

Information Memo

Member Firm Regulation



NYSE Regulation, Inc. | 20 Broad Street
New York, NY 10005
nyse.com

Number 07-75
July 23, 2007

ATTENTION: CHIEF EXECUTIVE OFFICER, FINANCIAL & OPERATIONS OFFICER, MANAGING PARTNERS, CREDIT AND MARGIN DEPARTMENTS, COMPLIANCE AND LEGAL DEPARTMENTS

TO: ALL MEMBER ORGANIZATIONS

SUBJECT: PORTFOLIO MARGINING SUITABILITY

In connection with the recent amendments to NYSE Rule 431 governing Portfolio Margining,¹ the attention of member organizations is directed to the need for care in the determination of suitability for the use of such accounts by individual investors and small institutional clients. This Information Memo will raise certain considerations which may guide this process.

Background

On December 18, 2006, the SEC approved² amendments to Rule 431 expanding the application of a prescribed risk-based margin requirement ("Portfolio Margin") to include all equity-based securities, futures and derivatives as an alternative to strategy-based margin requirements.

Portfolio Margining enables member organizations to calculate a customer's margin requirement by using a portfolio-stressing technique rather than a strategy-based approach. Such a technique more appropriately recognizes the risks in a diversified portfolio. By utilizing a more risk-based approach to determine initial and maintenance margin requirements, the broker-dealer can provide additional leverage to customers creating the possibility of increased activity using existing portfolio assets. This also creates certain responsibilities for the member organization. Among these responsibilities is the need to determine the suitability of a given customer for the establishment of a Portfolio Margin account.

¹ See NYSE Information Memo 07-71 (July 16, 2007), reporting a one year extension in the Portfolio Margin Pilot Program, as reflected in SR-NYSE-2007-56 (June 28, 2007). See also Release No. 34-54918 (December 12, 2006) 71 FR 75790 (December 18, 2006)(SR-NYSE-2006-13) and NYSE Information Memo 06-86, dated December 21, 2006.

² See Release No. 34-52031 (July 14, 2005) 70 FR 42130 (July 21, 2005)(SR-NYSE-2002-19 and NYSE Information Memo 05-56, dated August 18, 2005.

Suitability Concerns

At the outset, in order to be eligible for Portfolio Margin, customers³ must be approved for writing uncovered options.⁴ While this may limit the availability of Portfolio Margin for many customers,⁵ even persons and entities thus qualified must be affirmatively determined to be suitable for such an account. This will necessarily entail a review of the customer's ability to absorb losses in excess of the necessary collateral, and must also reflect the customer's stated investment objectives.

The foundation of this process is a determination that the prospective customer fully understands the terms and procedures governing the Portfolio Margin account. To this end, several SROs have created a Sample Portfolio Margining Risk Disclosure Statement and Acknowledgement.⁶ This document must be provided to customers, and the Acknowledgement must be obtained, prior to the initial transaction in a Portfolio Margin account.⁷

Questions concerning this Information Memorandum may be directed to Thomas Drogan at (212) 656-5412 or Gregory Taylor at (212) 656-2920.

Grace B. Vogel
Executive Vice President
Member Firm Regulation

³ In the context of this Information Memo, we will be excluding customers which are registered broker-dealers and/or members of a national futures exchange.

⁴ See NYSE Rule 721(e). Accounts to be subject to Portfolio Margin must be so qualified even if the customer has no intention of effecting transactions in uncovered options.

⁵ For considerations bearing on the utility of dollar suitability thresholds in the context of a sophisticated financial product, see SEC Release No. 33-8766 (December 27, 2006).

⁶ See NYSE Information Memo 07-27, dated March 19, 2007.

⁷ See NYSE Rule 431(g) and Rule 726(d).

