

# FIMAT

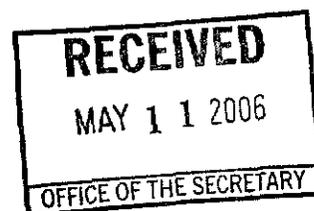
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**BY FAX AND OVERNIGHT MAIL**

May 11, 2006

Ms. Nancy M. Morris  
Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-1090  
FAX: (202) 772-9324



Re: Self-Regulatory Organizations; New York Stock Exchange LLC; Notice of Filing of Proposed Rule Change to Rule 431 ("Margin Requirements") and Rule 726 ("Delivery of Options Disclosure Document and Prospectus") to Expand the Products Eligible for Customer Portfolio Margining and Cross Margining and Eliminate Separate Cross-Margin Accounts (Release No. 34-53577; File No. SR-NYSE-2006-13); Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing of Proposed Rule Change Relating to Customer Portfolio Margining Requirements (Release No. 34-53576; File No. SR-CBOE-2006-14).

Dear Ms. Morris:

We are pleased to submit this letter to applaud the New York Stock Exchange LLC ("NYSE") for taking the very important initiative, along with the Chicago Board Options Exchange, Inc. ("CBOE"), to accommodate portfolio margining. We believe it is important that qualified United States ("US") brokers be permitted to accommodate in single accounts both their clients' futures and securities positions. Frankly, this is how the business typically is done in Europe, and it is important that it be done this way in the US in order for US brokers and exchanges to remain competitive. We believe that by approving these rule proposals, the Securities and Exchange Commission ("SEC") would be taking an important step (1) in continuing to recognize the growing convergence as an asset class of all exchange-traded financial products, whether they be designated as "futures" or "securities" under US law, and (2) by allowing for a sensible, integrated treatment of such products by financial brokers, clearing agents and other intermediaries.

As background, the Fimat Group, part of the French-based Société Générale Group, is one of the world's largest intermediaries of exchange-traded derivatives (both as an executing and clearing broker), and an increasingly

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significant intermediary for equities. Companies of the Fimat Group are members of most of the world's largest derivatives and equity exchanges. In the US, Fimat is represented by, among other companies, Fimat USA, LLC ("Fimat USA") and Fimat Preferred, LLC ("Fimat Preferred"), both broker-dealers and futures commission merchants registered with the SEC and the Commodity Futures Trading Commission ("CFTC"), respectively, and members of the National Association of Securities Dealers, Inc. ("NASD").<sup>1</sup>

In this letter, we will first present our views on portfolio margining, which we wholeheartedly support. Second, we will address the NYSE's specific rule proposal precluding day trading in portfolio margining accounts, a proposal that we respectfully request be amended.

A. Portfolio Margining

The Fimat Group applauds the NYSE and CBOE for presenting to the SEC rules allowing for the portfolio margining of securities products. Portfolio margining, which is common in the US futures industry and in securities and futures markets globally (and particularly in Europe), provides – as stated in the SEC's Release soliciting comments on the NYSE rule proposal – "an accurate and realistic assessment of reasonable margin requirements" based on a customer's overall risk.<sup>2</sup> More specifically:

[w]hen utilizing a portfolio margin methodology, offsets are fully realized, whereas under strategy or position-based methodology, positions and or groups of positions comprising a single strategy are margined independently of each other and offsets between them do not efficiently impact the total margin requirement.

SEC Release at 37 n.18.<sup>3</sup>

From a global perspective, we believe that the portfolio margining of securities products will help US brokers and exchanges compete more effectively with their overseas counterparts (many of which, as noted, already have the ability to portfolio margin securities products), and thereby increase the strength and liquidity of US markets. Indeed, from our perspective as a global intermediary that operates in the world's largest markets, we know that the international competition for investment dollars is only going to increase. Without question, the current NYSE and CBOE rule proposals will assist US brokers and exchanges greatly in competing for these resources.

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<sup>1</sup> Fimat Preferred, which is also a member of the NYSE, is a wholly-owned subsidiary of Fimat USA.

<sup>2</sup> SEC Release No. 34-53577, File Number SR-NYSE-2006-13 (March 30, 2006) at 39 ("SEC Release").

<sup>3</sup> We would note in this regard that, in our view, it should be the exchanges, rather than the Government, that determine the risk methodologies that may be used in portfolio margining, because it is the exchanges, we believe, that are most acutely aware of the risks and operational and system needs and resources of their members.

The Fimat Group further applauds the (a) NYSE and CBOE on their proposals to include futures products in the array of products eligible for portfolio margining, and (b) the NYSE on its proposal to combine securities and futures positions into one portfolio margining account.<sup>4</sup> Joint US broker-dealers and futures commission merchants ("BD/FCM"), such as Fimat USA have, over the years, received considerable interest from customers – both locally and abroad – seeking to combine their securities and futures positions into one portfolio margining account and enjoy the benefits such combined assets provide. We believe this "cross" margining of securities and futures products will, among other things, "better align margin requirements with the actual risk of hedged products ..... potentially alleviate excess margin calls and potentially reduce the risk of forced liquidations of positions in customer accounts." SEC Release at 44. The current rule proposals are an important step in achieving this goal.<sup>5</sup>

We agree, however, with concerns raised by the Securities Industry Association ("SIA") and Futures Industry Association ("FIA") that, before such cross-margining can occur, the SEC and CFTC will have to issue relief from certain securities and futures rules currently in existence.<sup>6</sup> For example, the CFTC will have to grant relief from the futures rule currently requiring customer funds to be held in a so-called "segregated" funds futures account. We believe the CFTC clearly has this authority under Section 4d(a)(2) of the Commodity Exchange Act ("CEA"). We urge the SEC and the CFTC to work together closely to issue the relief necessary to effectuate the cross-margining of securities and futures products, and to do so expeditiously.<sup>7</sup>

#### B. NYSE Proposal To Preclude Day Trading in Portfolio Margining Accounts

We would now like to address the NYSE's proposed rule that would preclude day trading from occurring in portfolio margining accounts, a proposal with which we respectfully disagree.<sup>8</sup> Indeed, for the reasons set forth below, we believe allowing day trading activities to occur in portfolio margining accounts will actually be beneficial to both customers and their brokers.

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<sup>4</sup> It appears that the CBOE, in its proposal, would require the use of a portfolio margining account and a separate cross-margining account. For reasons of efficiency, we encourage the CBOE to adopt the NYSE's more unified approach of combining securities and futures products in one portfolio margining account.

<sup>5</sup> The current NYSE proposal involves combining securities and futures products in a securities environment subject to applicable SEC rules. While we support this approach as a very important first step toward the portfolio margining of securities and futures products in one combined account, we ask the SEC and CFTC to consider, at some future point, permitting the placement of securities and futures products in a combined futures portfolio margining account too. We believe giving BD/FCMs this added flexibility will allow them to better serve each individual customer's particular interests and needs.

<sup>6</sup> SIA Comment Letter, dated February 13, 2006 and FIA Comment Letter, dated February 13, 2006.

<sup>7</sup> While we have not researched the matter extensively, it would appear that such relief: (a) could be issued, as a procedural matter, pursuant to Section 36(a) of the Securities Exchange Act of 1934 and, as noted, Rule 4d(a)(2) of the CEA, respectively, and (b) would not be inconsistent with the Federal Reserve Board's 1998 amendments to Regulation T, in which it authorized exchanges to develop and implement, subject to SEC approval, portfolio margining rules. 63 Federal Register 2805 (January 16, 1998).

<sup>8</sup> Proposed rule 431(g)(13) states: "Day trading is not permitted in portfolio margin accounts. Member organizations are expected to monitor portfolio margin accounts to detect and prevent circumvention of the day trading requirements." SEC Release at 17.

As an initial matter, it appears to us that the NYSE's proposal is contrary to the spirit and intent of the movement toward portfolio margining; namely, to establish risk-based margining systems rather than margin systems based on specific trading strategies or products. As noted in the SEC Release, in "permitting a margin computation based on actual net risk, member organizations are no longer required to compute a margin requirement for each individual position or strategy in a customer's account." SEC Release at 38. In this case, however, the NYSE is proposing to retain a margining system based not on risk, but on a specific trading strategy; *i.e.*, day trading.<sup>9</sup>

Second, we believe that risk-based margining could manage risk and determine leverage in day trading accounts more effectively than the current strategy-based methodology. Among other things, portfolio margining would give credit to certain off-sets or hedged positions held by the day trader, thereby providing a more accurate and complete picture of the customer's and broker's risks. And, creating a more accurate view of overall risk would, we believe, prevent unnecessary margin calls and forced liquidations, activities difficult for customers and brokers alike. In addition, a risk-based margin system would require – unlike the current day trading margin methodology – the daily "stress-testing" of the customer's positions, thereby providing the firm with advance notice of possible margin deficiencies based on theoretical market movements. SEC Release at 36, n.17.

Third, we believe the comprehensive account opening, risk monitoring, risk disclosure, margin requirements and close-out procedures required to conduct portfolio margining would further control the risks associated with day trading. For example, under the NYSE's proposal, brokers engaging in portfolio margining would be required to: (a) stress-test positions held in portfolio margin accounts across a specified range of possible market movements using sophisticated risk-based methodologies; (b) obtain NYSE approval and SEC review prior to the use of such methodology; (c) designate a person within their organization to be responsible for the risk function; (d) obtain and review appropriate account documentation and financial information necessary for assessing the amount of credit to be extended to eligible participants; (e) manage the impact of credit related to portfolio margining accounts on its overall risk exposure; (f) periodically review its credit extension activities for consistency with NYSE requirements; (g) provide comprehensive risk disclosures relating to portfolio margining to eligible participants; (h) establish initial and maintenance margin requirements, and (i) initiate margin calls, discontinue trading and/or liquidate accounts based on specified equity deficiencies.<sup>10</sup>

Fourth, we believe that such a rule would be difficult to enforce, particularly for on-line brokers such as Fimat Preferred. Specifically, such brokers typically have difficulty in

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<sup>9</sup> We also note that the NYSE is not proposing to prohibit certain other trading strategies from occurring in portfolio margining accounts – such as writing uncovered calls – which, in our view, can involve more risk than day trading.

<sup>10</sup> We would not, however, be opposed to the creation of a reasonable minimum net equity that day traders would be required to maintain in portfolio margining accounts, or other reasonable requirements for day traders to satisfy as a condition to benefiting from the NYSE's proposal.

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identifying day trading activities before they occur since, by definition, day trading does not occur until after the customer has affected the closing transaction. And, because it is difficult for such brokers to identify day trading before it occurs, it is necessarily difficult for such brokers to prevent it from occurring. At best, a clearing member can monitor day-trading activity against certain equity or buying power criteria, as set forth in Rule 431(d)(8)(B)(b)(iii).

Finally, "day-trading" activities can in fact be a necessary part of a customer's overall spreading or hedging strategy, the preclusion of which would strike at the core of portfolio margining. For example, assume a customer holds a position consisting of short call options hedged against a long underlying stock position (a delta neutral hedge). As the stock price moves up or down during the course of a trading day, the customer will typically seek to adjust the stock position to maintain the hedge. However, if the stock price happens to move up and down on the same day, the underlying stock hedging trades could constitute pattern day trading. Thus, to prohibit this activity from portfolio margining accounts would restrict one of the most basic option hedging strategies.<sup>11</sup>

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Again, however, we would like to stress our primary message: portfolio margining is an important initiative and the NYSE and CBOE rules should be approved, and moreover, effectuated. The SEC and CFTC should work together to make this happen – as quickly as possible!

We appreciate the opportunity to comment on these proposed rules. If you have any questions, please do not hesitate to contact the undersigned at (646) 557-8458, or John Nicholas, the Director of Securities Compliance for Finmat USA, at (646) 557-8516.

Very truly yours,

The Finmat Group

Gary Alan DeWaal  
Group General Counsel and Director of  
Legal and Compliance

<sup>11</sup> We would also like to point out that, to our knowledge, other risk-based rules approved by the SEC have not carved out particular trading strategies, including the: (1) cross-margining rules adopted by the Options Clearing Corporation with respect to options and related futures transactions; (2) provisions of Rule 15c3-1 permitting broker-dealers to take risk-based haircuts on their options positions, and; (3) capital rules adopted for OTC derivative dealers based on Value-at-Risk calculations.