for cross-margining. A cross-margin account is a securities account, and must be maintained separately from all other securities account.

25. Cross-margining is automatically accomplished with the portfolio margining methodology. Cross-margin positions are subject to the same minimum margin requirement for every contract, including futures contracts.

26. Margin calls arising in a cross-margin account, and any shortfall in aggregate net equity across accounts, must be satisfied within the same timeframe, and subject to the same consequences, as in a portfolio margin account.

27. A position in a futures product may not be established in a cross-margin account unless there exists, or there is established on the same day, an offsetting position in securities options and/or other eligible securities. Related instruments will be transferred out of the cross-margin account and into a futures account if, for more than ten business days and for any reason, the offsetting securities options and/or other eligible securities no longer remain in the account. If the transfer of related instruments to a futures account causes the futures account to be undermargin, a margin call will be issued or positions will be liquidated to the extent necessary to eliminate the deficit.

28. Customers participating in cross-margining will be required to sign an agreement acknowledging that their positions and property in the cross-margin account will be subject to the customer protection provisions of Rule 15c3-3 under the Securities Exchange Act of 1934 and the Securities Investor Protection Act, and will not be subject to the provisions of the Commodity Exchange Act, including segregation of funds.

29. According to the rules of the exchanges, a broker-dealer is required to immediately liquidate[,] or, if feasible, transfer to another broker-dealer eligible to carry cross-margin accounts, all customer cross-margin accounts that contain positions in futures and/or options on futures in the event that the carrying broker-dealer becomes insolvent.

30. In signing the agreement referred to in paragraph 28 above, a customer also acknowledges that a cross-margin account that contains positions in futures and/or options on futures will be immediately liquidated, or, if feasible, transferred to another broker-dealer eligible to carry cross-margin accounts, in the event that the carrying broker-dealer becomes insolvent.

#### Special Risks of Cross-Margining

31. Cross-margining must be conducted in a portfolio margin account type. Generally, cross-margining and the portfolio margining methodology both contribute to provide greater leverage than a *standard* [regular] margin account, and greater leverage creates greater losses in the event of adverse market movements.

32. Since cross-margining must be conducted in a portfolio margin account type, the time required for meeting margin calls is shorter than in a *standard* [regular] securities margin account and may be shorter than the time ordinarily required by a futures commission merchant for meeting margin calls in a futures account. Consequently, there is increased risk that a customer's cross-margin positions will be liquidated involuntarily, causing possible loss to the customer.

33. As noted above, cross-margin accounts are securities accounts and are subject to the customer protections set forth in Rule 15c3-3 under the Securities Exchange Act of 1934 and the Securities Investor Protection Act. Cross-margin positions are not subject to the customer protection rules under the segregation provisions of the Commodity Exchange Act and the rules of the CFTC adopted pursuant to the Commodity Exchange Act.

34. Trading of index options and futures contracts in a cross-margin account is generally subject to all the risks of trading those same products in a futures account or a standard [regular] securities margin account. Customers should be thoroughly familiar with the risk disclosure materials applicable to those products, including the booklet entitled *Characteristics and Risks of Standardized Options* and the risk disclosure document required by the CFTC to be delivered to futures customers. Because this disclosure statement does not disclose the risks and other significant aspects of trading in futures and options, customers should review those materials carefully before trading in a cross-margin account.

35. Customers should bear in mind that the discrepancies in the cash flow characteristics of futures and certain options are still present even when those products are carried together in a cross-margin account. Both futures and options contracts are generally marked to the market at least once each business day, but the marks may take place with different frequency and at different times within the day. When a futures contract is marked to the market, the gain or loss is immediately credited to

<sup>7</sup> For purposes of this Rule, the term "related instruments," within an option class or product means futures contracts and options on futures contracts covering the same underlying instrument.

or debited from[, respectively,] the customer's account in cash. While an increase in the value of a long option contract may increase the equity in the account, the gain is not realized until the option is sold or exercised. Accordingly, a customer may be required to deposit cash in the account in order to meet a variation payment on a futures contract even though the customer is in a hedged position and has experienced a corresponding (but yet unrealized) gain on a long option. Alternatively, a customer who is in a hedged position and would otherwise be entitled to receive a variation payment on a futures contract may find that the cash is required to be held in the account as margin collateral on an offsetting option position.

36. Customers should consult with their tax advisers to be certain that they are familiar with the tax treatment of transactions in index products, including tax consequences of trading strategies involving both futures and option contracts.

37. The descriptions in this disclosure statement relating to eligibility requirements for cross-margining, and minimum equity and margin requirements for cross margin accounts, are minimums imposed under Exchange rules. Time frames within which margin and equity calls must be met are maximums imposed under Exchange rules. The broker-dealer carrying a customer's portfolio margin account, including any cross-margin account, may impose [its own] more stringent requirements.

\* \* \* \* \*

#### *Sample Portfolio Margining and Cross-Margining Acknowledgements*

##### **Acknowledgement for Customers Utilizing a Portfolio Margin Account—Cross-Margining And Non-Cross-Margining—**

Rule 15c3-3 under the Securities Exchange Act of 1934 requires that a broker or dealer promptly obtain and maintain physical possession or control of all fully-paid securities and excess margin securities of a customer. Fully-paid securities are securities carried in a cash account and margin equity securities carried in a margin or special account (other than a cash account) that have been fully paid for. Excess margin securities are a customer's margin securities having a market value in excess of 140% of the total of the debit balances in the customer's non-cash accounts. For the purposes of Rule 15c3-3, securities held subject to a lien to secure obligations of the broker-dealer are not within the broker-dealer's

physical possession or control. The Commission staff has taken the position that all long option positions in a customer's portfolio[-]margin account (including any cross-margin account) may be subject to such a lien by OCC and will not be deemed fully-paid or excess margin securities under Rule 15c3-3.

The hypothecation rules under the Securities Exchange Act of 1934 (Rules 8c-1 and 15c2-1)[,] prohibit broker-dealers from permitting the hypothecation of customer securities in a manner that allows those securities to be subject to any lien or liens in an amount that exceeds the customer's aggregate indebtedness. However, all long option positions in a portfolio[-]margin account (including any cross-margining account) will be subject to OCC's lien, including any positions that exceed the customer's aggregate indebtedness. The Commission staff has taken a position that would [to] allow customers to carry positions in portfolio[-]margin accounts[,] (including any cross-margining account) even when those positions exceed the customer's aggregate indebtedness. Accordingly, within a portfolio margin account or cross-margin account, to the extent that you have long option positions that do not operate to offset your aggregate indebtedness and thereby reduce your margin requirement, you receive no benefit from carrying those positions in your portfolio[-]margin account or cross-margin account and incur the additional risk of OCC's lien on your long option position(s).

By signing below the customer affirms that the customer has read and understood the foregoing disclosure statement and acknowledges and agrees that long option positions in portfolio[-]margin accounts, and cross-margining accounts, will be exempted from certain customer protection rules of the Securities and Exchange Commission as described above and will be subject to a lien by the options clearing corporation without regard to such rules.

Customer Name: \_\_\_\_\_

By: \_\_\_\_\_

Date: \_\_\_\_\_

(Signature/title)

##### **Acknowledgement for Customers Engaged in Cross-Margining**

As disclosed above, futures contracts and other property carried in customer accounts with Futures Commission Merchants ("FCM") are normally subject to special protection afforded under the customer segregation provisions of the Commodity Exchange

Act ("CEA") and the rules of the Commodity Futures Trading Commission adopted pursuant to the CEA. These rules require that customer funds be segregated from the accounts of financial intermediaries and be accounted for separately. However, they do not provide for, and *standard* [regular] futures accounts do not enjoy the benefit of, insurance protecting customer accounts against loss in the event of the insolvency of the intermediary carrying the accounts.

As discussed above, cross-margining must be conducted in a portfolio margin account, dedicated exclusively to cross-margining and cross-margin accounts are not treated as a futures account with an FCM. Instead, cross-margin accounts are treated as securities accounts carried with broker-dealers. As such, cross-margin accounts are covered by Rule 15c3-3 under the Securities Exchange Act of 1934, which protects customer accounts. Rule 15c3-3, among other things, requires a broker-dealer to maintain physical possession or control of all fully-paid and excess margin securities and maintain a special reserve account for the benefit of their customers. However, with regard to cross-margin accounts, there is an exception to the possession or control requirement of Rule 15c3-3 that permits The Options Clearing Corporation to have a lien on long positions. This exception is outlined in a separate acknowledgement form that must be signed prior to or concurrent with this form. Additionally, the Securities Investor Protection Corporation ("SIPC") insures customer accounts against the financial insolvency of a broker-dealer in the amount of up to \$500,000 to protect against the loss of registered securities and cash maintained in the account for purchasing securities or as proceeds from selling securities (although the limit on cash claims is \$100,000). According to the rules of the exchanges, a broker-dealer is required to immediately liquidate[, or, if feasible, transfer to another broker-dealer eligible to carry cross-margin accounts, all customer cross-margin accounts that contain positions in futures and/or options on futures in the event that the carrying broker-dealer becomes insolvent.

By signing below the customer affirms that the customer has read and understood the foregoing disclosure statement and acknowledges and agrees that: (1) Positions and property in cross-margining accounts, will not be subject to the customer protection rules under the customer segregation provisions of the Commodity Exchange Act and the



rules of the Commodity Futures Trading Commission adopted pursuant to the CEA and (2) cross-margining accounts that contain positions in futures and/or options on futures will be immediately liquidated, or if feasible, transferred to another broker-dealer eligible to carry cross-margin accounts in the event that the carrying broker-dealer becomes insolvent.

Customer Name: \_\_\_\_\_

By: \_\_\_\_\_

Date: \_\_\_\_\_

(Signature/title)

## II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the Exchange included statements concerning the purpose of, and basis for, the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

### A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

#### 1. Purpose

Amendments to NYSE Rule 431 ("Margin Requirements") are proposed that would include security futures<sup>8</sup> and single stock options as products eligible for treatment under portfolio margin requirements as part of the Portfolio Margin Pilot Program recently approved by the Commission. Amendments to Rule 726 ("Delivery of Options Disclosure Document and Prospectus") also are proposed to include the SEC approved products on the disclosure document required to be furnished to customers pursuant to this rule.

#### a. Background

Section 7(a)<sup>9</sup> of the Exchange Act of 1934<sup>10</sup> empowers the Board of Governors of the Federal Reserve System to prescribe the rules and regulations regarding credit that may be extended by broker-dealers on securities (Regulation T) to their customers. NYSE Rule 431 prescribes specific margin

requirements that must be maintained in all customer accounts, based on the type of securities products held in such accounts.

In April 1996, the Exchange established a Rule 431 Committee (the "Committee") to assess the adequacy of Rule 431 on an ongoing basis, review margin requirements, and make recommendations for change. A number of proposed amendments resulting from the Committee's recommendations have been approved by the Exchange's Board of Directors since the Committee was established. Similarly, the Committee has endorsed the proposed amendments discussed below.<sup>11</sup>

#### b. The Pilot

The Board of Governors of the Federal Reserve System in its amendments to Regulation T in 1998 permitted SROs to implement portfolio margin rules, subject to SEC approval.<sup>12</sup> As noted above, on July 14, 2005 the Commission approved amendments to Exchange Rules 431 and 726 to permit, on a two year pilot basis, the use of a prescribed risk-based methodology ("Portfolio Margin")<sup>13</sup> for certain products as an alternative to the strategy or position based margin requirements currently required in Rule 431(a) through (f). Exchange member organizations may utilize portfolio margin for listed, broad-based U.S. index options and index warrants, along with any underlying instruments.<sup>14</sup> These positions are to be margined (either for initial or

maintenance) in a separate portfolio margin account dedicated exclusively for such margin computation.

#### c. Strategy or Positioned-Based Margin Requirements

Prior to the Pilot, member organizations were subject, pursuant to NYSE Rule 431, to strategy or positioned-based margin requirements. This methodology applied specific margin percentage requirements as prescribed in Rule 431 to each security position and/or strategy, either long or short, held in a customer's account, irrespective of the fact that all security (e.g., options) prices do not change equally (in percentage terms) with a change in the price of the underlying security. As discussed in more detail below, when utilizing a portfolio margin methodology, offsets are fully realized, whereas under strategy or positioned-based methodology, positions and or groups of positions comprising a single strategy are margined independently of each other and offsets between them do not efficiently impact the total margin requirement.

#### d. Portfolio Margin Requirements

Portfolio margining is a margin methodology that sets margin requirements for an account based on the greatest projected net loss of all positions in a product class or group. The Pilot utilizes a Commission approved theoretical options pricing model using multiple pricing scenarios to set or determine the risk level.<sup>15</sup> These scenarios are designed to measure the theoretical loss of the positions given changes in both the underlying price and implied volatility inputs to the model. Accordingly, the margin required is based on the greatest loss that would be incurred in a portfolio if the value of its components move up or down by a predetermined amount.

Generally, the purpose and benefit of portfolio margining is to efficiently set levels of margin that reflect historical moves that more precisely reflects actual net risk of all positions in the account. A customer benefits from portfolio margining in that margin requirements calculated on net position

<sup>11</sup> The Committee is composed of several member organizations, including Goldman, Sachs & Co., Morgan Stanley & Co., Inc., Merrill Lynch, Pierce, Fenner and Smith, Inc., Bear Stearns Corp. and Credit Suisse First Boston Corp. and several self-regulatory organizations, including: the NYSE, the Chicago Board Options Exchange, the Options, Clearing Corporation, the American Stock Exchange, the Chicago Board of Trade, the Chicago Mercantile Exchange, and the National Association of Securities Dealers.

<sup>12</sup> See Federal Reserve System, "Securities Credit Transactions; Borrowing by Broker and Dealers;" Regulations G, T, U and X; Docket Nos. R-0905, R-0923 and R-0944, 63 FR 2806 (January 16, 1998).

<sup>13</sup> As a pre-condition to permitting portfolio margining, member organization are required to establish procedures and guidelines to monitor credit risk to the member organization's capital, including intra-day credit risk and stress testing of portfolio margin accounts. Further, member organizations must establish procedures for regular review and testing of these required risk analysis procedures (see Rule 431(g)(1)).

<sup>14</sup> For purposes of these amendments, the term "underlying instrument," means long and short positions in an exchange traded fund of other fund product registered under the Investment Company Act of 1940, that holds the same securities, and in the same proportion, as contained in a broad-based index on which options are listed. The term "underlying instrument" shall not be deemed to include futures contracts, options on futures contracts, underlying stock baskets, or unlisted instruments.

<sup>8</sup> For purposes of this filing term "security futures" utilizes the definition at Section 3(a)(55) of the Exchange Act, excluding narrow-based security indices.

<sup>9</sup> 15 U.S.C. 78g.

<sup>10</sup> 15 U.S.C. 78a et seq.

<sup>15</sup> The theoretical options pricing model is used to derive position values at each valuation point for the purpose of determining the gain or loss. The amount of initial and maintenance margin required with respect to a portfolio would be the larger of: (1) The greatest loss amount among the valuation calculations; or (2) the sum of \$.375 for each option and security future in the portfolio multiplied by the contract's (e.g. 100 shares per contract) or instrument's multiplier. This computation establishes a minimum margin requirement to ensure that a certain level of margin is required from a customer.

risk are generally lower than strategy-based margin methodologies currently in place. In permitting margin computation based on actual net risk, member organizations are no longer required to compute a margin requirement for each individual position or strategy in a customer's account (see NYSE Rule 431).

As discussed in more detail below, utilizing portfolio margin for options portfolios and any related instruments enables the portfolio to be subjected to certain preset market volatility parameters that reflect historical moves in the underlying security thereby assessing potential loss in the portfolio in the aggregate. Accordingly, such a methodology provides an accurate and realistic assessment of reasonable margin requirements.

#### e. Proposed Amendments

The Exchange and CBOE received letters in late September 2005 from Commission Chairman Christopher Cox asking the SROs to consider expanding portfolio margining to a broader universe of products. The Commission encouraged the Exchanges to file a rule proposal before year-end.<sup>16</sup> Accordingly, the Exchange is proposing the amendments discussed below.

#### f. Eligible Products/Minimum Equity Requirements

The proposed amendments to Rule 431 seek to expand the eligible products previously approved, provided all products can be priced within a prescribed risk-based theoretical pricing methodology. Specifically, the proposed amendments will expand the eligible products to include security futures as well as listed single stock options. The proposed amendments will also permit customers effecting transactions in security futures and listed single stock options to do so without maintaining the \$5 million equity requirement, which is currently required under the Pilot for all other eligible products.

#### g. Valuation Points

Further, the proposed amendments will establish theoretical prices at 10 equidistant valuation points within a range consisting of an increase or a decrease of  $\pm 15\%$ <sup>17</sup> (i.e.,  $\pm 3\%$ ,

6%, 9%, 12%, and 15%) in the current market value of the underlying instrument. As proposed, the price range for computing a portfolio margin requirement is the same parameter required under Appendix A of Rule 15c3-1a<sup>18</sup> under the Exchange Act for computing deductions to a firm's net capital for proprietary positions. Currently the only theoretical model qualified pursuant to Rule 15c3-1a under the Exchange Act is the Theoretical Intermarket Margin System ("TIMS") administered by The Options Clearing Corporation.

#### h. Margin Deficiency

In addition, the proposed amendments will require a member organization to deduct from its net capital the amount of any portfolio margin maintenance call which is not met by the close of business of trade date plus one (T+1).<sup>19</sup> Member organizations will not be permitted to deduct any portfolio margin maintenance call amount from net capital in lieu of collecting the required margin.

#### i. Definitions

The proposed amendments expand upon the core definition of the term "equity" as defined in section (a)(4) of Rule 431 (see proposed Rule 431(g)(2)(H) for purposes of portfolio margin and cross-margin to include the market value of any long or short option positions held in an eligible participant's account. In addition, other non-substantive changes and/or modification to other definitions in Rule 431 were made in light of the proposed amendments.

Options ( $\pm 10\%$ ) and High Capitalization/Broad-based U.S. Market Index Options ( $\pm 6\% - 8\%$ ).

<sup>16</sup> 17 CFR 240.15c3-1a(b)(1)(i)(B). The requirements of this rule include, among other things, that any model be non-proprietary, approved by a Designated Examining Authority ("DEA") and available on the same terms to all broker-dealers. Referencing to the SEC's net capital coupled with DEA approval and SEC review assures uniformity across pricing models and that portfolio and cross-margin requirements will not vary significantly from firm to firm.

<sup>19</sup> Several paragraphs in the proposed rule amendments use the term "portfolio margin maintenance call" rather than the term "portfolio margin maintenance deficiency." The proposed rule text was intended to measure the time period for a customer to meet a margin call or a member to make a deduction in calculating net capital from the time of the margin deficiency, not the time of the margin call. The Exchange has represented that it will amend the proposed rule changes to clarify this technical non-substantive change prior to any Commission approval of the proposed rule change. Telephone conversation between William Jannace, Director, Rule and Interpretive Standards, Member Firm Regulation, NYSE and Randall Roy, Branch Chief, and Sheila Swartz, Special Counsel, Division of Market Regulation, Commission, on January 13, 2006.

#### j. Disclosure Document and Customer Attestation

Exchange Rule 726 prescribes requirements for the delivery of options disclosure documents concerning the opening of customer accounts. As part of the Pilot amendments, members and member organizations are required to provide every portfolio margin customer with a written risk disclosure statement at or prior to the initial opening of a portfolio margin account. The disclosure statement is divided into two sections, one dealing with portfolio margining and the other with cross-margining. The statement discloses the special risk and operation of portfolio margin accounts, including cross-margining, and the differences between portfolio margin and strategy-based margin requirements. The disclosure statement also addresses who is eligible to open a portfolio margin account, the instruments that are allowed, and when deposits to meet margin and minimum equity are required.

In addition, at or prior to the time a portfolio margin account is initially opened, members and member organizations are required to obtain a signed acknowledgement regarding certain implications of portfolio margining (e.g. treatment under Exchange Act Rules 8c-1, 15c2-1 and 15c3-3) from the customer. Further, prior to providing cross-margining, members and member organizations are required to obtain a second signed customer acknowledgement relative to the segregation treatment for futures contracts and Securities Investor Protection Corporation coverage. As proposed, the disclosure document required by Rule 726 is being amended to incorporate the approved Commission products.

Finally, the filing includes several minor technical amendments to the rules for purposes of clarity and consistency.

## 2. Statutory Basis

The statutory basis for this proposed rule change is Section 6(b)(5)<sup>20</sup> of the Exchange Act which requires, among other things, that the rules of the Exchange are designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to perfect the mechanism of a free and

<sup>16</sup> Chairman of the Commission, Christopher Cox, in a letter dated September 27, 2005, to William J. Brodsky and John A. Thain, the Chief Executive Offices of CBOE and NYSE, respectively, encouraged each SRO to file a rule proposal to make portfolio margin available to equity options and security futures with the Commission by year-end 2005.

<sup>17</sup> The Pilot established valuation points for the following eligible products: Non-High Capitalization/Broad-based U.S. Market Index

<sup>20</sup> 15 U.S.C. 78f(b)(5).

open market and national market system, and in general to protect investors and the public interest. The proposed amendments are consistent with this section in that they will better align margin requirements with the actual risk of hedged products, will also potentially alleviate excess margin calls and potentially reduce the risk of forced liquidations of positions in customer accounts.

#### *B. Self-Regulatory Organization's Statement on Burden on Competition*

The Exchange does not believe that the proposed rule change will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.

#### *C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants or Others*

The Exchange has neither solicited nor received written comments on the proposed rule change.

### **III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action**

Within 35 days of the date of publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding, or (ii) as to which the Exchange consents, the Commission will:

- (A) By order approve such proposed rule change, as amended; or
- (B) Institute proceedings to determine whether the proposed rule change should be disapproved.

### **IV. Solicitation of Comments**

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Exchange Act. Comments may be submitted by any of the following methods:

#### *Electronic Comments*

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-NYSE-2005-93 on the subject line.

#### *Paper Comments*

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549-9303.

All submissions should refer to File Number SR-NYSE-2005-93. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing also will be available for inspection and copying at the principal office of the NYSE. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submission should refer to File Number SR-NYSE-2005-93 and should be submitted on or before February 13, 2006.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>21</sup>

**Nancy M. Morris,**  
Secretary.

[FR Doc. E6-668 Filed 1-20-06; 8:45 am]

BILLING CODE 8010-01-P

## **SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-53124; File No. SR-NYSE-2005-37]

### **Self-Regulatory Organizations; New York Stock Exchange, Inc.; Order Approving a Proposed Rule Change and Amendments No. 1 and 2 Thereto and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 3 Thereto Relating to Amendments to Certain Sections of the Exchange Constitution Concerning the Exchange's Hearing Board and Related Amendments to Exchange Rule 475 and Rule 476**

January 13, 2006.

#### **I. Introduction**

On May 23, 2005, the New York Stock Exchange, Inc. ("NYSE" or "Exchange") filed with the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to amend Article IX of the Exchange's Constitution and Exchange Rules 475 and 476 to modify certain aspects of the Exchange's disciplinary procedures and to provide a structure for a summary suspension hearing and a "call up" procedure for review by members of the Board of Directors ("Board"), certain members of the Board of Executives listed in NYSE Rule 476(f), any member of the Regulation, Enforcement and Listing Standards Committee, and either the Division of the Exchange that initiated the proceedings or the respondent. On September 9, 2005, the NYSE filed Amendment No. 1 to the proposed rule change. The proposed rule change, as amended by Amendment No. 1, was published for comment in the **Federal Register** on October 26, 2005.<sup>3</sup> The Commission received no comments regarding the proposal, as amended. On November 28, 2005 and December 2, 2005, the NYSE filed Amendments No. 2<sup>4</sup> and 3,<sup>5</sup> respectively, to the proposed rule change. This order approves the proposed rule change, as amended by

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See Securities Exchange Act Release No. 52638 (October 19, 2005), 70 FR 61866.

<sup>4</sup> In Amendment No. 2, the Exchange makes minor, non-substantive changes to the rule text contained in Exhibit 5 of the proposed rule change. This was a technical amendment and is not subject to notice and comment.

<sup>5</sup> In Amendment No. 3, the Exchange proposes that the proposed rule change, as amended, be implemented on or about April 1, 2006 and attaches a revised Exhibit 5 to reflect changes made to the rule text in Amendments No. 1 and 2.

<sup>21</sup> 17 CFR 200.30-3(a)(12).