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Ms. Nancy Morris
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

RE: File Nos. SR-CBOE-2006-14 and SR-NYSE-2006-13
Relating to Portfolio Margining

Dear Ms. Morris:

In a May 9, 2006, comment letter on proposed rule changes by the Chicago Board Options Exchange, Inc. (the "CBOE" or "Exchange") and New York Stock Exchange regarding portfolio margining (rule filings SR-CBOE-2006-14 and SR-NYSE-2006-13), the Chicago Mercantile Exchange (the "CME") advocates the adoption of a "two pot" approach to the cross-margining of related securities and futures products.¹ The CME comment letter presents arguments for utilizing a two pot approach in lieu of the one pot approach proposed in the CBOE and NYSE rule filings.²

The CBOE finds the CME's comments thoughtful and constructive, and recognizes the CME's letter as a means to facilitate the implementation of a broad portfolio margining program, especially in respect of finding a way to overcome the impasse that exists in respect of how to implement a cross-margining capability. For the reasons discussed below, however, the CBOE strongly believes that a two pot approach should not be

¹ In a two pot approach, eligible cross-margin positions are held separately by each respective clearing organization. Each clearing organization holds and manages its own margin required from the clearing firm, the amount of margin reflecting risk offsets at the other clearing organization. Each clearing organization guarantees the clearing firm's obligation to the other clearing organization through a written agreement. Daily settlement is collected by both clearing organizations on a net basis. Operationally, nothing changes in the settlement process between the clearing firm and each clearing organization. At the customer account level, securities are carried in a securities account and futures in a futures account. The clearing firm requires margin in both the securities and futures account, the amount of margin reflecting the risk offsetting positions in the other account.

² In a one pot approach, the clearing organizations have joint custody of a single bank account to which the clearing firm deposits margin. There is one margin requirement at the clearing level, determined by combining the eligible cross-margin positions held by each clearing organization. The clearing firm simultaneously settles its obligations with both clearing organizations via a single netted payment each day to/from the joint custody account of the clearing organizations. At the customer account level, eligible cross margin positions (securities and futures) are combined in one account, either a securities account or a futures account. The clearing firm requires margin on the combined positions in this one account.

pursued at this time and that the CBOE and NYSE rule proposals should be approved based upon a one pot approach.

From both a clearing house and customer account level perspective, CBOE believes that the disadvantages of a two pot model outweigh its advantages. The Options Clearing Corporation (the "OCC") has submitted a comment letter (dated May 19, 2006) that explains the advantages, at the clearing house level, of a one pot approach. CBOE fully agrees with and supports the OCC letter.

At the customer account level, CBOE believes that the two pot approach offers no appreciable advantages over the one pot approach proposed in the currently pending rule filings, which is patterned on the programs for firm proprietary and market-maker cross-margining that have been employed successfully for many years. The CBOE believes that, for the purpose of computing margin to be required from customers by the clearing firm for offsetting securities and futures positions, a two pot model is not as efficient as a one pot model. The two pot model does not offer the level of safety and soundness afforded by a one pot model. At the customer account level, the two pot approach is not a viable alternative for the reasons highlighted below.

1. The most problematic aspect of a two pot model is that clearing firms would be required to comply with the requirements of two separate customer protection rules and two separate liquidation proceedings (SEC and CFTC) in the event of clearing firm insolvency. The two pot model does nothing to resolve the conflict between the two different customer protection and insolvency/liquidation structures. The two pot model would result in practically the same impasse that besets the cross-margining approach as currently proposed.
2. A two pot approach would be operationally cumbersome. The cost to clearing firms of implementation would be significantly more than a one pot approach. For example:
 - a. A separate position record of offsetting securities and futures (i.e., cross-margin positions) would have to be maintained by the clearing firm as a separate function to compute a margin requirement.
 - b. Using the separate position record, a margin requirement would have to be computed twice, once for the securities account margin requirement and once for the futures account margin requirement. These margin requirements must then be posted to the respective accounts, canceling and replacing the normal margin requirement. This would require programming changes or manual intervention, or both.
 - c. Frequent movement of funds between the securities account and futures account may be necessary to maintain equity as needed, necessitating journal entries. The

journaling of funds would also require programming changes or manual intervention.

- d. To the extent that manual intervention is required, delays and mistakes could result.
3. Abandoning the cross-margining approach currently set-forth in the proposed rules in favor of a two pot approach would not be acceptable to most dual broker-dealers/futures commission merchants ("FCM"). In discussions with dual broker-dealer/FCMs during development of a customer portfolio margin program, a large majority preferred to have a one pot approach for cross-margining. Dual broker-dealer/FCMs that are now set-up operationally under the one pot model for proprietary and market professional cross-margining would have to add new operational structure and systems. Additionally, securities self-regulatory organizations would be required to develop a new regulatory (rules) framework to accommodate use of a two pot approach. To embark on a new framework at this juncture would considerably delay implementation of a cross-margining capability, without any appreciable improvement in the structure as proposed by the CBOE and NYSE. Moreover, a two pot approach for customer cross-margining would necessitate that the clearing houses, at least The OCC, develop rules and new operational procedures.
4. While the CME notes that it has used a two pot arrangement with the Fixed Income Clearing Corp., LCH Clearnet Group and the New York Mercantile Exchange, these arrangements do not involve futures vs. securities, except in cases involving FICC. However, two pot models involving FICC have been limited to cross-margining of proprietary accounts. The two pot approach is unproven in respect of customer account cross-margining of securities and futures. There exists no regulatory precedent in the context of customer cross-margining of securities and futures under a two pot approach, especially with regard to how funds could be moved between a securities and futures account in the event of a clearing firm insolvency.

A two pot approach would require the development of a regulatory mechanism that would provide for the movement of funds and property from the securities domain to the futures domain and vice versa when insolvency/liquidation proceedings have been initiated. Development of such a mechanism could require considerable time and effort. It would be counterproductive to change course now, especially considering our view that a two pot approach is not an optimal solution.

5. While a two pot approach may offer a margin reduction at the customer account level, a margin requirement may have to be satisfied in a securities account as well as in a futures account for the same offsetting positions. Margin may be reduced, but would likely be greater than it would be if the cross-margined positions were carried in one account and handled under one regulatory structure for customer protection and insolvency purposes.

6. It is not clear how the two pot approach could be implemented in the context of equity derivatives, including non-linear derivatives such as options. Firms might be required to run two different margin systems on the combined (cross-margin) positions, the model supported by the futures industry for the futures account, and the model supported by the securities industry for the securities account. One of the primary goals of portfolio margining is to provide a more efficient means of quantifying risk in a portfolio, including a cross-margining situation. Cross-margining should be structured in a way that allows portfolio margining and its advantages to be utilized to the fullest. In any event, it is clear that the method and its associated inputs used to determine margin requirements on cross-margined accounts, whatever the method may be, must be acceptable to both the SEC and CFTC.

It should be noted that in order to make customer cross-margining possible using a one pot approach as proposed by the CBOE and NYSE, the CBOE, in a letter dated December 20, 2004, requested relief from the Commodity Futures Trading Commission ("CFTC").³ Relief was, and still is, sought to enable equity index futures and options on such futures to be carried in accounts that are regulated as securities accounts under the Securities Exchange Act of 1934 for the purpose of cross-margining.

In conclusion, CBOE values the CME's comments, and is appreciative of the CME's efforts to put forth an alternative approach for consideration. We are willing to continue a dialogue with the CME on whether a two pot approach might be workable in the future should regulatory disparities between customer protection structures of the securities and futures markets be removed. At the present time, however, CBOE strongly believes that a one pot approach is a far preferable model to use. The CBOE urges the Securities and Exchange Commission to proceed with approval of a one pot cross-margining approach as proposed in the subject rule filings, and to press forward with regulatory initiatives necessary to make cross-margining a reality. The CBOE would be happy to participate in a discussion with staff of the CME, OCC, CFTC and other interested parties in respect of the two pot proposal or the cross-margining initiative generally.

I would be pleased to discuss any of the issues raised in this letter.

Sincerely,



Timothy H. Thompson

³ This relief was actually requested in connection with previous customer portfolio margining and cross-margining rule proposals of the CBOE and NYSE that were limited to broad-based index options. The relief request was submitted while action on the rule proposals was pending at the SEC. The SEC approved the rules in July 2005. However, cross-margining of broad-based index products has not been possible in that, to date, no relief has been granted by the CFTC.

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cc: Mr. Christopher Cox, Chairman
U.S. Securities and Exchange Commission

Mr. Reuben Jeffery III, Chairman
Commodity Futures Trading Commission

Mr. Robert L.D. Colby, Director
Division of Market Regulation
U.S. Securities and Exchange Commission

Mr. Michael A. Macchiaroli, Associate Director
Division of Market Regulation
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Mr. Ananda Radhakrishnan, Director
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