

of the bid-ask price⁵⁶ 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.

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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].*

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).

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 15c3–1a(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.*

(iii) 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 days (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] aspects 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+

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 require 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.

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

⁷ 15 U.S.C. 78f(b)(5).

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 Act⁴ 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-4² 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

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.

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

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).

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