Regulatory Information Circular			
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Date:	April 10, 2005	Telephone:	212/897-0233

Subject: Rule Change Notice – CBOE & 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 CBOE's and the NYSE's margin rules published by the Securities and Exchange Commission, attached.

In the April 6, 2006 *Federal Register*, the Commission published a notice of filing of a proposed rule change by the CBOE (SR-CBOE-2006-14) that proposes to broaden its Rule 12.4 – Portfolio Margin and Cross margin for Index Options – to allow portfolio margining of listed equity options, narrow-based index options, and security futures, as well as certain OTC instruments. (Securities Exchange Act Release No. 34-53576 (March 30, 2006)).

The Commission, in the April 6, 2006 *Federal Register*, also published a notice of filing of a proposed rule change by the NYSE (SR-NYSE-2006-13) that would, among other things, further expand the scope of products that are eligible for treatment as part of the Commission approved Portfolio Margin Pilot Program and eliminate the requirement for a separate cross margin account for margining eligible security products with eligible commodity products. (Securities Exchange Act Release No. 34-53577 (March 30, 2006)).

Please contact me with any questions.

of the bid-ask price [56] in relation to the NAV as of the time the NAV is calculated (the "Bid-Ask Price"); (3) calculation of the premium or discount of such price against such NAV; (4) data in chart form displaying the frequency distribution of discounts and premiums of the Bid-Ask Price against the NAV, within appropriate ranges for each of the four (4) previous calendar quarters; (5) the prospectus and the most recent periodic reports filed with the Commission or required by the CFTC; and (6) other applicable quantitative information. In addition, information on USOF's daily portfolio holdings will be available on its Web site at (*http://www.unitedstatesoilfund.com*) and will be equally accessible to investors and Authorized Purchasers.

In addition, the NAV for the USOF will be calculated and disseminated on a daily basis. The Exchange represents that it intends to disseminate for USOF on a daily basis by means of CTA/CQ High Speed Lines information with respect to the Indicative Partnership Value, recent NAV, Units outstanding, the estimated Basket Amount and the Actual Basket Amount. The Exchange will also make available on its Web site (*http://www.amex.com*) daily trading volume, closing prices and the NAV. The Commission believes that the wide availability of information about the Units the Oil Futures Contracts held by the USOF and NAV will facilitate transparency with respect to the proposed Units and diminish the risk of manipulation or unfair informational advantage.

C. Listing and Trading

The Commission finds that the Exchange's proposed rules and procedures for the listing and trading of the proposed Units are consistent with the Act. The Units will trade as equity securities subject to Amex rules including, among others, rules governing priority, parity and precedence of orders, specialist responsibilities, account opening and customer suitability requirements. The Commission believes that the listing and delisting criteria for the Units should help to maintain a minimum level of liquidity and therefore minimize the potential for manipulation of the Units. Finally, the Commission notes that the Information Circular the Exchange will distribute will inform members and member organizations about the terms, characteristics and risks in trading the Units, including their prospectus delivery obligations.

IV. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (SR–Amex–2005–127), as amended, be, and it hereby is, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[57]

Nancy M. Morris,

Secretary.

[FR Doc. E6–4971 Filed 4–5–06; 8:45 am]

BILLING CODE 8010–01–P

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[56] The Bid-Ask Price of Units is determined using the highest bid and lowest offer as of the time of calculation of the NAV.

[57] 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–53576; File No. SR–CBOE–2006–14]

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing of Proposed Rule Change Relating to Customer Portfolio Margining Requirements

March 30, 2006.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 (the "Exchange Act" or "Act"),[1] and Rule 19b–4 thereunder,[2] notice is hereby given that on February 2, 2006, the Chicago Board Options Exchange, Incorporated ("CBOE" 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

CBOE is proposing to broaden its Rule 12.4—*Portfolio Margin and Cross-Margin for Index Options*—to allow portfolio margining of listed equity options, narrow-based index options, and security futures, as well as certain OTC instruments. The text of the proposed rule change is below. Additions are in italics. Deletions are in brackets.

* * * * *

Chicago Board Options Exchange, Inc.

Chapter XII

Margins

Rule 12.4. Portfolio Margin for Index and Equity Options, and Cross-Margin for Index Options

As an alternative to the transaction / position specific margin requirements set forth in Rule 12.3 of this Chapter 12, members may require margin for listed[, broad-based U.S.] index *and equity* options *(defined below as a "listed option"), options on exchange traded funds, security futures products,* index warrants, [and] underlying instruments *and unlisted derivatives* (as defined below) in accordance with the portfolio margin requirements contained in this Rule 12.4.

In addition, members, 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 Rule 12.4 to combine a customer's related instruments (as defined below), *listed index options, options on exchange traded funds* [and listed, broad-based U.S. index options], index warrants, [and]underlying instruments *and unlisted derivatives* and compute a margin requirement ("cross-margin") on a portfolio margin basis. Members must confine cross-margin positions to a portfolio margin account dedicated exclusively to cross-margining.

Application of the portfolio margin and cross-margining provisions of this Rule 12.4 to IRA accounts is prohibited.

(a) Definitions.

(1) The term "listed option" shall mean any option traded on a registered national securities exchange or automated facility of a registered national securities association.

(2) The term "security future" means a contract of sale for future delivery of a single security or of a narrow-based security index, including any interest therein or based on the value thereof, to the extent that that term is defined in Section 3(a)(55) of the Securities Exchange Act of 1934.

(3) The term "security futures product" means a security future, or an option on any security future.

([2]*4*) The term "unlisted *derivative*[option]" means any *equity-based (or equity index-based) unlisted* option, *forward contract or swap that can be priced by a model approved by a "DEA" covering the same underlying instrument*[not included in the definition of listed option].

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[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

(5) The term "option series" 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.

([3]*6*) *The term "options class" refers to all options contracts covering the same underlying instrument.*

([4]*7*) The term "portfolio" means options of the same options class *grouped with their corresponding security futures products,* underlying instruments and related instruments.

([6]*8*) The term "related instrument" within an option class or product group means futures contracts and options on futures contracts covering the same underlying instrument , *but does not include security futures products.*

([7]*9*) The term "underlying instrument" means long and short positions, *as appropriate, covering the same security, group or index of securities, or a security which is exchangeable for or convertible into the underlying security or group of securities within a period of 90 days, or* [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 *an* [broad-based]index on which options are listed. The term underlying instrument shall not be deemed to include futures contracts, options on futures contracts[,] *or* underlying stock baskets[, or unlisted instruments]. *Securities that are included in the FT Actuaries World index can qualify as an underlying instrument. Restricted and control stock qualify as an underlying instrument provided that the offsetting option or other eligible derivative has been established in a manner consistent with SEC Rule 144 or SEC "no-action" positions to permit the sale of the stock without restriction upon exercise of the option or other eligible derivative.*

([8]*10*) The term "product group" means two or more portfolios of the same type [(see subparagraph (a)(9) below)]for which it has been determined by Rule 15c3–1*a(b)(ii)* under the Securities Exchange Act of 1934 that a percentage of offsetting profits may be applied to losses at the same valuation point.

([9]*11*) The terms "theoretical gains and losses" means the gain and loss in the value of *each eligible position*[individual 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:

Portfolio type	Up/down market move (high & low valuation points)
[Non-]High Capitalization, Broad-based U.S. Market Index [Option] [1].	[+/−10%]*+6%/−8%*
Non-High Capitalization, Broad-based U.S. Market Index [Option] [1].	[+6%/−8%]*+/−10%*
Narrow-based Index [1] ..	*+/−15%*
Individual Equity [1]	*+/−15%*

[1] In accordance with sub-paragraph (b)(1)(i)(B) of Rule 15c3–1a under the Securities Exchange Act of 1934.

(b) Eligible Participants.

Any member organization intending to apply the portfolio margin provisions of this Rule 12.4 to its accounts must receive prior approval from its Designated Examining Authority ("DEA"). The member organization will be required to, among other things, demonstrate compliance with Rule 15.8A—Risk Analysis of Portfolio Margin Accounts, and with the net capital requirements of Rule 13.5—Customer Portfolio Margin Accounts.

The application of the portfolio margin provisions of this Rule 12.4, including cross-margining, is limited to the following:

(1) Any broker or dealer registered pursuant to section 15 of the Securities Exchange Act of 1934 *subject to minimum margin requirements under paragraph (e)(2)(A) below;*

(2) Any member of a national futures exchange to the extent that listed index options hedge the member's index futures *subject to minimum margin requirements under paragraph (e)(2)A) below,* and

(3)*(i)* Any [other]person or entity not included in (b)(1) or (b)(2) above that has or establishes, and maintains, equity of at least 5 million dollars subject to minimum margin requirements under paragraph (e)(2)(A) below. For purposes of this equity requirement, all securities and futures accounts carried by the member for the same customer may be combined provided ownership across the accounts is identical. A guarantee by any other account for purposes of the minimum equity requirement is not to be permitted.

(ii) Any other person or entity not included in (b)(1), (b)(2) or (b)(3)(i) above that is approved under paragraph (c) below, provided that no unlisted derivative as defined in paragraph (a)(4) above is carried, and the minimum margin requirements under paragraph (e)(2)(B) below are applied.

(c) Opening of Accounts.

(1) Only customers that, pursuant to Rule 9.7, have been approved [for options transactions, and specifically approved] to engage in uncovered short option contracts, are permitted to utilize a portfolio margin account.

(2) On or before the date of the initial transaction in a portfolio margin account, a member shall:

A. Furnish the 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, and

B. Obtain a signed acknowledgement(s) from the customer, both of which are required for cross-margining customers, and record the date of receipt.

(d) Establishing Account and Eligible Positions.

(1) Portfolio Margin Account. For purposes of applying the portfolio margin requirements provided in this Rule 12.4, members are to establish and utilize a dedicated 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 a customer.

(2) Cross-Margin Account. For purposes of combining related instruments *and unlisted derivatives,* and listed [broad-based U.S.] index options, index warrants and underlying instruments and applying the portfolio margin requirements provided in this Rule 12.4, members 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 a customer.

A margin deficit in either the portfolio margin account or the cross-margin account of 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.

(3) Portfolio Margin Account—Eligible Positions

(i) A transaction in, or transfer of, a listed[, broad-based U.S.] index *or equity* option, *security futures product,*[or] index warrant, *or unlisted derivative (except for an account approved under paragraph (b)(3)(ii))* may be effected in the portfolio margin account.

(ii) *With the exception of eligible participants operating pursuant to paragraphs (b)(1), (b)(2) or (b)(3)(i) above, a*[A] transaction in, or transfer of, an underlying instrument may *not* be effected in the portfolio margin account *unless*[provided] a position in an offsetting listed[, broad-based U.S.] index *or equity* option, *security futures product,*[or] index warrant *or unlisted derivative* is in the account or is established in the account on the same day.

(iii) *With the exception of eligible participants operating pursuant to paragraphs (b)(1), (b)(2) or (b)(3)(i) above,* [If, in the portfolio margin account,]*if* the listed[, broad-based U.S.] index *or equity* option, *security futures product,*[or] index warrant, *or unlisted derivative* position offsetting an underlying instrument position ceases to exist and is not replaced within 10 business days, the underlying instrument position must be transferred to a regular margin account, subject to [Regulation T initial margin and] the margin required pursuant to the other provisions of this chapter. Members 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 pursuant to the other provisions of this chapter, 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.

(4) Cross-Margin Account—Eligible Positions

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

(ii) If the listed[, U.S. broad-based] index option, index warrant,[or] underlying instrument or *unlisted derivative* position offsetting a related instrument ceases to exist and is not replaced within 10 business days, the related instrument position must be transferred to a futures account. Members will be expected to monitor cross-margin accounts for possible abuse of this provision.

(iii) With the exception of eligible participants operating pursuant to paragraphs (b)(1), (b)(2) or (b)(3)(i) above, if the related instrument position offsetting an underlying instrument position ceases to exist and is not replaced within 10 business days, the underlying instrument position must be transferred to a regular margin account, subject to the margin required pursuant to the other provisions of this chapter. Members will be expected to monitor portfolio margin accounts for possible abuse of this provision.

(ii*i*) In the event that fully paid for long *index* 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 pursuant to the other provisions of this chapter, 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.

(e) Initial and Maintenance Margin Required. The amount of margin required under this Rule 12.4 for each portfolio shall be the greater of:

(1) The amount for any of the 10 equidistant valuation points representing the largest theoretical loss as calculated pursuant to paragraph (f) below or

(2)*(A) In the case of an account operating under paragraph (b)(1), (b)(2) or (b)(3) of this Rule 12.4,* $.375 for each listed [index]option, *security futures product,*[and] related instrument *and unlisted derivative,* multiplied by the contract or instrument's multiplier, not to exceed the market value in the case of long positions in listed options, *including options on security futures,* and options on futures contracts.

(B) In the case of an account operating under paragraph (b)(3)(ii) of this Rule 12.4, for any portfolio that holds a position in the underlying instrument, $.75 for each listed option (excluding broad-based index options and options on broad-based exchange traded funds), security futures product and related instrument multiplied by the contract or instrument's multiplier, not to exceed the market value in the case of long options, including options on security futures, and options on futures contracts. In the case of a portfolio not holding a position in the underlying instrument, or a broad-based index portfolio, $.375 shall be applied instead of $.75.

(f) Method of Calculation.

(1) Long and short positions in listed options, *security futures products,* underlying instruments,[and] related instruments *and unlisted derivatives* are to be grouped by option class; each option class group being a "portfolio". Each portfolio is categorized as one of the portfolio types specified in paragraph (a)([9]*11*) above.

(2) For each portfolio, theoretical gains and losses are calculated for each position as specified in paragraph (a)([9]*11*) above. For purposes of determining the theoretical gains and losses at each valuation point, members shall obtain and utilize the theoretical value of a listed [index]option, *security futures product,* underlying instrument, [or]related instrument *and unlisted derivative,* rendered by a theoretical pricing model that, in accordance with 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.

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

Offsets between portfolios within the High Capitalization, Broad-Based Index Option, [product group and the]Non-High Capitalization, Broad-Based Index Option [product group]*and Narrow-Based Index Option product groups* may then be applied as permitted by Rule 15c3–1a under the Securities Exchange Act of 1934.

(4) After applying paragraph (3) 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).

If a security that is exchangeable or convertible into the underlying security requires the payment of money or results in a loss upon conversion at the time when the security is deemed an underlying instrument, the full amount of the conversion loss will be required.

(g) Equity Deficiency. If, at any time, equity declines below the[5 million dollar] minimum required under Paragraph (b)[(4)] of this Rule 12.4 and is not brought back up to *the required level*[at least 5 million dollars] within three (3) business days (T+3) by a deposit of funds or securities, or

through favorable market action; members 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 such time as *the*[an] *required minimum account* equity [of 5 million dollars] is *re*-established.

A deduction in computing net capital in the amount of a customer's equity deficiency may not serve in lieu of complying with the above requirements.

(h) Determination of Value for Margin Purposes. For the purposes of this Rule 12.4, all [listed index options and related instruments] *eligible* positions shall be valued at current market prices. Account equity for the purposes of this Rule 12.4 shall be calculated separately for each portfolio 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.

(i) Additional Margin.

(1) If at any time, the equity in any portfolio margin account, including a cross-margin account, is less than the margin required, additional margin must be obtained within [one]*three* business day*s* (T+[1]*3*). *During the three business day period, member organizations are prohibited from accepting opening or closing orders that would increase the margin requirement until the additional margin is obtained.* In the event a customer fails to deposit additional margin within [one]*three* business days, the member must liquidate positions in an amount sufficient to, at a minimum, lower the total margin required to an amount less than or equal to account equity. Exchange Rule 12.9—Meeting Margin Calls by Liquidation shall not apply to portfolio margin accounts. However, members will be expected to monitor the risk of portfolio margin accounts pursuant to the risk monitoring procedures required by Rule 15.8A. Guarantees by any other account for purposes of margin requirements is not to be permitted.

(2) Pursuant to Chapter XIII—Net Capital and Rule 13.5—Customer Portfolio Margin Accounts—thereunder, if additional margin required is not obtained by the close of business on T+1, member organizations must deduct in computing net capital any amount of the additional margin that is still outstanding until such time as the additional margin is obtained or positions are liquidated pursuant to (i)(1) above.

(3) A deduction in computing net capital in the amount of a customer's margin deficiency may not serve in lieu of complying with the requirements of (i)(1) above.

(4) A member organization may request from its Designated Examining Authority an extension of time for a customer to deposit additional margin. Such request must be in writing and will be granted only in extraordinary circumstances.

(*5*[2]) The day trading requirements of Exchange Rule 12.3(j) shall not apply to portfolio margin accounts, including cross-margin accounts.

(j) Cross-Margin Accounts—Requirement to Liquidate.

(1) A member is required immediately either to liquidate, or 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 if the member is:

(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;

(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;

(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 customers' securities; or

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

(2) Nothing in this paragraph (j) 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.

* * * * *

Chapter 9

Doing Business with the Public

Rule 9.15. Delivery of Current Options Disclosure Documents and Prospectus

(a) no change.

(b) no change.

(c) The special written disclosure statement describing the nature and risks of portfolio margining and cross-margining, and acknowledgement for customer signature, required by Rule 12.4(c)(2) 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 the prescribed Exchange format and has received prior written approval of the Exchange.

Sample Risk Description for Use by Firms To Satisfy Requirements of Exchange Rule 9.15(d)

Portfolio Margining and Cross-Margining

Disclosure Statement and Acknowledgement

For a Description of the Special Risks Applicable to a Portfolio Margin Account and its Cross-Margining Features, See the Material Under Those Headings Below.

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 "*portfolio*[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 *equity and equity index products*[product classes and groups of index products relating to broad-based market indexes].

2. The goal of portfolio margining is to set levels of margin that more precisely reflect actual net risk. The 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. *If a customer wishes to utilize unlisted derivatives,* [and]*the customer* must have and maintain at all times account net equity of not less than $5 million, aggregated across all accounts under identical ownership at the clearing broker. The 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).

Carrying broker-dealers will have their own minimum account equity requirement, and possibly other eligibility requirements. Also, pursuant to exchange rules, a higher per contract minimum margin requirement will apply to portfolios holding the underlying instrument whenever account net equity is less than $5 million and no position in an unlisted derivative is held.

Neither the $5 million minimum account equity requirement nor the higher per contract minimum is applicable to portfolio margining of customers that are broker-dealers or futures locals.

Positions Eligible for a Portfolio Margin Account

4. All positions in [broad-based U.S. market]index *and equity* options, *security futures products,* and index warrants listed on a national securities exchange, *underlying instruments (including*[and] exchange traded funds and other fund 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. *Additionally, an account that elects to operate with account net equity of not less than $5 million may carry positions in unlisted derivatives (e.g., OTC swaps, options) that have the same underlying instrument as an index or equity option and can be priced by an approved vendor of theoretical values.*

Special Rules for Portfolio Margin Accounts

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

6. A portfolio margin account or subaccount *that elects to operate with account equity of not less than $5 million* will be subject to a minimum margin requirement of $.375 multiplied by the index multiplier for every options contract, *security futures product,* [or]index warrant, *unlisted derivative and related instrument* carried long or short in the account. No minimum margin is required in the case of *underlying instruments,* eligible exchange traded funds or other eligible fund products. *A portfolio margin account that elects to operate with account equity of less than $5 million will be subject to a minimum margin requirement of $.75 multiplied by the index multiplier for every options contract, security futures product, index warrant, unlisted derivative and related instrument carried long or short in any portfolio that contains a position in the underlying instrument. For portfolios that do not contain a position in the underlying security, a $.375 minimum will apply.*

7. Margin calls in the portfolio margin account or subaccount, regardless of whether due to new commitments or the effect of adverse market moves 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. *Once a margin call is incurred, the entry of an opening or closing order that would increase the margin requirement is prohibited until the margin call is met.* Failure to meet a margin call when due will result in immediate liquidation of positions to the extent necessary to reduce the margin requirement. Failure to meet an equity call prior to the end of the third business day will result in a prohibition on entering any *new orders that would increase the margin requirement*[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. *Except for accounts that maintain account net equity of $5 million, a*[A] position in an underlying instrument[exchange traded 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.

Underlying instruments[Exchange traded index funds and/or other eligible funds] will be transferred out of the portfolio margin account and into a regular securities account subject to strategy based margin if, for more than 10 business days and for any reason, the offsetting securities options or other eligible securities no longer remain in the account.

9. When a broker-dealer carries a 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") in 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. *Furthermore, the carrying broker-dealer has a lien on all long securities in a portfolio margin account, including underlying instruments, even if fully paid.* Accordingly, to the extent that a customer does not borrow against long option *and underlying instrument* positions in a portfolio margin account or have margin requirements in the account against which the long option *or underlying instruments* can be credited, there is no advantage to carrying the long options *and underlying instruments* 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 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 OCC.

13. For the reasons noted above, a customer that carries long options *and underlying instrument* 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 *and equity* products in a portfolio margin account is generally subject to all the risks of trading those same products in a 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 index *and equity* 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. 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 futures products and securities products are viewed separately, thus providing more leverage in the account.

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

19. When index futures and options *on index* 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, 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 *index option* products eligible for portfolio margining are also eligible for cross-margining. *Additionally, accounts that elect to maintain equity of not less than $5 million may carry positions in unlisted derivatives (e.g., OTC index swaps, options).*

23. All [broad-based U.S. market]index futures and options on index futures [traded on a designated contract market]*that have the same underlying index as a securities index option permitted in paragraph 22 above and that are traded on a designated contract market* subject to the jurisdiction of the Commodity Futures Trading Commission 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 separate from all other securities accounts.

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 the cross-margin account, and any shortfall in aggregate net equity across accounts, must be satisfied within the same time frames [(10 business days),] and subject to the same consequences, as in a portfolio margin account (*see paragraph 7 above*).

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. Futures products will be transferred out of the cross-margin account and into a futures account if, for more than 10 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 futures products to a futures account causes the futures account to be undermargined, a margin call will be issued or positions will be liquidated to the extent necessary to eliminate the deficit.

28. Except for accounts maintain account net equity of $5 million, a[A] position in an underlying instrument may not be established in a cross-margin account unless there exists, or there is established on the same day, an offsetting position in a related instrument. Underlying instrument positions will be transferred out of the cross-margin account and into a regular securities account if, for more than 10 business days and for any reason, the offsetting related instrument or other eligible instrument no longer remains in the account.

[28]*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.

[29]*30.* 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.

[30]*31.* In signing the agreement referred to in paragraph 29 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]*32.* 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 regular margin account, and greater leverage creates greater losses in the event of adverse market movements.

[32]*33.* As cross-margining must be conducted in a portfolio margin account type, the time required for meeting margin calls is shorter than in a 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. As a result, there is increased risk that a customer's cross-margin positions will be liquidated involuntarily, causing possible loss to the customer.

[33]*34.* 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 Commodity Futures Trading Commission ("CFTC") adopted pursuant to the Commodity Exchange Act.

[34]*35.* 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 regular securities margin account, as the case may be. 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]*36.* 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 or debited from, respectively, the customer's account in cash. While *a change*[an increase] in *the* value of [a long]*an* option contract may increase *or decrease* the equity in the account, the gain *or loss* is not realized until the option is *liquidated,* [sold or]exercised *or assigned.* 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 as yet unrealized) gain on an [long]option. On the other hand, 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]*37.* 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]*38.* 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.

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 Securities and Exchange Commission has taken the position that all long option positions in a customer's portfolio-margining account (including any cross-margining 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. *Furthermore, long positions, including underlying instruments, in a portfolio margin account (including any cross-margin account) are held subject to a lien by the carrying broker-dealer, even if fully paid.*

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-margining account (including any cross-margining account) will be subject to OCC's lien, including any positions that exceed the customer's aggregate indebtedness. *Furthermore, long positions, including underlying instruments, in a portfolio margin account (including any cross-margin account) are held subject to a lien by the carrying broker-dealer, even if fully paid.* The Securities and Exchange Commission has granted an exemption from the hypothecation rules to allow customers to carry positions in portfolio-margining 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 or *underlying instrument* 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) *and the carrying broker-dealer's lien on your long underlying instrument 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-margining 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 CFTC adopted pursuant to the CEA. These rules require that customer funds be segregated from the accounts of financial intermediaries and be separately accounted for, however, they do not provide for, and 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 also has been 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, in respect of 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 *option* positions*, and the carrying broker-dealer to have a lien on any long securities. These*[This] aspect*s are*[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 ("CEA") 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)

* * * * *

Chapter XIII

Net Capital

Rule 13.5. Customer Portfolio Margin Accounts

(a) No member organization that requires margin in any customer accounts pursuant to Rule 12.4—Portfolio *Margin for Index and Equity Options*, and Cross-Margin for Index Options, shall permit gross customer portfolio margin requirements to exceed 1,000 percent of its net capital for any period exceeding three business days. The member organization shall, beginning on the fourth business day of any non-compliance, cease opening new portfolio margin accounts, *including cross-margin accounts* until compliance is achieved.

(b) If, at any time, a member organization's gross customer portfolio margin requirements exceed 1,000 percent of its net capital, the member organization shall immediately transmit telegraphic or facsimile notice of such deficiency to the Office of Market Supervision, Division of Market Regulation, Securities and Exchange Commission, *100 F Street, NE*[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 its Designated Examining Authority.

(c) *If any customer portfolio margin account becomes subject to a call for additional margin, and all of the additional margin is not obtained by the close of business on T+1, member organizations must deduct in computing net capital any amount of the additional margin that is still outstanding until such time as it is obtained or positions are liquidated pursuant to Rule 12.4(i)(1).*

* * * * *

Chapter XV

Records, Reports and Audits

Rule 15.8A. Risk Analysis of Portfolio Margin Accounts

(a) Each member organization that maintains any portfolio margin accounts for customers shall establish and maintain *a sophisticated* written risk analysis methodology[procedures] for assessing and monitoring the potential risk to the member organization's capital over a specified range of possible market movements of positions maintained in such accounts. [Current procedures shall be filed and maintained with the Department of Financial and Sales Practice Compliance.] The *risk analysis methodology*[procedures] 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 must be approved by the member organization's Designated Examining Authority and then submitted to the SEC prior to the implementation of portfolio margining and cross-margining.*

(b) Upon direction by the Department of *Member Firm Regulation*[Financial and Sales Practice Compliance], each affected member organization shall provide to the Department such information as the Department may reasonably require with respect to the member organization's risk analysis for any or all of the portfolio margin accounts it maintains for customers.

(c) In conducting the risk analysis of portfolio margin accounts required by this Rule 15.8A, each affected member organization is required to follow the Interpretations and Policies set forth under Rule 15.8—Risk Analysis of Market-Maker Accounts. In addition, each affected member organization shall include in *the* written *risk analysis methodology*[procedures] required pursuant to paragraph (a) above *procedures and guidelines for*[the following:

(1) Obtaining and reviewing the appropriate customer account documentation and financial information necessary for assessing the amount of credit extended to customers,

(*2*[1]) [Procedures and guidelines for]the determination, review and approval of credit limits to each customer, and across all customers, utilizing a portfolio margin account[.]*,*

(*3*[2]) [Procedures and guidelines]for monitoring credit risk exposure to the member organization, including intra-day credit risk, related to portfolio margin accounts[.]*,*

(*4*[3]) [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[.]*,*

(*5*[4]) [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[.]*,*

(6) The type, scope and frequency of reporting by management on credit extension exposure,

(7) Managing the impact of credit extension on the member organization's overall risk exposure,

(8) The appropriate response by management when limits on credit extensions have been exceeded, and

(9) Determining the need to collect margin from a particular eligible participant, including whether that determination was based upon the creditworthiness of the participant and/or the risk of the eligible position(s).

Moreover, management must periodically review, in accordance with written procedures, the member organization's credit extension activities for consistency with these guidelines. Management must determine if the data necessary to apply this Rule 15.8A is accessible on a timely basis and information systems are available to capture, monitor, analyze and report relevant data.

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

In its filing with the Commission, CBOE 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. CBOE 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

CBOE Rule 12.4—*Portfolio Margin and Cross-Margin for Index Options*—permits member organizations to compute a margin requirement for broad-based index option positions carried for customers using a portfolio (or risk-based) margin approach. The CBOE is proposing to broaden this rule by enabling portfolio margining of listed equity options, narrow-based index options, and security futures. The inclusion of offsetting (underlying) equity securities and related instruments (i.e., futures, options on futures) in a portfolio margin account is also proposed. The CBOE is also proposing to allow portfolio margining of certain unlisted options, forward contracts and swaps (or unlisted derivatives). Under the proposed amendments, a $5 million minimum account equity requirement would apply only to portfolio margin accounts that contain unlisted derivatives.

The Exchange is proposing amendments to current Rule 12.4, as necessary, to accommodate portfolio margining of listed equity options,[3] narrow-based index options, and security futures, as well as underlying securities, related instruments and unlisted derivatives that offset risk.[4] In proposing these changes, the Exchange, in large part, is adopting the recommendations of a portfolio margining working group of the Securities Industry Association ("SIA").[5] The New York Stock Exchange's ("NYSE") Rule 431 Committee endorsed the SIA working group's proposal, and the CBOE understands that the NYSE has, or will be, filing a substantively similar rule change proposal.

For portfolios of equity options, narrow-based index options, and/or security futures, the Exchange is proposing that the risk array for computing the portfolio margin requirement be set at up/down market moves of +15%/−15%. A portfolio of only broad-based index options and futures would continue to be stress tested as specified under the current rule: +6%/-8% for highly capitalized broad-based indices and +/−10% for non-highly capitalized broad-based indices. Computation of the portfolio margin requirement would otherwise follow the same process prescribed by Rule 12.4. All equity options having the same underlying security, the underlying security itself, and any related futures, options on futures or security futures could be combined as a portfolio for purposes of computing a portfolio margin requirement. The +/−15% price range for computing a portfolio margin requirement is the same parameter required under Appendix A of the Commission's net capital rule (Exchange Act Rule 15c3–1) for computing deductions to a firm's net capital for proprietary positions.

Rule 12.4 currently requires a person or entity that wishes to open a portfolio margin account to have and maintain $5 million dollars in account equity. All of a customer's accounts in the same name, at the same broker-dealer, including any futures accounts, may be combined for purposes of meeting this equity requirement. CBOE proposes to eliminate the requirement of a $5 million account equity requirement except for accounts that carry unlisted derivatives.

The Exchange believes that there are a large number of market participants for which portfolio margining would be an appropriate and more practical methodology, but that do not qualify for portfolio margining only because they are unable to meet the $5 million minimum account equity requirement. The Exchange believes that portfolio margining provides an efficient and prudent margin methodology and that it should be available to as broad a population of market participants as possible. Portfolio margining as designed in this proposal would provide for an adequate level of margin for portfolios of options and any related, offsetting instruments (futures, options on futures). By testing the portfolio against assumed up and down market moves that reflect historical moves in the underlying security with a high level of confidence, and thereby assessing potential loss in a portfolio taken as a whole, portfolio margining provides an accurate and efficient means for deriving a reasonable margin requirement. A minimum account equity requirement is unnecessary to provide adequate margin coverage, particularly with the higher minimum contract charges contained in this proposal for accounts with less than $5 million equity that hold stock positions.[6] The Exchange is proposing an amendment of Rule 12.4 that would permit customers that do not have $5 million in account equity to open a portfolio margin account, but under more stringent controls. Under the proposed amendments, a portfolio margin account could be opened for a customer that does not meet the $5 million minimum account equity, but such account would be subject to the following requirements:

1. Only *listed* derivatives and underlying securities are permitted (no OTC instruments),

2. A $75.00 per contract minimum charge for portfolios that contain underlying stock positions ($37.50 per contract minimum charge for portfolios that do not contain underlying stock positions).

Additionally, Rule 12.4 is being amended to require that margin calls in a portfolio margin account be met by T+

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[3] Including options on exchange traded funds.

[4] It should be noted that the Chairman of the Commission, Christopher Cox, in a letter, dated September 27, 2005, to William J. Brodsky and John A. Thain, the Chief Executive Officers of CBOE and NYSE, respectively, encouraged each exchange to file a rule proposal to make portfolio margining available to equity options and security futures with the Commission by year-end 2005.

[5] Goldman, Sachs & Co., Morgan Stanley & Co., Inc., Merrill Lynch, Pierce, Fenner and Smith, Inc., Bear Stearns Securities Corp. and Credit Suisse First Boston Corp comprise the working group.

[6] CBOE notes that the proposal would continue to equire that an account must be approved for uncovered options writing to be eligible for portfolio margining. As the equity requirement for uncovered accounts imposed by firms is generally at least $100,000, this will result in a minimum account equity requirement of at least $100,000.

3, instead of on T+1 (the current requirement). This is being done based on the SIA Working Group's proposal. Based on its input, the T+1 requirement is onerous in that, from an operational and customer service standpoint, it is not practical, and risk is not viewed as significantly increased by going from a T+1 to a T+3 requirement.

For added safety and soundness, the Exchange is also proposing a change to Rule 12.4 that would require carrying firms to deduct the amount of any outstanding customer margin call in a portfolio margining customer's account from net capital on T+1. Additionally, an amendment is proposed that would prohibit entry of new orders that would increase the margin requirement once a margin call is made, and continuing until the margin call is met. Additionally, amendments to Rule 15.8A—Risk Analysis of Portfolio Margin Accounts—are proposed under which the currently required risk analysis procedures for assessing and monitoring the risk of portfolio margin accounts to the carrying firm's capital would have to be sophisticated and be approved in advance by the firm's Designated Examining Authority. Also, several procedures/guidelines have also been added to Rule 15.8A. Lastly, Rule 13.5—Customer Portfolio Margin Accounts—will continue to require that a carrying firm limit its aggregate customer portfolio margin requirements (including cross-margin requirements) to not more than 1,000% of its net capital.

As with the current rule for broad-based index options, only the theoretical option values provided by The Options Clearing Corporation (the "OCC") may be used for computing gain or loss on portfolio positions.

Additionally, it is being proposed that an unlisted derivative be allowed in a portfolio margin account only if the OCC can provide theoretical values.

The Exchange proposes to amend Rule 12.4 to add a requirement that a firm be approved in advance by its Designated Examining Authority ("DEA") to offer portfolio margining to customers. Exchange Rule 15.8A—*Risk Analysis of Portfolio Margin Accounts*—currently requires firms to file and maintain procedures with the Exchange for assessing and monitoring the potential risk to the firm's capital of carrying customer portfolio margin accounts. The Exchange is proposing to delete this requirement given the proposed amendment of Rule 15.8A that would require prior DEA approval of written risk monitoring procedures.

A further revision of Rule 12.4 is proposed that would allow control and restricted stock to be held in a portfolio margin account, provided the option (or other derivative) to which the stock relates is established in a manner that is consistent with SEC Rule 144, or any applicable Commission guidelines or no-action letters. Additionally, it is proposed that foreign equity securities be permitted in a portfolio margin account provided that they have a ready market. The term ready market in respect of a foreign equity security would be defined the same as in the Commission's net capital rule—i.e., a security included in the FT Actuaries World Index.

The requirement under current Rule 12.4 that an account must be approved for writing uncovered option contracts in order to receive portfolio margin treatment will continue to apply. The current rules of the exchanges and NASD pertaining to approval of accounts for writing uncovered option contracts require the account to have a minimum level of account equity, which is set by the firm.

Finally, the requirement to furnish a special disclosure document concerning portfolio margining to each customer on or before the date of an initial transaction in a portfolio margin account will continue to apply. The disclosure document is being amended as necessary to incorporate references to equity options, narrow-based index options and security futures, and hedging positions in underlying equity securities.

2. Statutory Basis

The proposed portfolio margin rules are intended to promote greater reasonableness, accuracy and efficiency in respect of Exchange margin requirements for complex, multiple position listed option strategies, and offer a cross-margin capability with related index futures positions, in eligible accounts. As such, the proposed rule change is consistent with and furthers the objectives of section 6(b)(5) [7] of the Act, in that it is designed to perfect the mechanisms of a free and open market and to protect investors and the public interest.

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

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

[7] 15 U.S.C. 78f(b)(5).

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

No written comments were solicited or received with respect to 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; 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. Please include File Number SR–CBOE–2006–14 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 20549–1090.

All submissions should refer to File Number SR–CBOE–2006–14. 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 CBOE. 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–CBOE–2006–14 and should be submitted on or before April 27, 2006.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[8]

Nancy M. Morris,

Secretary.

[FR Doc. E6–4989 Filed 4–5–06; 8:45 am]

BILLING CODE 8010–01–P

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–53567; File No. SR–CBOE–2006–09]

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Order Approving Proposed Rule Change Relating to the Exposure Period for Crossing Orders in the Hybrid Trading System

March 29, 2006.

On January 30, 2006, the Chicago Board Options Exchange, Incorporated ("CBOE" or "Exchange"), filed with the Securities and Exchange Commission ("Commission") a proposed rule change pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act") [1] and Rule 19b–4 thereunder,[2] to decrease the exposure period for crossing orders in its Hybrid Trading System ("Hybrid") from 10 seconds to 3 seconds. The proposed rule change was published for comment in the **Federal Register** on February 22, 2006.[3] The Commission received no comments on the proposal.

After careful consideration, the Commission finds that the proposed rule change is consistent with the requirements of Section 6(b) of the Act [4] and the rules and regulations thereunder applicable to a national securities exchange,[5] and in particular with Section 6(b)(5) of the Act.[6] The Commission believes that, in the electronic environment of Hybrid, reducing the exposure period to 3 seconds could facilitate the prompt execution of orders, while providing participants in Hybrid with an adequate opportunity to compete for exposed bids and offers.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,[7] that the proposed rule change (SR–CBOE–2006–09) is hereby approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[8]

Nancy M. Morris,

Secretary.

[FR Doc. E6–5034 Filed 4–5–06; 8:45 am]

BILLING CODE 8010–01–P

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–53580; File No. SR–NASD–2006–040]

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change To Expand NASD's Order Audit Trail System Exemptive Authority To Include Recording Requirements

March 30, 2006.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act") [1] and Rule 19b–4 [2] thereunder, notice is hereby given that on March 28, 2006, the National Association of Securities Dealers, Inc. ("NASD") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I and II below, which Items have been prepared by NASD. The Commission is publishing this notice and order to solicit comments on the proposed rule change from interested persons and to approve the proposal on an accelerated basis.

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

NASD is proposing to expand NASD's current Order Audit Trail System (OATS) exemptive authority to include recording requirements. Below is the text of the proposed rule change. Proposed new language is in *italics*; proposed deletions are in [brackets].[3]

* * * * *

6950. Order Audit Trail System

* * * * *

6955. Order Data Transmission Requirements

(a) through (c) No Change.

[(d) Exemptions]

[(1) Pursuant to the Rule 9600 Series, the staff, for good cause shown after taking into consideration all relevant factors, may exempt, subject to specified terms and conditions, a member from the order data transmission requirements of this Rule for manual orders, if such exemption is consistent with the protection of investors and the public interest, and the member meets the following criteria:]

[(A) the member and current control affiliates and associated persons of the member have not been subject within the last five years to any final disciplinary action, and within the last ten years to any disciplinary action involving fraud;]

[(B) The member has annual revenues of less than $2 million;]

[(C) The member does not conduct any market making activities in Nasdaq Stock Market equity securities;]

[(D) The member does not execute principal transactions with its customers (with limited exception for principal transactions executed pursuant to error corrections); and]

[(E) The member does not conduct clearing or carrying activities for other firms.]

[(2) An exemption provided pursuant to this paragraph (d) shall not exceed a period of two years. At or prior to the expiration of a grant of exemptive relief under this paragraph (d), a member meeting the criteria set forth in paragraph (d)(1) may request, pursuant to the Rule 9600 Series, a subsequent exemption, which will be considered at the time of the request, consistent with the protection of investors and the public interest.]

[(3) This paragraph shall be in effect until May 8, 2011.]

* * * * *

6958. Exemption to the Order Recording and Data Transmission Requirements

(a) Pursuant to the Rule 9600 Series, the staff, for good cause shown after

[8] 17 CFR 200.30–3(a)(12).

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] *See* Securities Exchange Act Release No. 53278 (February 13, 2006), 71 FR 9184.

[4] 15 U.S.C. 78f(b).

[5] In approving this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. *See* 15 U.S.C. 78c(f).

[6] 15 U.S.C. 78f(b)(5).

[7] 15 U.S.C. 78s(b)(2).

[8] 17 CFR 200.30–3(a)(12).

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] The proposed changes indicated herein are based on rule text approved by the SEC on September 28, 2005, which become effective on May 8, 2006. *See* Securities Exchange Act Release No. 52521 (September 28, 2005), 70 FR 57909 (October 4, 2005) (File No. SR–NASD–00–23).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–53577; File No. SR–NYSE–2006–13]

Self-Regulatory Organizations; New York Stock Exchange LLC; 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 and Eliminate Separate Cross-Margin Accounts

March 30, 2006.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act"), [1] and Rule 19b–4 thereunder,[2] notice is hereby given that on March 2, 2006, the New York Stock Exchange LLC ("NYSE" or "Exchange") filed with the Securities and Exchange Commission ("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 further expand the scope of products that are eligible for treatment as part of the Commission approved Portfolio Margin Pilot Program [3] ("Pilot") and eliminate the requirement for a separate cross-margin account for margining eligible security products with eligible commodity products. Amendments to Rule 726 ("Delivery of Options Disclosure Document and Prospectus") 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]

(g) As an alternative to the "strategy" based margin requirements set forth in sections (a) through (f) of this Rule, member organizations may elect to apply the portfolio margin requirements set forth in this section (g) to [1) listed, broad-based U.S. index options, index warrants and underlying instruments and 2) listed security futures contracts and listed single stock options] *all margin eligible securities* [4]*, listed options, OTC derivatives, and U.S. security futures* [5]*, provided certain requirements are met. (See section (g)(6)(C)(1))*

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 section (g) to combine an eligible participant's related instruments as defined in section (g)(2)*(D)* [(C)], with listed, [broad-based] U.S. index options, *options on exchange traded funds ("ETF"),* index warrants and underlying instruments and compute a margin requirement for such combined products 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 monitor the risk of portfolio margin accounts and maintain a *comprehensive* 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) within the organization responsible for the risk function. This risk analysis methodology [shall be made available to] *must be approved by* the *New York Stock* Exchange *("Exchange")* [upon request.] *and submitted to the Securities and Exchange Commission ("SEC") prior to the implementation of portfolio margining.* 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 *procedures and guidelines for*:

(A) *obtaining and reviewing the appropriate account documentation and financial information necessary for assessing the amount of credit to be extended to eligible participants.*

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

(C) [(B) Procedures and guidelines for] monitoring credit risk exposure to the member organization *from portfolio margin accounts, on both an* [including] intra-day and *end of day basis* [credit risk], *including the type, scope and frequency of reporting to senior management* [related to portfolio margin accounts.],

(D) [(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[.],

(E) [(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[.],

(F) Managing the impact of credit extension related to portfolio margin accounts on the member organization's overall risk exposure,

(G) The appropriate response by management when limits on credit extensions related to portfolio margin accounts have been exceeded, and

(H) Determining the need to collect additional margin from a particular eligible participant, including whether that determination was based upon the

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] *See* 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 (*e.g.*, listed, broad-based U.S. index options and warrants, along with any underlying instruments), as an alternative to the strategy based margin requirements currently required by Rule 431. Amendments to Rule 726 were also approved to require disclosure to, and written acknowledgment from, customers in connection with the use of portfolio margin. *See* NYSE Information Memo 05–56 for additional information; *see also* SR–NYSE–2005–93 in which the Exchange filed with the Commission amendments to Rule 431 which would expand the approved products for certain customers that are eligible for treatment under portfolio margin requirements to include U.S. security futures and single stock options. *See* Exchange Act Release No. 53126 (Jan.13, 2006), 71 FR 3586 (Jan. 23, 2006) (SR–NYSE–2005–93).

[4] *For purposes of this section (g) of the Rule, the term "margin eligible security" utilizes the definition at section 220.2 of Regulation T of the Board of Governors of the Federal Reserve System, excluding a nonequity security.*

[5] For purposes of this section *(g)* of the Rule, the term "security future" utilizes the definition at section 3(a)(55) of the Exchange Act. [, excluding narrow-based indices.]

creditworthiness of the participant and/or the risk of the eligible product.

Moreover, management must periodically review, in accordance with written procedures, the member organization's credit extension activities for consistency with these guidelines. Management must periodically determine if the data necessary to apply this section (g) is accessible on a timely basis and information systems are available to adequately capture, monitor, analyze and report relevant data.

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

(A) The term "listed option" means any option traded on a registered national securities exchange or automated facility of a registered national securities association.

(B) The term "OTC derivative" means any equity-based or equity index-based unlisted option, forward contract, or security-based swap that can be valued by a theoretical pricing model approved by the Exchange and submitted to the SEC.

(C) [(B)] The term "underlying instrument" means *a security or security index upon which any listed option, OTC derivative, U.S. security future, or broad-based U.S index future is based.* [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. In the case of a listed security futures contract, "underlying instrument" means listed single stock option on the same security and in the same proportion. The term "underlying instrument" shall not be deemed to include options on futures contracts, or unlisted instruments.]

(D) [(C)] The term "related instrument" within *a security* [an option] class or product group means *broad-based U.S. index* futures [contracts] and options on *broad-based U.S index* futures [contracts] covering the same underlying instrument. *The term "related instrument" does not include security futures or options on security futures.*

(E) [(D)] The term "*security* [options] class" refers to all *securities* [options] covering the same underlying instrument.

(F) [(E)] The term "portfolio" means any eligible product, as defined in section (g)(6)(C)(1), grouped with their underlying instruments and related instruments.

[(F) 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 (g)(2)(I) below) for which it has been determined by Rule 15c3–1a under the Securities Exchange Act of 1934 *("Exchange Act")* 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] *requirements* 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* [a customer's] account.

(I) The term "theoretical gains and losses" means the gain and loss in the value of individual eligible products and related instruments at *ten* [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:

Portfolio type	Up/down market move (high & low valuation points)
High Capitalization Broad-based U.S. Market Index [Option][6]	*+6% − 8%*
Non-High Capitalization, Broad-based U.S. Market Index [Option][7]	*+/− 10%*
Margin Eligible Security,Listed Equity Option, Listed Narrow-based Index Option, [Listed] U.S. Security Future, and OTC Derivative [Instrument] (Including forward contracts and swaps) [Listed Security Futures Contract and Listed Single Stock Option].	*+/− 15%*

(3) Approved Theoretical Pricing Models.—Theoretical pricing models must be approved by *the Exchange* [a Designated Examining Authority] and *submitted to* [reviewed by] the *SEC* [Securities and Exchange Commission ("The Commission")] in order to qualify.[8] [Currently, the theoretical model utilized by the Options Clearing Corporation ("The OCC") is the only model qualified pursuant to the Commission's Net Capital Rule. All member organizations shall obtain their theoretical values from the OCC.]

(4) Eligible Participants.—The application of the portfolio margin provisions of this section (g)[, including cross-margining, is limited to] *include* 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 person or entity not included in sections (g)(4)(A) and (g)(4)(B) above approved for options or U.S. security futures transactions. However, an eligible participant under this section (g)(4)(C) may not establish or maintain positions in OTC derivatives unless minimum equity of at least five million dollars is established and maintained with the member organization. [any other person or entity not included in sections (g)(4)(A) and (g)(4)(B) above that has or establishes, and maintains, equity of at least five million dollars.] For purposes of this *minimum* equity requirement, all securities and futures accounts carried by the member organization for the same eligible participant may be combined provided ownership across the accounts is identical. A guarantee pursuant to section (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 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

[6] In accordance with section (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).

[7] See footnote above.

[8] Currently, the theoretical model utilized by the Options Clearing Corporation ("OCC") is the only model qualified.

[or cross-margin] methodology for eligible participants.

(B) Only eligible participants 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) On or before the date of the initial transaction in a portfolio margin account, a member organization shall:

(1) Furnish the eligible participant 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] *is* provided (see Exchange Rule 726 (d)), and

(2) Obtain the signed acknowledgement[(s)] noted above from the eligible participant [(both of which are required for cross-margining eligible participants)] and record the date of receipt.

(6) Establishing Account and Eligible Positions

(A) [Portfolio Margin Account.] For purposes of applying the portfolio margin requirements prescribed in this section (g), *and combining related instruments with listed, U.S. index options, options on exchange traded funds ("ETF"), index warrants, and underlying instruments,* 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.

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

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

(*B*) [(C)] [Portfolio Margin Account—] Eligible 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 portfolio margin account. Eligible products under this section *(g)* 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.]

(i) A margin eligible security, a listed option, a security future, an option on a security future, or OTC derivative.

(ii) A foreign equity security and option on a foreign equity security, provided the foreign equity security is deemed to have a "ready market" under SEC Rule 15c3–1 or a "no-action" position issued thereunder.

(iii) A margin eligible control or restricted security, provided the security has met the requirements in a manner consistent with SEC Rule 144 or an SEC "no-action" position issued thereunder, sufficient enough to permit the sale of the security, upon exercise of any listed option or OTC derivative written against it, without restriction.

(iv) related instruments as defined in section (2)(D)

[(2) A transaction in, or transfer of, an underlying instrument may be effected in the portfolio margin account provided a position in an offsetting eligible product 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.]

(2) [(4)] *For eligible participants as described in section (g)(4)(C) that do not maintain five million dollars in equity, any* [Any] long position or any short position in any *OTC derivative* [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 will be expected to monitor portfolio margin accounts for possible abuse of this provision.

[(D) Cross-Margin Account—Eligible 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) 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 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 will be expected to monitor cross-margin accounts for possible abuse of this provision.]

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

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

(B) *for eligible participants as described in section (g)(4)(A) through (g)(4)(C),* $.375 for each *listed option, OTC derivative, U.S. security future,* [contract] and related instrument, multiplied by the contract's or instrument's multiplier, not to exceed the market value in the case of long *contracts* [positions] in eligible products.

(C) Account guarantees pursuant to section (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, including underlying instruments and related instruments, are to be grouped *by security class; each security class group being* [as] a "portfolio". Each portfolio is categorized as one of the portfolio types specified in section (g)(2)(I) above.

(B) For each portfolio, theoretical gains and losses are calculated for each position as specified in section (g)(2)(I) 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 *(g)* rendered by an approved theoretical pricing model.

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

eligible product groups, as described in section (g)(2)(I), may then be applied as permitted by Rule 15c3–1a under the [Securities] Exchange Act [of 1934].

(D) After applying the 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 *Deficiency* [Call]

(A) If, *as of the close of business,* [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 five million dollar minimum equity required, and is not restored to at least five million dollars within three business days [(T+3)] by a deposit of funds and/or securities, member organizations are prohibited from accepting [opening] *new* orders *beginning on the fourth business day,* [starting on T+4,] except that [opening] *new* 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,

(1) Equity of five million dollars is established[.] *or,*

(2) any OTC derivative is liquidated or transferred from the portfolio margin account to the appropriate securities account. [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 *deficiency* [call] amount from Net Capital in lieu of collecting the minimum equity required.

(10) Portfolio Margin [Maintenance] *Deficiency* [Call]

(A) If, *as of the close of business,* [at any time,] the equity in the portfolio margin [or cross-margin] account of an eligible participant, as described in section (g)(4)(A) through (g)(4)(C), is less than the margin required, the eligible participant may deposit additional margin or establish a hedge to meet the margin requirement within three business days [(T+3)]. *After* [During] the three business day period, member organizations are prohibited from accepting [opening] *new* orders, except that [opening] *new* 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 fails to hedge existing positions or deposit additional margin *in an amount sufficient to eliminate any margin deficiency after* [within] 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.

(B) If the portfolio margin [maintenance] *deficiency* [call] is not met by the close of business *on the next business* day after the business day on which such deficiency arises, [T+1,] member organizations will be required to deduct *the amount of the deficiency* from Net Capital [the amount of the call] until such time the *deficiency* [call] is satisfied.

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

(D) The Exchange may grant additional time for an eligible participant to meet a portfolio margin deficiency upon written request, which is expected to be granted in unique circumstances only.

(E) Member organizations should not permit an eligible participant to make a practice of meeting a portfolio margin deficiency by liquidation.

(11) Determination of Value for Margin Purposes.—For the purposes of this section (g), all eligible products and related instrument positions shall be valued at current market prices. Account equity for the purposes of [this] section*s (g)(9)(A) and (g)(10)(A)* shall be calculated separately for each portfolio margin [or cross-margin] account.

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

(A) No member organization that requires margin in any *portfolio margin* [eligible participant] account pursuant to section (g) of this Rule shall permit the aggregate [eligible participant] portfolio margin [and cross-margin initial and maintenance] requirements to exceed ten times its *Net Capital* [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 aggregate [eligible participant] portfolio margin [and cross-margin] requirements exceed ten times 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, 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.

(13) Day Trading Requirements.—[The requirements of sub-paragraph (f)(8)(B) of this Rule—Day-Trading shall not apply to portfolio margin accounts including cross-margin accounts.] Day trading is not permitted in portfolio margin accounts. Member organizations are expected to monitor portfolio margin accounts to detect and prevent circumvention of the day trading requirements.

(14) [Cross-Margin Accounts—] Requirements to Liquidate

(A) A member *organization* is required immediately either to liquidate, or transfer to another broker-dealer eligible to carry *portfolio* [cross-] margin accounts, all [eligible participant] *portfolio* [cross-] margin accounts that contain positions eligible for *portfolio* [cross-] margining if the member *organization* is:

(1) 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) 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) 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 securities; or

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

(B) Nothing in this section (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.

(15) Member organizations must ensure that portfolio margin accounts are in compliance with all other applicable Exchange rules promulgated in Rules 700 through 795.

* * * * *

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 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 "*security* [product] class" or "product group" as determined by [an options] *a theoretical* 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 reflect[s] actual net risk. The eligible participant 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, eligible participants (other than broker-dealers) must meet the basic standards for having an options account that is approved for uncovered writing. *In addition, eligible participants holding positions in over-the-counter ("OTC") derivatives* [and] must have and maintain at all times account net equity of not less than five million dollars, aggregated across all accounts under identical ownership at the clearing broker. The 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 security futures contracts and single stock options, the five million dollar equity requirement shall be waived.]

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

Positions Eligible for a Portfolio Margin Account

5. [4.] All positions in [listed] margin eligible securities, listed options, OTC *derivatives, and U.S. security futures [contracts, listed single stock options, listed, broad-based U.S. index options or index warrants, 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. In addition, listed, U.S index options, options on exchange traded funds ("ETF"), index warrants and underlying instruments can be combined with offsetting positions in related 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*[9] *and securities products are viewed separately, thus providing more leverage in the account.*

6. 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 portfolio margining.

Special Rules for Portfolio Margin Accounts

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

8. [6.] A portfolio margin account or sub-account will be subject to a minimum margin requirement of $.375, multiplied by the contract's multiplier, for [every] *each listed option, OTC derivative, U.S. security future, and related instrument* [contract] 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.]

9. [7.] *A margin* [Margin] *deficiency* [calls] in the portfolio margin account or sub-account, regardless of whether due to new commitments or the effect of adverse market movements on existing positions, must be met within 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] *deficiency* [call] when due will result in immediate liquidation of positions to the extent necessary to reduce the margin requirement. Failure to meet a minimum equity *deficiency* [call] prior to the end of the third business day will result in a prohibition on entering any [opening] *new* orders, with the exception of [opening] *new* orders that hedge existing positions, beginning on the fourth business day and continuing until such time as the minimum equity requirement is satisfied[.] *or until any OTC derivative is liquidated or transferred from the portfolio margin account to the appropriate securities account.*

[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 a related or underlying security, or other eligible securities. The position(s) will be transferred out of the portfolio margin account and into a standard securities account subject to any applicable margin requirement if the offsetting securities options, other eligible securities and/or related instruments no longer remain in the account for ten business days.]

10. [9.] When a broker-dealer carries a standard cash account or margin account for a customer, the broker-dealer is limited by rules of the Securities and Exchange Commission and of *the* [The] Options Clearing Corporation ("OCC") to the extent to which the broker-dealer may permit *the* OCC to have a lien against long option positions in those accounts. In contrast, *the* 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

[9] *For purposes of this Rule, the term "related instruments," within a security class or product group means broad-based U.S. index futures and options on broad-based U.S. index futures covering the same underlying instrument.*

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.

11. Customers participating in portfolio margining will be required to sign an agreement acknowledging that their positions and property in the portfolio 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.

Special Risks of Portfolio Margin Accounts

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

13. [11.] Because the time limit for meeting *a* margin *deficiency* [calls]is shorter than in a standard margin account, *and may be shorter than the time ordinarily required by a Futures Commission Merchant for meeting a margin deficiency in a futures account,* there is increased risk that a customer's portfolio margin account will be liquidated involuntarily, possibly causing losses to the customer.

14. [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 *any* future margin *deficiency* [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] *the* Options Clearing Corporation.

15. [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.

16. [14.] Trading of [securities index] *eligible* products in a portfolio margin account is generally subject to all the risks of trading those same products in a standard 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. Customers should review these materials carefully before trading in a portfolio margin account.*

17. [15.] Customers should consult with their tax advisers to be certain that they are familiar with the tax treatment of transactions in *these products,* [securities options and futures products] *including tax consequences of trading strategies involving these eligible products.*

18. [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 *a* margin *or* [and] equity *deficiency* [calls] must be met are maximums imposed under Exchange rules. Broker-dealers may impose [their own] more stringent requirements.

19. 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 portfolio margin accounts, all customer portfolio margin accounts that contain positions in futures in the event that the carrying broker-dealer becomes insolvent.

20. In signing the agreement referred to above, a customer also acknowledges that a portfolio margin account that contains positions in futures will be immediately liquidated, or, if feasible, transferred to another broker-dealer eligible to carry portfolio margin accounts, in the event that the carrying broker-dealer becomes insolvent.

21. As noted above, portfolio 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.

22. 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 portfolio 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 or debited from 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.

[Overview of Cross-Margining

17. In a cross-margin account, index futures, security futures and options on index and security futures are combined with offsetting positions in listed securities 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 [10] and securities products are viewed separately, thus providing more leverage in the account.

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

19. Cross-margining is achieved when index 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.

Customers Eligible for Cross-Margining

20. The eligibility requirements for cross-margining are generally the same as for portfolio margining. Accordingly, 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

[10] [For purposes of this Rule, the term "related instruments," within an option class or product group means futures contracts and options on futures contracts covering the same underlying instrument.]

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 undermargined, 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 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 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 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 *a* margin *deficiency* [calls] is shorter than in a standard securities margin account and may be shorter than the time ordinarily required by a futures commission merchant for meeting *a* margin *deficiency* [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 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 or debited from 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 these 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 more stringent requirements.]

* * * * *

Sample Portfolio Margining [and Cross-Margining] Acknowledgement[s]

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 margining account [(including any cross-margin account)] may be subject to such a lien by *the* 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 margining account [(including any cross-margining account)] will be subject to *the* OCC's lien, including any positions that exceed the customer's aggregate indebtedness. The Commission staff has taken a position that would allow customers to carry positions in portfolio margining 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 *the* 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 margining 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: ____

(Signature/title)

Date ____

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 *("CFTC")* 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 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, *portfolio* [cross-] margining must be conducted in [a portfolio margin] *an* account[,] dedicated exclusively to *portfolio* [cross-] margining and *portfolio* [cross-] margin accounts are not treated as a futures account with an FCM. Instead, *portfolio* [cross-] margin accounts are treated as securities accounts carried with broker-dealers. As such, *portfolio* [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 portfolio [cross] margin accounts, there is an exception to the possession or control requirement of Rule 15c3–3 that permits [The] *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 *portfolio* [cross-] margin accounts, all customer portfolio [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) *long option positions in portfolio 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, and* [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) *portfolio* [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 *portfolio* [cross-] margin accounts in the event that the carrying broker-dealer becomes insolvent.

Customer name: ____

By:____

(Signature/title)

Date: ____

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. 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.[11]

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

1. Purpose

Proposed amendments to NYSE Rule 431 would further expand the recently Commission approved and NYSE proposed products that are eligible for

[11] The Commission has modified the text of the summaries prepared by the NYSE. Telephone conversation between William Jannace, Director—Rule & Interpretive Standards, Member Firm Regulation, NYSE and Randall Roy, Branch Chief, and Sheila Swartz, Special Counsel, Division of Market Regulations, Commission, on March 29, 2006.

treatment under portfolio margin requirements to include: All margin eligible securities,[12] listed options, OTC derivatives, and U.S. security futures provided certain requirements are met. Amendments to Rule 726 are also proposed to include the Commission approved products on the disclosure document required to be furnished to options customers pursuant to this rule.

a. Background

Section 7(a)[13] of the Exchange Act[14] 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 customers 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. The Committee has endorsed the proposed amendments discussed below.[15]

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 Commission approval.[16]

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")[17] for certain

[12] The term all "margin eligible security" utilizes the definition at Section 220.2 of Regulation T of the Board of Governors of the Federal Reserve System.

[13] 15 U.S.C. 78g.

[14] 15 U.S.C. 78a *et seq.*

[15] The Committee is currently composed of several member organizations, including Goldman, Sachs & Co., Morgan Stanley & Co., Inc., Merrill Lynch, Pierce, Fenner and Smith, Inc., Bear Stearns Corp, Credit Suisse First Boston Corp, and several self-regulatory organizations ("SROs") including: the NYSE, the Chicago Board Options Exchange ("CBOE"), NASD as well as representatives from the Securities Industry Association's Ad Hoc Committee on Portfolio Margining.

[16] *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).

[17] 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)).

products, as an alternative to the strategy or position based margin requirements[18] 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.[19] These positions are to be margined (either for initial or maintenance) in a separate portfolio margin account dedicated exclusively for such margin computation.

In addition, as noted above, the Exchange on December 29, 2005, filed with the Commission amendments to Rule 431 which would expand the approved products for certain customers that are eligible for treatment under portfolio margin requirements to include security futures and single stock options.[20] The filing was noticed for comment in the **Federal Register** on January 23, 2006[21] and resulted in the Commission receiving three comment letters.[22]

c. 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

[18] Prior to the Pilot, member organizations were solely 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 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. When utilizing a portfolio margin methodology, offsets are fully realized, whereas under strategy or position-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.

[19] For purposes of the Pilot and SR–NYSE–2005–93, 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.

[20] Commission Chairman Christopher Cox, in a letter dated September 27, 2005 to William J. Brodsky and John A. Thain, the Chief Executive Officers of CBOE and NYSE, respectively, encouraged each SRO to file a rule proposal to expand portfolio margining to a broader universe of products.

[21] *See supra* note 3.

[22] Comment letters were received from: (1) The Futures Industry Associations; (2) the Securities Industry Association; and (3) Citigroup Global Markets Inc. The Exchange will be filing a separate response to comments with the Commission. Some of the major comments, however, have been addressed by the amendments the Exchange is proposing herein.

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.[23] 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. In permitting a 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.[24]

As discussed in more detail below, utilizing portfolio margin for the above noted products and any underlying 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.

d. Proposed Amendments

Eligible Products

The proposed amendments to Rule 431 seek to expand the scope of eligible products[25] previously approved, provided all such products can be priced within a prescribed risk-based theoretical pricing methodology that has been approved by the Exchange and submitted to the Commission. Specifically, the proposed amendments noted above will expand the eligible products to further include all margin eligible securities, listed options, OTC

[23] The theoretical options pricing model is used to derive position values at each valuation point for the purpose of determining the gain or loss. For purposes of the Pilot and SR–NYSE–2005–93 the amount of initial and maintenance margin required with respect to a portfolio was 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.

[24] *See* NYSE Rule 431.

[25] Under the current Pilot, eligible products consist of listed broad-based U.S. index options, index warrants along with any underlying instruments. On December 29, 2005, the Exchange filed with the Commission amendments to Rule 431, which would expand the approved products that are eligible for treatment under portfolio margin requirements to include security futures and single stock options. *See* SR–NYSE–2005–93.

derivatives and U.S. security futures, provided certain requirements are met.

Risk Analysis Methodology

Rule 431(g)(1) requires member organizations to monitor the risk of portfolio margin accounts and maintain a written risk analysis methodology for assessing potential risk to the firm's capital. Such methodology must specify the computations to be made, the frequency of the computations, the records to be reviewed and maintained and the person responsible for such risk function. Under the approved pilot, this risk analysis methodology shall be made available to the Exchange upon request. As proposed, the risk analysis methodology must now be comprehensive, approved by the Exchange and submitted to the Commission prior to implementation.

Minimum Equity Requirements

The proposed amendments also will permit eligible participants (as defined in proposed Rule 431(g)(4)) effecting transactions in eligible products to do so without maintaining $5.0 million in equity, which is currently required for eligible products under the Pilot.[26] As proposed, however, eligible participants may not establish or maintain positions in OTC derivatives unless equity of at least $5.0 million is established and maintained in a portfolio margin account.

Portfolio Margin Minimum Equity Deficiency

Proposed Rule 431(g)(9)(A) provides that in the event the equity of an eligible participant, subject to the $5.0 million equity requirement, declines below such minimum requirement, it must be restored within three business days and prohibits member organizations from accepting new orders beginning on the fourth business day, except for new orders effected solely for the purpose of hedging existing positions and lowering margin requirements.

Valuation Points

The Pilot established ten equidistant valuation points for the following eligible products: Non-High Capitalization/Broad-based U.S. Market Index Options (+/−10%) and High Capitalization/Broad-based U.S. Market Index Option (+6%/−8%). In SR–NYSE–2005–93, the Exchange proposed amendments that would establish theoretical valuation points within a range consisting of an increase or a decrease of +/−15% (*i.e.*, +/−3%, 6%, 9%, 12%, and 15%) for security futures and single stock options. Similarly, the proposed amendments also would establish theoretical valuation points of +/−15% for margin eligible securities, listed equity options, listed narrow-based index options, and OTC derivatives (including forward contracts and swaps).

Cross-Margin Account

The proposed amendments will remove the provisions approved in the Pilot pertaining to the use of a cross-margin account for margining eligible securities products with eligible commodity products. Under the proposed rule change, a single portfolio margin account would be used for margining all eligible products. Maintaining and monitoring two separate accounts for a customer's trading activities would be operationally difficult for both broker-dealers and customers. In this regard, the SIA and FIA comment letters received to the Exchange's recent portfolio margin filing,[27] stated that the industry has legal, regulatory and operational concerns regarding the maintenance of a separate cross margin account for customers who maintain both securities and commodity positions.[28] Both the SIA and the FIA urged the Commission to work with the CFTC, the exchanges and the clearing corporations to resolve the legal and regulatory issues that may create a barrier to comprehensive cross-margining at both the broker-dealer and clearing organization level.[29]

Definitions

The proposed amendments change the definition of "underlying instrument" to mean a security or security index upon which any listed option, OTC derivative, U.S. security future, or broad-based U.S. Index future is based. In addition the term "related instrument" (as approved in the Pilot) is being changed to mean broad-based U.S. index futures, and options on broad-based index futures covering the same underlying instrument.

In addition, a new definition of "OTC derivative" was added to the proposed rule change to include any equity-based or equity index-based unlisted option, forward contract or swap that can be valued by a theoretical pricing model approved by the Exchange and submitted to the Commission.

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, members and member organizations are required to provide every portfolio margin customer with a written risk disclosure statement[30] at or prior to the initial opening of a portfolio margin account.

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 15c2–1 and 15c3–3) from the customer. As proposed, the disclosure document required by Rule 726 is being amended to incorporate the expanded list of eligible 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)[31] 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

[26] Under the approved pilot, eligible participants are any broker-dealer registered pursuant to Section 15 of the Exchange Act, any member of a national futures exchange to the extent that listed index options hedge the member's index futures, and any other person or entity not included above that has or establishes, and maintains, equity of at least $5.0 million dollars. In SY–NYSE–2005–93, the Exchange proposed amendments that would permit customers effecting transactions in listed security futures and listed single stock options to do so without maintaining the $5.0 million equity requirement, which is currently required under the Pilot for all other eligible products. However, as proposed herein, only customer transactions in OTC derivatives (including forwards and swaps) with require an minimum equity $5 million dollars. For transactions in all other eligible products (including all listed products), this minimum requirements would not apply.

[27] *See supra* note 3.

[28] *See* letter from Gerard J. Quinn, Vice President and Associate General Counsel, Securities Industry Association, to Nancy M. Morris, Secretary, Commission, dated February 13, 2006 ("SIA Letter"); letter from Barbara Wierzynski, Executive Vice President and General Counsel, Futures Industry Association, to Nancy M. Morris, Secretary, Commission, dated February 13, 2006 ("FIA Letter"); and letter from Severino Renna, Director, Citigroup Global Markets, Inc., to Nancy M. Morris, Secretary, dated February 13, 2006 ("Citigroup Letter").

[29] *Id.*

[30] The disclosure statement discloses the special risk and operation of portfolio margin accounts, 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.

[31] 15 U.S.C. 78f(b)(5).

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 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 that is 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; 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.* Please include File Number SR–NYSE–2006–13 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 20549–1090.

All submissions should refer to File Number SR–NYSE–2006–13. 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–2006–13 and should be submitted on or before April 27, 2006.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[32]

Nancy M. Morris,

Secretary.

[FR Doc. E6–5019 Filed 4–5–06; 8:45 am]

BILLING CODE 8010–01–P

[32] 17 CFR 200.30-3(a)(12).

SMALL BUSINESS ADMINISTRATION

Interest Rates

The Small Business Administration publishes an interest rate called the optional "peg" rate (13 CFR 120.214) on a quarterly basis. This rate is a weighted average cost of money to the government for maturities similar to the average SBA direct loan. This rate may be used as a base rate for guaranteed fluctuating interest rate SBA loans. This rate will be 4.500 (4½) percent for the April–June quarter of FY 2006.

James E. Rivera,

Associate Administrator for Financial Assistance.

[FR Doc. E6–5022 Filed 4–5–06; 8:45 am]

BILLING CODE 8025–01–P

SOCIAL SECURITY ADMINISTRATION

Agency Information Collection Activities: Proposed Request and Comment Request

The Social Security Administration (SSA) publishes a list of information collection packages that will require clearance by the Office of Management and Budget (OMB) in compliance with Public Law 104–13, the Paperwork Reduction Act of 1995, effective October 1, 1995. The information collection packages that may be included in this notice are for new information collections, approval of existing information collections, revisions to OMB-approved information collections, and extensions (no change) of OMB-approved information collections.

SSA is soliciting comments on the accuracy of the agency's burden estimate; the need for the information; its practical utility; ways to enhance its quality, utility, and clarity; and on ways to minimize burden on respondents, including the use of automated collection techniques or other forms of information technology. Written comments and recommendations regarding the information collection(s) should be submitted to the OMB Desk Officer and the SSA Reports Clearance Officer. The information can be mailed and/or faxed to the individuals at the addresses and fax numbers listed below: (OMB), Office of Management and Budget, Attn: Desk Officer for SSA, Fax: 202–395–6974.(SSA), Social Security Administration, DCFAM, Attn: Reports Clearance Officer, 1333 Annex Building, 6401 Security Blvd., Baltimore, MD 21235, Fax: 410–965–6400.

I. The information collections listed below are pending at SSA and will be submitted to OMB within 60 days from the date of this notice. Therefore, your comments should be submitted to SSA within 60 days from the date of this publication. You can obtain copies of the collection instruments by calling the SSA Reports Clearance Officer at 410–965–0454 or by writing to the address listed above.

1. *Application for Special Age 72-or-Over Monthly Payments—20 CFR 404.380–404.384—0960–0096.* Form SSA–19–F6 collects the information