

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-46576; File No. SR-NYSE-2002-19]

### Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the New York Stock Exchange, Inc. Relating to Customer Portfolio and Cross-Margining Requirements

October 1, 2002.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on May 13, 2002, the New York Stock Exchange, Inc. ("NYSE" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Exchange. On August 21, 2002, the NYSE filed Amendment No. 1 to the proposed rule change.<sup>3</sup> The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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

The Exchange proposes to amend NYSE Rule 431 to permit self-clearing members and member organizations to margin listed, broad-based, market index options, index warrants and related exchange-traded funds according to a prescribed portfolio margin methodology relating to a portfolio margin account of a registered broker-dealer, any affiliate of a self-clearing member or member organization, certain qualified members of a national futures exchange, and any other person or entity that maintains account equity of at least \$5 million.

The Exchange further proposes to amend NYSE Rule 726 to require that a disclosure statement and written acknowledgement for use with the proposed portfolio margining and cross-margining changes be furnished to customers.

The text of the proposed rule change is available at the Office of the Secretary, NYSE, at the Commission, and on the Commission's Web site.

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

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

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

###### 1. Purpose

###### a. Background

NYSE Rule 431 generally prescribes minimum maintenance margin requirements for customer accounts held at members and member organizations. In April 1996, the Exchange established the Committee to assess the adequacy of NYSE Rule 431 on an ongoing basis, review margin requirements, and make recommendations for change. A number of proposed amendments resulting from the Committee's recommendations have been approved by the Exchange's Board of Directors since the Committee was established. Similarly, the proposed amendments discussed below have been recommended by the Committee and have been adopted by the Exchange in this proposal, as amended.<sup>4</sup> The Exchange represents that the proposed portfolio margin and cross-margin rules have been developed in conjunction with the CBOE, The Options Clearing Corporation, the American Stock Exchange, LLC, the Board of Trade of the City of Chicago, Inc., the Chicago Mercantile Exchange, Inc., and the National Association of Securities Dealers, Inc.

###### b. Portfolio Margin

The Exchange proposes to amend NYSE Rule 431 to expand the scope of its margin rule by providing a portfolio margin methodology for listed, broad-based market index options, index

warrants and related exchange-traded funds. The Exchange believes that the proposed amendments would allow clearing members and member organizations to extend to eligible customers portfolio margin methodology as an alternative to the current strategy-based margin requirements. The Exchange further believes that the proposed rule would also allow broad-based market index futures and options on such futures to be included in a portfolio margin account, thus providing a cross-margin capability. The Exchange proposes to introduce the amendments as a two-year pilot program that would be available on a voluntary basis to member organizations.

Portfolio margining is a margin methodology that sets margin requirements for an account based on the greatest projected net loss of all positions in a product class or group as determined by the Commission-approved options pricing model using multiple pricing scenarios. 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.

The Exchange represents that the purpose and benefit of portfolio margining is to efficiently set levels of margin that more precisely reflect actual net risk of all positions in the account. A customer benefits from portfolio margining in that margin requirements calculated on net position risk are generally lower than strategy-based margin methodologies currently in place. In permitting margin computation based on actual net risk, members and member organizations will no longer be required to compute margin requirement for each individual position or strategy in a customer's account.

However, as a pre-condition to permitting portfolio margining, the member or member organization would be required to establish procedures and guidelines to monitor credit risk to the member or member organization's capital, including intra-day credit risk, and stress testing of portfolio margin accounts. Further, members and member organizations would have to establish procedures for regular review and testing of these required risk analysis procedures.

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

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

<sup>3</sup> See letter from Mary Yeager, Assistant Secretary, NYSE, to T.R. Lazo, Senior Special Counsel, Division of Market Regulation, Commission, dated August 20, 2002 ("Amendment No. 1"). In Amendment No. 1, the NYSE made technical corrections to its proposed rule language to eliminate any inconsistencies between its proposal and the Chicago Board Options Exchange, Inc.'s ("CBOE") proposal pursuant to the rule 431 Committee's ("Committee") recommendations. See Securities Exchange Act Release No. 45630 (March 22, 2002), 67 FR 15263 (March 29, 2002) (File No. SR-CBOE-2002-03) ("CBOE Proposal").

<sup>4</sup> Many aspects of the proposed rule change are similar to the CBOE's proposed rule change to permit customer portfolio margining and cross-margining. See CBOE Proposal, *supra* note 3.

### c. Cross-Margining Capability

In addition, the proposed rule change permits a clearing member or member organization to establish a separate portfolio margin account (securities margin account) exclusively for cross-margining. In this regard, related index futures and options on such futures would be allowed to be carried in the portfolio margin account, thus affording a cross-margin capability. In a portfolio margin account that is used exclusively for cross-margining, separate portfolios may be established containing index options, index warrants and exchange-traded funds structured to replicate the composition of the index underlying a particular portfolio, as well as related index futures and options on such futures.

To determine theoretical gains and losses, and resulting margin requirements, the same portfolio margin computation procedure will be applied to portfolio margin accounts that contain a cross-margin element.

### d. Disclosure Document and Customer Attestation

Exchange Rule 726 prescribes requirements for the delivery of options disclosure documents concerning the opening of customer accounts. As proposed by the Exchange, members and member organizations would be required to provide every portfolio margin customer with a written risk disclosure statement at or prior to the initial opening of a portfolio margin account. The disclosure statement is divided into two sections, one dealing with portfolio margining, and the other with cross-margining.

The statement would disclose the risk and operation of portfolio margin accounts, including cross-margining, and the differences between portfolio margin and strategy-based margin requirements. The disclosure statement would also address 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.

Included within the portfolio margin section of the disclosure statement would be a list of certain of the risks unique to portfolio margin accounts, such as: increased leverage; shorter time for meeting margin; involuntary liquidation if margin not received; inability to calculate future margin requirements because of the data and calculations required; and that long positions are subject to a lien. The risks and operation of a cross-margin feature are delineated in the cross-margin section of the disclosure statement, and

a list of certain of the risks associated with cross-margining will be included as well.

In addition, at or prior to the time a portfolio margin account is initially opened, members and member organizations would be required to obtain a signed acknowledgement regarding certain implications of portfolio margining (e.g., treatment under SEC Rules 8c-1, 15c2-1 and 15c3-3 under the Act) from the customer. Further, prior to providing cross-margining, members and member organizations would be required to obtain a second signed customer acknowledgement relative to the segregation treatment for futures contracts and Securities Investor Protection Corporation coverage.

### 2. Statutory Basis

The Exchange believes the proposed rule change, as amended, is consistent with section 6(b) of the Act<sup>5</sup> in general, and furthers the objectives of section 6(b)(5) of the Act<sup>6</sup> in particular, because it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investor and the public interest. In addition, the Exchange believes that section 6(b)(5) of the Act<sup>7</sup> requires that the rules of an exchange foster cooperation and coordination with persons engaged in regulating transactions in securities.

### 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 the furtherance of the purposes of the 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, as amended.

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

Within 35 days of the date of publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to

90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the Exchange consents, the Commission will:

(A) By order approve such proposed rule change, as amended, or

(B) Institute proceedings to determine whether the proposed rule change should be disapproved.

### IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change, as amended, is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609. 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 will also be available for inspection and copying at the principal office of the NYSE. All submissions should refer to File No. SR-NYSE-2002-19 and should be submitted by October 21, 2002.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.<sup>8</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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**BILLING CODE 8010-01-P**

## DEPARTMENT OF STATE

[Public Notice 4149]

**Culturally Significant Objects Imported for Exhibition; Determinations: "Millet to Matisse: Nineteenth-and-Twentieth-Century French Painting From Kelvingrove Art Gallery, Glasgow"**

**AGENCY:** Department of State.

**ACTION:** Notice.

**SUMMARY:** Notice is hereby given of the following determinations: Pursuant to the authority vested in me by the Act of October 19, 1965 [79 Stat. 985; 22 U.S.C.

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

<sup>6</sup> 15 U.S.C. 78f(b)(5).

<sup>7</sup> 15 U.S.C. 78f(b)(5).

<sup>8</sup> 17 CFR 200.30-2(a)(12).