trade report modifiers provided in NASD Rule 6130C(f) could not be implemented as of December 1, 2006. For that reason, NASD Rule 6130C(f) prohibits NASD members from reporting transactions covered by NASD Rule 6130(f) to the NASD/NSX TRF prior to December 15, 2006, and requires them to use an alternative electronic mechanism to satisfy their reporting obligations prior to that date.

The Commission believes that waiving the 30-day operative delay is consistent with the protection of investors and the public interest because it will allow NASD members to submit to the NASD/NSX TRF trade reports for the transactions specified in NASD Rule 6130C(f) on or after December 15, 2006, thereby providing NASD members with an additional means to satisfy their obligation to report these transactions.[16] For this reason, the Commission designates that the proposal become operative on December 1, 2006.

At any time within 60 days of the filing of such proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

VI. 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 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 an e-mail to *rule-comments@sec.gov.* Please include File Number SR–NASD–2006–129 on the subject line.

Paper Comments

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, Station Place, 100 F Street, NE., Washington, DC 20549–1090.

All submissions should refer to File Number SR–NASD–2006–129. 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 NASD. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make publicly available. All submissions should refer to File Number SR–NASD–2006–129 and should be submitted on or before January 8, 2007.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[17]

Florence E. Harmon,

Deputy Secretary.

[FR Doc. E6–21452 Filed 12–15–06; 8:45 am]

BILLING CODE 8011–01–P

[16] For purposes only of waiving the 30-day operative delay, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

[17] 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

Release No. 34–54918; File No. SR–NYSE–2006–13]

Self-Regulatory Organizations; New York Stock Exchange LLC; Order Approving a Proposed Rule Change to Rule 431 (''Margin Requirements'') and Rule 726 (''Delivery of Options Disclosure Document and Prospectus''), and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 1 to the Proposed Rule Change Relating to Customer Portfolio Margining

December 12, 2006.

I. Introduction

On March 2, 2006, the New York Stock Exchange LLC (''NYSE'' or ''Exchange'') filed with the Securities and Exchange Commission (''Commission''), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Act'' or ''Exchange Act'')[1] and Rule 19b–4[2] thereunder, a proposed rule change seeking to amend NYSE Rules 431 and 726 to expand the scope of products that are eligible for treatment as part of the NYSE's approved portfolio margin pilot program and to eliminate the requirement for a separate cross-margin account.[3] The proposed rule change would expand the scope of eligible products in the pilot to include margin equity securities and unlisted derivatives.[4] The proposed rule change was published in the **Federal Register** on April 6, 2006.[5] The Commission subsequently extended the comment period for the original proposed rule filing until May 11, 2006.[6] The Commission received 8 comment letters in response to the **Federal Register** notice.[7] On July 20,

[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 Rule 431 that permit broker-dealers to determine customer margin requirements for portfolios of listed broad-based securities index options, warrants, futures, futures options and related exchange-traded funds using a specified portfolio margin methodology. The Commission also approved amendments to Rule 726 to require disclosure to, and written acknowledgment from, customers using a portfolio margin account. *See also* NYSE Information Memo 05–56, dated August 18, 2005 (for additional information); and Exchange Act Release No. 54125 (July 11, 2006), 71 FR 40766 (July 18, 2006) (SR–NYSE–2005–93) (approving securities futures products and listed single stock options as eligible products for portfolio margining).

[4] For purposes of the pilot, a margin equity security is a security that meets the definition of a ''margin equity security'' under Regulation T of the Federal Reserve Board (''FRB''). *See* 12 CFR 220.2. An unlisted 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 SEC.'' *See* proposed Rule 431(g)(2)(I).

[5] *See* Exchange Act Release No. 53577 (March 30, 2006), 71 FR 17539 (April 6, 2006) (SR–NYSE–2006–13). The Chicago Board Options Exchange, Incorporated (''CBOE'') also filed a similar proposed rule filing seeking to expand the scope of eligible products under its portfolio margin pilot program. *See* Exchange Act Release No. 53576 (March 30, 2006), 71 FR 17519 (April 6, 2006) (SR–CBOE–2006–14).

[6] *See* Exchange Act Release No. 53728 (April 26, 2006), 71 FR 25878 (May 2, 2006).

[7] *See* letter from Timothy H. Thompson, Senior Vice President, Chief Regulatory Officer, Regulatory Services Division, CBOE, to Nancy Morris, Secretary, Commission, dated June 5, 2006 (''CBOE Letter''); letter from William H. Navin, Executive Vice President, General Counsel and Secretary, The Options Clearing Corporation (''OCC''), to Nancy M. Morris, Secretary, Commission, dated May 19, 2006 (''OCC Letter''); letter from James Barry, on behalf of the *Ad Hoc* Portfolio Margin Committee, John Vitha, Chair, Derivatives Product Committee and Christopher Nagy, Chair, Options Committee, Securities Industry Association, to Nancy M. Morris, Secretary, dated May 16, 2006 (''SIA Letter''); letter from Gary Alan DeWaal, Group

2006, the Exchange filed a response to these comments.[8] The comment letters and the Exchange's responses to the comments are summarized below. On September 13, 2006, the Exchange filed Amendment No. 1 to the proposed rule change.[9]

This order approves the proposed rule change. Simultaneously, the Commission provides notice of filing of Amendment No. 1, grants accelerated approval of Amendment No. 1 and solicits comments from interested persons on Amendment No. 1.[10]

II. Description

a. Portfolio Margining

The proposed rule change consists of amendments to Rule 431 to include margin equity securities (as defined in Regulation T) and unlisted derivatives as eligible products for the portfolio margining pilot.[11] The proposed rule change also includes amendments to eliminate the requirement of a separate cross-margin account. Rule 431 prescribes specific margin requirements for customers based on the type of securities held in their accounts.[12] Outside the existing pilot program, Rule 431 requires that margin be calculated using fixed percentages, on a position-by-position basis. In contrast, the current portfolio margin pilot program permits a broker-dealer to calculate customer margin requirements by grouping all products in an account that are based on the same index or issuer into a single portfolio. For example, futures, options and exchange traded funds based on the S&P 500 would each be grouped in a portfolio and products based on IBM would be grouped into a separate portfolio.

The broker-dealer then calculates a customer's margin requirement by "shocking" each portfolio at different equidistant points along a range representing a potential percentage increase and decrease in the value of the instrument or underlying instrument in the case of a derivative product. Currently, under the pilot, products of portfolios based on high capitalization, broad-based securities indexes are shocked along a range spanning an increase of 6% and a decrease of 8%. Portfolios of products based on non-high capitalization, broad-based securities indexes are shocked along a range spanning an increase of 10% and a decrease of 10%. Portfolios of products based on an equity security are shocked along a range spanning an increase of 15% and a decrease of 15%.[13] The proposed rule change would continue to apply these shock ranges. In addition, as with the current pilot, a theoretical options pricing model would continue to be used to derive position values at each valuation point for the purpose of determining the gain or loss.[14]

The portfolio shocks described above result in a gain or loss for each instrument in a portfolio at each calculation point along the range. These gains and losses are netted to derive a potential portfolio-wide gain or loss for the point. The margin requirement for a portfolio is the amount of the greatest portfolio-wide loss among the calculation points. The margin requirements for each portfolio are added together to calculate the total margin requirement for the portfolio margin account. This approach, in most cases, will generally lower customer margin requirements.[15]

The amount of margin (initial and maintenance) required with respect to a given portfolio would be the larger of: (1) The greatest portfolio-wide loss amount among the valuation point calculations; or (2) the sum of $.375 for each option and future in the portfolio multiplied by the contract's or instrument's multiplier.[16] The second computation establishes a minimum margin requirement to ensure that a certain level of margin is required from the customer in the event the greatest portfolio-wide loss among the valuation points is *de minimis*.

b. Expansion of Eligible Products

Under the Exchange's proposed rule, products eligible for portfolio margining would be expanded to include margin equity securities (as defined under Regulation T),[17] unlisted derivatives and futures contracts on narrow-based security indexes.[18] The unlisted derivatives would be included in a portfolio based on the underlying reference index or security. Individual equities and narrow-based index futures would be included in a portfolio shocked at a range spanning an increase of 15% and a decrease of 15% (as is the case with listed single stock options and securities futures).

c. Margin Deficiency

The current rule requires a customer to satisfy a margin deficiency in a portfolio margin account within three business days by depositing additional securities or cash or effecting an offsetting hedge.[19] The current pilot also requires a broker-dealer to deduct from its net capital the amount of any portfolio margin call not met by the close of business on T+1 and until the

General Counsel and Director of Legal and Compliance, Fimat USA, LLC, to Nancy M. Morris, Secretary, Commission, dated May 11, 2006 ("Fimat Letter"); letter from Stuart J. Kaswell, Partner, Dechert LLP, Counsel for Federated Investors, Inc., to Nancy M. Morris, Secretary, Commission, dated May 10, 2006 ("Federated Letter"); letter from Craig S. Donohue, Chief Executive Officer, Chicago Mercantile Exchange Inc., to Jonathan G. Katz, Secretary, Commission, dated May 9, 2006 ("CME Letter"); letter from Gerard J. Quinn, Vice President and Associate General Counsel, SIA, to Nancy M. Morris, Secretary, Commission, dated April 21, 2006 ("SIA Extension Letter"); and e-mail from Stephen A. Kasprzak, Principal Counsel, Rule and Interpretive Standards, NYSE, dated April 21, 2006 ("Kasprzak e-mail").

[8] *See* letter from Mary Yeager, Assistant Secretary, NYSE, to Michael A. Macchiaroli, Associate Director, Division of Market Regulation, Commission, dated July 20, 2006 ("NYSE Response").

[9] The NYSE filed Amendment No. 1 in response to comments received and to make other clarifying changes to the proposed rule filing. *See* Section II. for a discussion of the changes in Amendment No. 1. A clean copy of the proposed rule, as amended by Amendment No. 1, is attached to this order as *Appendix A*.

[10] By separate order, the Commission also is approving a parallel rule filing by CBOE (SR–CBOE–2006–14). Exchange Act Release No. 54919; *see also supra* note 5.

[11] The list of eligible products under the pilot currently includes listed broad-based securities index options, warrants, futures, futures options and related exchange-traded funds, as well as single stock options and securities futures products.

[12] The margin rules specify the amount of equity a customer must maintain in his or her margin account with respect to securities positions financed by the broker-dealer. The equity protects the broker-dealer in the event the customer defaults on the obligation to re-pay the financing and the broker-dealer is forced to liquidate the position at a loss.

[13] For example, under the pilot, a portfolio of single stock futures and listed equity options would be shocked at 10 equidistant points along a range bounded on one end by a 15% increase in the market value of the instrument and at the other end by a 15% decrease (*i.e.*, at +/−3%, +/−6%, +/−9%, +/−12% and +/−15%).

[14] Currently, the only model that qualifies is the OCC's Theoretical Intermarket Margining System (TIMS).

[15] For example, the current required initial and maintenance margin requirements for an equity security are 50% and 25%, respectively. The market movement range to calculate the potential gains and losses under the proposed portfolio margin rule for equity securities is +/−15%.

[16] The multiplier for a standard listed option is fixed by the options market on which the options series is traded. For example, a cash settled equity option generally has a multiplier of 100. Therefore, the minimum margin for one options contract would be $37.50. The multipliers for different securities and futures products may vary.

[17] Margin equity securities include certain foreign equity securities and options on foreign equity securities. *See* 12 CFR 220.2

[18] The Commission approved listed single stock options and securities futures products (excluding narrow-based indexes) as eligible products on July 11, 2006. *See* supra note 3.

[19] The original pilot required margin calls to be met by T+1. The current requirement of meeting margin calls within three business days was approved in SR-NYSE–2005–93. *See* Exchange Act Release No. 54125 (July 11, 2006), 71 FR 40766 (July 18, 2006).

call is satisfied. The proposal would now further require the broker-dealer to have in place procedures to identify accounts that periodically liquidate positions to eliminate margin deficiencies, and to take appropriate action when warranted.[20]

d. $5 Million Equity Requirement

The current pilot requires customers that are not broker-dealers or futures firms to maintain minimum account equity of $5 million if they opt to include portfolios of broad-based securities index products in their accounts.[21] The proposed rule change would eliminate the $5 million account equity requirement for all portfolio margin accounts, except those holding unlisted derivatives.[22]

e. Risk Management Methodology

The pilot requires member broker-dealers to monitor the risk of portfolio margin accounts and maintain a written risk analysis methodology for assessing potential risk to the firm's capital. This risk analysis methodology must be made available to the Exchange upon request. The proposed rule change strengthens these requirements by providing that, the member broker-dealer must file the risk analysis methodology with the Exchange (or the firm's Designated Examining Authority, if not the Exchange)[23] and submit it to the Commission prior to implementation. The proposed rule change also requires the inclusion of additional procedures and guidelines as part of the methodology.[24]

f. Cross-Margin Account

The proposed rule change would eliminate the requirement that portfolios with futures positions be held in a separate cross-margin account. Under the proposal, a customer would be permitted to use a single securities margin account for all eligible products. The Exchange and commenters have indicated that maintaining and monitoring two separate margin accounts would be operationally difficult and that it would be more efficient to hold all positions in one securities account.

g. Hedged Positions

Under the pilot, an underlying security in a portfolio margin account must be removed from the account if it is no longer offset by an option position. The amendments propose to eliminate the requirement to remove instruments that are no longer offset by options positions. The Exchange made this change in response to comments that all positions eligible for a portfolio margin account, including underlying securities, should receive equal treatment. Moreover, the Exchange noted that it would be operationally difficult to move positions in and out of the portfolio margin account based on whether they are currently being offset.

h. Discussion of Changes to the Proposed Rule Change in Amendment No. 1

The Exchange filed Amendment No. 1 to the proposed rule change in response to comments received, to make conforming changes to the CBOE rule filing[25] and to otherwise clarify certain terms and definitions. The following summarizes the changes made in Amendment No. 1 to the proposed rule change. In Amendment No. 1, the Exchange:

- Clarifies certain definitions and conforms others to the CBOE filing;
- Adds language allowing a customer to use excess equity in a regular margin account to meet a margin deficiency in a portfolio margin account without having to transfer any funds or securities where the portfolio margin account is a sub-account of the regular margin account;
- Adds language allowing positions not eligible for portfolio margin treatment to be carried in the portfolio margin account for their collateral value, subject to the margin requirements of a regular margin account;
- Adds language permitting shares of a money market mutual fund to be held in a portfolio margin account (subject to applicable margin requirements), provided certain requirements are met;
- Clarifies the restrictions with respect to day trading[26] in a portfolio margin account; and
- Eliminates the sample risk disclosure statement and acknowledgement in the rule text.[27]

III. Summary of Comments Received and NYSE Response

The Commission received a total of 8 comment letters to the proposed rule change.[28] The comments, in general, were supportive. One commenter stated that it strongly supports ''the significant step forward represented by the currently proposed changes.''[29] Another commenter stated that the portfolio margining of securities products will ''help U.S. brokers and exchanges compete more effectively with their overseas counterparts * * * and thereby increase the strength and liquidity of U.S. markets.''[30] Each commenter, however, recommended changes to specific provisions of the proposed rule change.

Several commenters[31] submitted comments regarding the ability to use portfolio margin methodologies other than the method prescribed in the rule to calculate customer margin requirements. One commenter stated that the Commission has experience in approving proprietary market risk models for consolidated supervised entities (CSEs) and OTC derivatives dealers.[32] In its response, the Exchange acknowledged that proprietary models may prove to be effective and efficient in managing risk.[33] The Exchange stated, however, that initially, regulators should gain experience with portfolio margining through the rule's specified methodology and that in the longer term, proprietary risk models could be considered as alternatives.

One commenter suggested that futures positions in a portfolio margin account be held in a separate futures account, while securities positions be held in a securities account.[34] The commenter referred to this approach as the ''two

[20] The current pilot requires that member firms not permit a customer to make a practice of meeting a portfolio margin deficiency through liquidation.

[21] The $5 million account equity requirement for such customers was eliminated to the extent they limited their accounts to portfolios of listed options and securities futures. *See* SR–NYSE–2005–93, *supra* note 3.

[22] *See* proposed Rule 431(g)(4)(C).

[23] Amendment No. 1 to the proposed rule amended the rule language to state that the written risk methodology must be filed with the Exchange, rather than approved by the Exchange, as proposed, in the March 2, 2006 rule filing.

[24] The current pilot also requires member firms to notify, and receive approval from the Exchange, prior to opening portfolio margin accounts for customers. The proposed rule modifies this requirement by requiring approval from a member firm's DEA, if it is not the Exchange.

[25] *See supra* note 5.

[26] NYSE proposed to amend the rule text to allow a customer that establishes and maintains at least $5 million in equity to engage in day trading without the restrictions of NYSE's day trading rules, if the member firm has the ability to monitor the intra-day risk associated with day trading. Further, if a participant has less than $5 million equity, the day trading restrictions will apply, unless the position or positions day traded were part of a hedge strategy.

[27] Instead the Exchange will send out an Information Memo with the sample disclosure language. The Exchange made this change to avoid having to file a proposed rule change each time in the risk disclosure document is changed.

[28] *See supra* note 7. Two of these comment letters related to the extension of the comment period for the proposed rule change. *See* SIA Extension Letter and Kasprzak e-mail.

[29] *See* SIA Letter.

[30] *See* Fimat Letter.

[31] *See* SIA Letter and OCC Letter; *see also* CME Letter (discussing SPAN).

[32] *See* SIA Letter.

[33] *See* NYSE Response, *supra* note 8.

[34] *See* CME Letter.

pot'' model.[35] The commenter stated that it favors this ''two pot'' approach because it believes that it more easily accommodates differences in customer protection and capital requirements of the Commission and the Commodity Futures Trading Commission (''CFTC'').[36] Commenters, in general, favored a single portfolio margin securities account (referred to as the ''one pot'' approach).[37] One commenter stated that the ''disadvantages of a two pot model outweigh its advantages.'' [38] The Exchange stated that it believes that a one pot approach will provide for more efficient margining, reduce broker-dealer/FCM liquidity risk and reduce operational inefficiencies.

Three commenters expressed the need for the Commission and the CFTC to continue working towards eliminating the legal and regulatory impediments to cross-margining futures and securities products.[39] In response, the Exchange stated that it will continue to work with the Commission and the CFTC on the regulatory issues related to holding securities and futures in a portfolio.

One commenter stated that portfolio margining should be expanded to include nonequity securities, interest rate derivatives, collateralized debt obligations and other similar non-equity related products, and foreign currency derivatives.[40] This commenter also requested that nonequity securities be permitted to be held in the portfolio margin account for collateral purposes only, subject to the other margin requirements of NYSE Rule 431.[41] The Exchange noted that it agrees with the commenter to the extent that nonequity securities may serve as collateral in the portfolio margin account.[42] The Exchange also stated that once the SROs and broker-dealers gain more experience with portfolio margining, the Exchange may consider whether nonequity products should be eligible for portfolio margining.

One commenter sought clarification as to whether broker-dealers and their customers could use shares of money market funds as collateral for portfolio margining.[43] The Exchange noted that it believes the rule currently permits the use of money market funds in a portfolio margin account, and clarified this issue through changes to the rule text in Amendment No. 1 to the proposed rule change.[44]

One commenter objected to the $0.375 per contract minimum margin requirement, and offered alternative lower minimums.[45] In response to this comment, the Exchange noted that the $.375 per contract minimum provides a cushion against significant market movements. The Exchange also noted that it is concerned about potential illiquidity in the market and the creation of gap risk in the event both sides of a hedge cannot be closed out simultaneously.

Several commenters objected to the proposed prohibition on day trading in a portfolio margin account.[46] The Exchange noted that the day trading prohibition is not intended to prohibit intraday trading in an account that contains a large portfolio of hedged instruments and, in response to the comments, amended the day trading rule language.[47]

Finally, the Exchange encouraged the Commission to move forward in approving the amendments.[48]

IV. Discussion and Commission Findings and Accelerated Approval of Amendment No. 1

The Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.[49] In particular, the Commission believes that the proposed rule change, as amended, is consistent with Section 6(b)(5) of the Act [50] in that it is designed to perfect the mechanism of a free and open market and to protect investors and the public interest. The Commission notes that the proposed portfolio margin rule change is intended to promote greater reasonableness, accuracy and efficiency with respect to Exchange margin requirements and will better align margin requirements with actual risk.

Under a portfolio margin system, offsets are fully realized, whereas under the Exchange's current margin rules, positions are margined independent of each other and offsets between them do not figure into the total margin requirement. A portfolio margin system recognizes the offsetting gains from positions that react favorably in market declines, while market rises are tempered by offsetting losses from positions that react negatively. Consequently, a portfolio margin approach can have a neutralizing effect on the volatility of margin requirements. Thus, a portfolio margin system may better align a customer's total margin requirement with the actual risk associated with the customer's positions taken as a whole. The Commission further notes portfolio margining may alleviate excessive margin calls, improve cash flows and liquidity, and reduce volatility.

Moreover, the Commission notes that approving the proposed rule change would enhance portfolio margining by permitting more products to be margined under this methodology. This is consistent with the amendments to Regulation T made by the FRB in 1998, which sought to advance the use of portfolio margining.[51] The Commission also believes that this expanded program for portfolio margining will serve to advance the development of even more risk-sensitive approaches to margining customer positions, including the use of internal models as advocated by commenters. The Commission intends to work with the NYSE and CBOE towards this objective after it gains experience with the portfolio margining system of this proposal.

The Commission believes that while the portfolio margining system in the proposed rule will have the effect of reducing customer margin (in most cases), the methodology is relatively conservative in that it requires positions to be shocked at specified market move ranges (*e.g.*, +/−15% for individual equities) that represent potential future stress events. Essentially the same portfolio methodology has been used by broker-dealers to calculate haircuts on options positions for net capital purposes.[52] Furthermore, the proposed requirement that a firm receive pre-approval from the Exchange prior to offering portfolio margining to its

[35] *Id.*

[36] *See* CME Letter.

[37] *See* OCC and CBOE Letters.

[38] *See* CBOE Letter.

[39] See SIA, Fimat and OCC Letters.

[40] *See* SIA Letter.

[41] *See* SIA Letter.

[42] *See* Amendment No. 1.

[43] *See* Federated Letter.

[44] *See* NYSE Response; *see also* Amendment No. 1 (adding language regarding use of money market mutual funds in a portfolio margin account).

[45] *See* SIA Letter.

[46] *See* SIA and Fimat Letters.

[47] *See* Amendment No. 1.

[48] *See* NYSE Response.

[49] In approving this proposed rule change, the Commission notes that it has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

[50] 15 U.S.C. 78f(b)(5).

[51] Federal Reserve System, ''Securities Credit Transactions; Borrowing by Brokers and Dealers,'' 63 FR 2806 (January 16, 1998); *see also* 12 CFR 220.1(b)(3)(i); *see also* letter from the FRB to James E. Newsome, Acting Chairman, Commodity Futures Trading Commission, and Laura S. Unger, Acting Chairman, Commission, dated March 6, 2001. The FRB concluded the letter by writing ''the Board anticipates that the creation of securities futures products will provide another opportunity to develop more risk-sensitive, portfolio-based approaches for all securities, including securities options and securities futures products.'' *Id.*

[52] *See* Exchange Act Release No. 38248 (February 6, 1997), 62 FR 6474 (February 12, 1997).

customers, coupled with the requirement for enhanced risk management procedures, is designed to ensure that only those firms with adequate controls would be eligible to implement a customer portfolio margining program.[53]

Accelerated Approval of Amendment No. 1

The Exchange also has requested that the Commission approve Amendment No. 1 to the proposed rule change prior to the thirtieth day after publication of notice of the filing in the **Federal Register**. The Commission believes that the changes in Amendment No. 1 to the proposed rule change do not raise significant new or unique issues from those previously raised in the earlier portfolio margin rule filings.[54] The changes proposed by the Exchange in Amendment No. 1 are designed to ensure consistency with the companion CBOE proposed rule filing and to respond to comments received as a result of the **Federal Register** notice.[55] The Commission believes that these proposed changes strengthen the proposed rule change.

Accordingly, the Commission finds good cause for approving Amendment No. 1 to the proposed rule change prior to the thirtieth day after the date of publication of notice thereof in the **Federal Register**. Specifically, the Commission believes that it is consistent with Section 19(b)(2) of the Act[56] to approve Amendment No. 1 to the Exchange's proposed rule change prior to the thirtieth day after publication of the notice of filing thereof in the **Federal Register**.

Uniform Effective Date

The Commission believes that approving the amendment on an accelerated basis will permit the NYSE to begin the process of approving broker-dealers to implement portfolio margining and would allow firms to begin to make the necessary changes and upgrades to their systems, as well as their policies and procedures, in order to accommodate customer portfolio. The Commission, however, believes that if some firms receive NYSE approval to begin offering customer portfolio margining to customers before other member firms, these other firms would be at a competitive disadvantage. Therefore, the Commission has determined to set a uniform effective date of April 2, 2007 for the proposed rule change, as amended. As stated above, the Commission believes that setting a uniform effective date will avoid placing some members firms at a competitive disadvantage and reduce confusion in the marketplace.

V. Solicitation of Comments of Amendment No. 1

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change, as amended, 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 Exchange. 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 January 8, 2007.

VI. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,[57] that the proposed rule change (File No. SR–NYSE–2006–13), is hereby approved, and that Amendment No. 1 to the proposed rule change be, and hereby is, approved on an accelerated basis, both on a pilot basis to expire on July 31, 2007. The effective date will be April 2, 2007.

By the Commission.

Florence E. Harmon,

Deputy Secretary.

Exhibit A—Margin Requirements

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

Portfolio 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 all margin equity securities [1], listed options, unlisted derivatives, and security futures products (as defined in Section 3(a)(56) of the Securities Exchange Act of 1934 (the "Exchange Act")), provided that the requirements of section (g)(6)(B)(1) of this Rule are met.

In addition, a member organization, provided that it is a Futures Commission Merchant ("FCM") and is either a clearing member of a futures clearing organization or has an affiliate that is a clearing member of a futures clearing organization, is permitted under this section (g) to combine an eligible participant's related instruments as defined in section (g)(2)(E), with listed 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.

The portfolio margin 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

[53] The proposed rules also would continue to require a minimum per contract charge of $.375. The Commission also notes that the proposed rules contain a leverage test under which a broker-dealer cannot permit the amount of portfolio margin required of its customers to exceed 10 times the firm's net capital.

[54] *See supra* note 3.

[55] *See supra* notes 5 and 7.

[56] 15 U.S.C. 78s(b)(2).

[57] 15 U.S.C. 78s(b)(2).

[1] For purposes of this section (g) of the Rule, the term "margin equity 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.

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 must be filed with the New York Stock Exchange (''Exchange''), or the member organization's designated examining authority (''DEA''), if other than the Exchange, 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 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) The determination, review and approval of credit limits to each eligible participant, and across all eligible participants, utilizing a portfolio margin account,

(C) Monitoring credit risk exposure to the member organization from portfolio margin accounts, on both an intra-day and end of day basis, including the type, scope and frequency of reporting to senior management,

(D) The use of stress testing of portfolio margin accounts in order to monitor market risk exposure from individual accounts and in the aggregate,

(E) 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 extended 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 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) For purposes of portfolio margin requirements the term ''equity'', as defined in section (a)(4) of this Rule, includes the market value of any long or short positions held in an eligible participant's account.

(B) The term ''listed option'' means any equity-based or equity index-based option traded on a registered national securities exchange or automated facility of a registered national securities association.

(C) The term ''portfolio'' means any eligible product, as defined in section (g)(6)(B)(1), grouped with its underlying instruments and related instruments.

(D) The term ''product group'' means two or more portfolios of the same type (see table in section (g)(2)(G) below) for which it has been determined by Rule 15c3–1a under the Exchange Act that a percentage of offsetting profits may be applied to losses at the same valuation point.

(E) The term ''related instrument'' within a security class or product group means broad-based index futures and options on broad-based index futures covering the same underlying instrument. The term ''related instrument'' does not include security futures products.

(F) The term ''security class'' refers to all listed options, security futures products, unlisted derivatives, and related instruments covering the same underlying instrument and the underlying instrument itself.

(G) The term ''theoretical gains and losses'' means the gain and loss in the value of individual eligible products and related instruments at ten 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 Market Index [2]	+6%/−8%
Non-High Capitalization, Broad-based Market Index [3]	+/−10%
Any other eligible product that is, or is based on, an equity security or a narrow-based index	+/−15%

(H) The term ''underlying instrument'' means a security or security index upon which any listed option, unlisted derivative, security future, or broad-based index future is based.

(I) The term ''unlisted 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 SEC.

(3) Approved Theoretical Pricing Models.—Theoretical pricing models must be approved by the SEC.

(4) Eligible Participants.—The application of the portfolio margin provisions of this section (g) is limited to the following:

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

(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 uncovered options and, if transactions in security futures are to be included in the account, approval for such transactions is also required. However, an eligible participant under this section (g)(4)(C) may not establish or maintain positions in unlisted derivatives unless minimum equity of at least five million dollars is established and maintained with the member organization. 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

[2] 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).

[3] See footnote above.

not permitted for purposes of the minimum equity requirement.

(5) Opening of Accounts.

(A) Member organizations must notify and receive approval from the Exchange or the member organization's DEA, if other than the Exchange, prior to establishing a portfolio margin methodology for eligible participants.

(B) Only eligible participants that have been approved to engage in uncovered short option contracts pursuant to Exchange Rule 721, or the rules of the member organization's DEA, if other than the Exchange, 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 which includes an acknowledgement for all portfolio margin account owners to sign, attesting that they have read and understood the disclosure statement, and agree to the terms under which a portfolio margin account is provided (see Exchange Rule 726(d)), and

(2) Obtain the signed acknowledgement noted above from the eligible participant and record the date of receipt.

(6) Establishing Account and Eligible Positions.

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

A margin deficit in the portfolio margin account of an eligible participant may not be considered as satisfied by excess equity in another account. Funds and/or securities must be transferred to the deficient account and a written record created and maintained. However, if a portfolio margin account is carried as a sub-account of a margin account, excess equity in the margin account (determined in accordance with the rules applicable to a margin account other than a portfolio margin account) may be used to satisfy a margin deficit in the portfolio margin sub-account without having to transfer any funds and/or securities.

(B) 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 margin equity security (including a foreign equity security and option on a foreign equity security, provided the security is deemed to have a ''ready market'' under SEC Rule 15c3–1 or a ''no-action'' position issued thereunder, and a 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 to permit the sale of the security, upon exercise or assignment of any listed option or unlisted derivative written or held against it, without restriction).

(ii) A listed option on an equity security or index of equity securities,

(iii) A security futures product,

(iv) An unlisted derivative on an equity security or index of equity securities,

(v) A warrant on an equity security or index of equity securities,

(vi) A related instrument as defined in section (g)(2)(E).

(7) 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 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, unlisted derivative, security future product, and related instrument, multiplied by the contract's or instrument's multiplier, not to exceed the market value in the case of long contracts in eligible products.

(C) Account guarantees pursuant to section (f)(4) of this Rule are not permitted for purposes of meeting margin requirements.

(D) Positions other than those listed in section (g)(6)(B)(1) above are not eligible for portfolio margin treatment. However, positions not eligible for portfolio margin treatment (except for ineligible related instruments) may be carried in a portfolio margin account, provided the member organization has the ability to apply the applicable strategy based margin requirements promulgated under this Rule. Shares of a money market mutual fund may be carried in a portfolio margin account, also subject to the applicable strategy based margin requirements under this Rule provided that:

(1) The customer waives any right to redeem shares without the member organization's consent, s

(2) The member organization (or, if the shares are deposited with a clearing organization, the clearing organization) obtains the right to redeem shares in cash upon request,

(3) The fund agrees to satisfy any conditions necessary or appropriate to ensure that the shares may be redeemed in cash, promptly upon request, and

(4) The member organization complies with the requirements of Section 11(d)(1) of the Exchange Act and Rule 11d1–2 thereunder.

(8) Method of Calculation.

(A) Long and short positions in eligible products including underlying instruments and related instruments, are to be grouped by security class; each security class group being a ''portfolio''. Each portfolio is categorized as one of the portfolio types specified in section (g)(2)(G) above as applicable.

(B) For each portfolio, theoretical gains and losses are calculated for each position as specified in section (g)(2)(G) 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)(G), may then be applied as permitted by Rule 15c3–1a under the Exchange Act.

(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.

(A) If, as of the close of business, the equity in the portfolio margin account of an eligible participant as described in section (g)(4)(C), declines below the five million dollar minimum equity required, if applicable, and is not restored to at least five million dollars within three business days by a deposit of funds and/or securities, member organizations are prohibited from accepting new opening orders beginning on the fourth business day, except that new opening orders entered for the purpose of reducing market risk 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) All unlisted derivatives are liquidated or transferred from the

portfolio margin account to the appropriate securities account.

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

(10) Portfolio Margin Deficiency

(A) If, as of the close of business, the equity in the portfolio 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 funds and/or securities or establish a hedge to meet the margin requirement within three business days. After the three business day period, member organizations are prohibited from accepting new opening orders, except that new opening orders entered for the purpose of reducing market risk 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 funds and/or securities in an amount sufficient to eliminate any margin deficiency after 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 deficiency is not met by the close of business on the next business day after the business day on which such deficiency arises, member organizations will be required to deduct the amount of the deficiency from Net Capital until such time as the deficiency is satisfied.

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

(D) The Exchange, or the member organization's DEA, if other than 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 extraordinary circumstances only.

(E) Member organizations should not permit an eligible participant to make a practice of meeting a portfolio margin deficiency by liquidation. Member organizations must have procedures in place to identify accounts that periodically liquidate positions to eliminate margin deficiencies, and the member organization is expected to take appropriate action when warranted. Liquidations to eliminate margin deficiencies that are caused solely by adverse price movements may be disregarded.

(11) Determination of Value for Margin Purposes.—For the purposes of this section (g), all eligible products shall be valued at current market prices. Account equity for the purposes of sections (g)(9)(A) and (g)(10)(A) shall be calculated separately for each portfolio margin account.

(12) Net Capital Treatment of Portfolio Margin Accounts.

(A) No member organization that requires margin in any portfolio margin account pursuant to section (g) of this Rule shall permit the aggregate portfolio margin requirements to exceed ten times its Net Capital for any period exceeding three business days. The member organization shall, beginning on the fourth business day, cease opening new portfolio margin accounts until compliance is achieved.

(B) If, at any time, a member organization's aggregate portfolio 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, D.C., 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 Exchange, or the member organization's DEA, if other than the Exchange.

(13) Day Trading Requirements.—The day trading restrictions promulgated under section (f)(8)(B) of this Rule shall not apply to portfolio margin accounts that establish and maintain at least five million dollars in equity, provided a member organization has the ability to monitor the intra-day risk associated with day trading. Portfolio margin accounts that do not establish and maintain at least five million dollars in equity will be subject to the day trading restrictions under section (f)(8)(B), provided the member organization has the ability to apply the applicable day trading requirements under this Rule. However, if the position or positions day traded were part of a hedge strategy, the day trading restrictions will not apply. A ''hedge strategy'' for the purpose of this rule means a transaction or a series of transactions that reduces or offsets a material portion of the risk in a portfolio. Member organizations are expected to monitor these portfolio margin accounts to detect and prevent circumvention of the day trading requirements.

(14) Requirements to Liquidate

(A) A member organization is required immediately either to liquidate, or transfer to another broker-dealer eligible to carry portfolio margin accounts, all portfolio margin accounts with positions in related instruments, 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 Exchange Act 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 Disclosure Statement and Acknowledgement

(d) The special written disclosure statement describing the nature and risks of portfolio margining, and acknowledgement for an eligible participant signature, required by Rule 431(g)(5)(C) 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.

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