

pursuant to SEA Rule 15c3-1 (*Net Capital*) shall be deducted in computing the Net Capital of the member organization under the Exchange's Capital Requirements. For purposes of this paragraph (f)(10)(F) the term "approved specialist" means a specialist who is deemed a specialist for all purposes under the Exchange Act and who is registered pursuant to the rules of a national securities exchange.

.70 Money market mutual funds, as defined under Rule 2a-7 of the Investment Company Act of 1940, can be used for satisfying margin requirements under this subsection (f)(10), provided that the requirements of Rule 404(b) of the Exchange Act and Rule 46(b)(2) under the CEA are satisfied.

.80 Day-trading of security futures is subject to the minimum requirements of this Rule. If deemed a pattern day-trader, the customer must maintain equity of \$25,000. The 20% requirement, for security futures contracts, should be calculated based on the greater of the initial or closing transaction and any amount exceeding NYSE excess must be collected. The creation of a customer call subjects the account to all the restrictions contained in Rule 431(f)(8)(B).

.90 The use of the "time and tick" method is based on the member's or member organization's ability to substantiate the validity of the system used. Lacking this ability dictates the use of the aggregate method.

.100 Security futures contracts transacted or held in a futures account shall not be subject to any provision of this Rule.

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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 and is set forth in Sections A, B, and C below.

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

1. Purpose

The Exchange proposes to make permanent the amendments to NYSE Rule 431 regarding margin requirements for SFCs. The original proposed rule

change to amend NYSE Rule 431 was approved by the Commission on a pilot basis for sixty days on November 7, 2002.⁸ On January 6, 2003, the Commission approved an extension to the Pilot for an additional sixty days, ending March 6, 2003.⁹

The proposed amendments are being made to make the Exchange's margin rule consistent with margin rules already adopted by the SEC and the CFTC and those filed by other SROs regarding security futures.

Specifically, the proposed amendments would: (1) Permit customer margining of SFCs, and establish initial and maintenance margin requirements for SFCs; (2) allow for initial and maintenance margin levels for offsetting positions involving SFCs and related positions at lower levels than would be required if margined separately; (3) provide for a Market Maker exclusion for proprietary trades of a SFD and allow for "good faith" margin treatment for the accounts of approved options specialists, market makers and other specialists; (4) provide definitions relative to SFCs for application of this rule; (5) provide that SFCs transacted in a futures account shall not be subject to any provisions of NYSE Rule 431; (6) provide for money market mutual funds, as defined under Rule 2a-7¹⁰ of the Investment Company Act of 1940,¹¹ to be used to satisfy margin requirements for SFCs provided certain conditions are met; (7) require that SFCs transacted in a securities account be subject to all other provisions of NYSE Rule 431, particularly Rule 431(f)(8)(B) ("Day Trading"); and (8) permit members and member organizations for which the Exchange is the DEA to participate in the trading of SFCs.

Background

The CFTC and SEC have adopted customer margin requirements for the trading of SFCs ("SEC/CFTC Margin Regulations")¹² pursuant to authority delegated to them by the Federal Reserve Board ("FRB") under section 7(c)(2)(B) of the Act.¹³ As noted in the adopting release,¹⁴ new subsection (2) to section 7(c) provides that the customer margin requirements for SFCs must satisfy four requirements: (1) They must preserve the financial integrity of

markets trading security futures products; (2) they must prevent systemic risk; (3) they must (a) be consistent with the margin requirements for comparable options traded on an exchange registered pursuant to section 6(a) of the Exchange Act,¹⁵ and (b) provide for initial and maintenance margin that are not lower than the lowest level of margin, exclusive of premium, required for comparable exchange traded options; and (4) they must be and remain consistent with the margin requirements established by the FRB under Regulation T.¹⁶ The regulations on customer margin for security futures became effective on September 13, 2002. Pursuant to these amendments the Exchange filed proposed amendments to NYSE Rule 431, which were approved temporarily on a pilot basis by the Commission.

Specifically, on October 23, 2002, the Exchange filed a proposed rule change with the Commission to amend NYSE Rule 431 with regard to SFCs.¹⁷ On November 6, 2002, the Exchange filed Amendment No. 1 to the proposed rule change.¹⁸ The proposed rule change was approved by the Commission as a sixty-day pilot on November 7, 2002,¹⁹ effective through January 6, 2003 ("Pilot").

Among the amendments approved, as part of the Pilot, was new NYSE Rule 431(f)(10) ("Customer Margin Rules Relating to Security Futures"), which provides that SFCs transacted in a securities account be subject to all other provisions of NYSE Rule 431, including Rule 431(f)(8)(B) ("Day Trading").

Also approved as part of the Pilot were NYSE Rule 431(f)(10)(D) ("Security Futures Dealers" Accounts"), Rule 431(f)(10)(E) ("Approved Options Specialists' or Market Makers' Accounts"), and Rule 431(f)(10)(F) ("Approved Specialists' Accounts-others"). The rule permits "good faith" margin treatment for specified hedged offset positions carried in the accounts noted above. However, unlike the SFD rules of other SROs,²⁰ the Exchange's

¹⁵ 15 U.S.C. 78f.

¹⁶ 12 CFR part 220.

¹⁷ See SR-NYSE-2002-53.

¹⁸ See letter from Darla C. Stuckey, Corporate Secretary, NYSE, to Nancy Sanow, Assistant Director, Division, Commission, dated November 5, 2002 ("Amendment No. 1"). Amendment No. 1 replaced the original rule filing in its entirety (SR-NYSE-2002-53). Amendment No. 1 also proposed that the proposal be effective for a sixty-day pilot and requested accelerated approval of the proposed rule change.

¹⁹ See Securities Exchange Act Release No. 46782 (November 7, 2002), 67 FR 69052 (November 14, 2002) (SR-NYSE-2002-53).

²⁰ See e.g., Securities Exchange Act Release No. 46555 (September 26, 2002), 67 FR 61707 (October 1, 2002) (SR-OC-2002-01).

⁸ See *supra* note 3.

⁹ See *supra* note 4.

¹⁰ 17 CFR 270.2a-7.

¹¹ 15 U.S.C. 80a *et seq.*

¹² 17 CFR 240.400 through 406; 17 CFR 41.41 through 41.48.

¹³ 15 U.S.C. 78g(c)(2)(B).

¹⁴ See Securities Exchange Act Release No. 46292 (August 1, 2002), 67 FR 53146 (August 14, 2002).