

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-40529; File No. SR-NYSE-98-16]

Self-Regulatory Organizations; Order Approving a Proposed Rule Change by the New York Stock Exchange, Inc., Relating to Margin Requirements for Exempted Borrowers and Good Faith Accounts

October 7, 1998.

I. Introduction

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ and Rule 19b-4 thereunder,² the New York Stock Exchange, Inc. ("NYSE" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission") a proposal to amend NYSE rule 431, "Margin Requirements," to accommodate certain recent changes to the federal margin requirements. In March 1998, the Commission originally approved the proposed changes on a temporary basis until July 27, 1998.³ The NYSE's current proposal request permanent approval of the changes the Commission approved on a temporary basis in the March Approval Order. On July 24, 1998, the NYSE amended its current proposal to request accelerated approval of the proposal for six months, or until the Commission approves the changes on a permanent basis.⁴ On July 27, 1998, the Commission approved the portion of the current proposal that requests accelerated approval of the proposal for six months, until January 22, 1999, or until the Commission approves the changes on a permanent basis,

whichever occurs first.⁵ The Partial Approval Order, which appeared in the **Federal Register** on August 3, 1998, also solicited comment on the NYSE's request for permanent approval of the proposal. No comments were received regarding the proposal. This order approves the NYSE's proposal on a permanent basis.

II. Description of the Proposal

In January 1998 the FRB amended Regulation T, which governs initial extensions of credit to customers and broker-dealers.⁶ Among other things, these amendments established a "good faith" account, which can be used for transactions in non-equity securities.⁷ Unlike transactions in a cash or margin account, transactions in the good faith account are *not* subject to the requirements of Regulation T with respect to initial margin and payment and liquidation time frames.

Good Faith Accounts

The NYSE believes that transactions in a good faith account raise the same safety and soundness concerns from a maintenance margin perspective as cash and margin account transactions. Accordingly, the NYSE proposes to amend NYSE Rule 431 so that transactions in all accounts of customers (except for cash accounts, as discussed below), including the new good faith account, will be subject to the current applicable maintenance margin requirements of NYSE Rule 431(c).⁸ As is currently the case, cash accounts subject to Regulation T will not be the subject to the overall NYSE Rule 431 requirements, but in certain cases will be covered by certain provisions of that rule. In this regard, as the NYSE notes, NYSE Rule 431 requirements will continue to apply to cash account transactions in exempted securities (NYSE Rule 431(e)(2)(F)); for certain options (NYSE Rule 431(f)(2)(M)); and for "when issued" and "when distributed" securities (NYSE Rule 431(f)(3)(B)).

Exempted Borrowers

In the Regulation T amendments adopted in January 1998, the FRB also established a class of borrowers that is exempt from Regulation T. An

"exempted borrower," as defined in Regulation T, is a broker-dealer "a substantial portion of whose business consists of transactions with persons other than brokers or dealers."⁹ The NYSE historically has not applied the requirements of NYSE Rule 431 to member organization accounts, except for transactions in the proprietary accounts of registered broker-dealers that are carried by a member organization. In this regard, NYSE Rule 431(e)(6) provides that a member organization may carry the proprietary account of another registered broker-dealer upon a margin basis that is satisfactory to both parties, provided the requirements of Regulation T are adhered to and the account is not carried in a deficit equity condition. In addition, NYSE Rule 431(e)(6) requires that the amount of any deficiency between the equity in the proprietary account and the margin required under NYSE Rule 431 be deducted in computing the net capital of the member carrying the proprietary account.

The NYSE believes that exempted borrowers would remain exempt from the requirements of NYSE Rule 431, and the Exchange proposes to amend the definition of "customer" in NYSE Rule 431(a)(2) to codify the Exchange's position that such borrowers are exempt from NYSE Rule 431.¹⁰ Specifically, the NYSE proposes to amend NYSE Rule 431(a)(2) to exclude from the definition of "customer" an "exempted borrower" as defined by Regulation T of the FRB, except for the proprietary account of a broker-dealer carried by a member pursuant to NYSE Rule 431(e)(6).¹¹

Under the new Regulation T definition of exempted borrower, the proprietary transactions of an introducing organization that qualifies as an exempted borrower (*i.e.*, an organization that conducts a substantial public business) will not be subject to Regulation T. Accordingly, the requirement in NYSE Rule 431(e)(6) that members adhere to the requirements of Regulation T will not apply to the proprietary accounts of exempted borrowers. However, for safety and soundness purposes, the proprietary accounts of a broker-dealer that are carried or cleared by another broker-dealer member organization will remain

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 39813 (March 27, 1998), 63 FR 16849 (April 6, 1998) (order approving File No. SR-NYSE-98-08) ("March Approval Order").

⁴ See Letter from James E. Buck, Senior Vice President and Secretary, NYSE, to Richard C. Strasser, Assistant Director, Division of Market Regulation ("Division"), Commission, dated July 23, 1998 ("Amendment No. 1"). In addition, Amendment No. 1 modifies the proposal to: (1) clarify that the proposal amends the definition of "customer" in NYSE Rule 431(a)(2) to codify the Exchange's position that exempted borrowers will remain exempt from the provisions of NYSE Rule 431; and (2) correct a reference in NYSE Rule 431(a)(2) to the Board of Governors of the Federal Reserve System ("FRB"). Subsequently, the NYSE confirmed that the Exchange was seeking to amend the changes to NYSE rule 431 that were approved in the March Approval Order for six months or until the Commission approves the changes on a permanent basis, whichever occurs first. Telephone conversation between Mary Anne Furlong, Attorney, NYSE, and Yvonne Fraticelli, Attorney, Division, Commission, on July 27, 1998.

⁵ See Securities Exchange Act Release No. 40266 (July 27, 1998), 63 FR 41310 (August 3, 1998) ("Partial Approval Order").

⁶ See Docket Nos. R-905, R-0923, and R-0944, 63 FR 2806 (January 16, 1998).

⁷ 12 CFR 220.6.

⁸ NYSE Rule 431(c), as amended, will specify the margin that must be maintained in all customer accounts, except for cash accounts subject to Regulation T, unless a transaction in a cash account is subject to other provisions of NYSE Rule 431.

⁹ 12 CFR 220.2.

¹⁰ See Amendment No. 1, *supra* note 4.

¹¹ Specifically, NYSE Rule 431(a)(2), as amended, excludes from the definition of "customer" (a) a broker or dealer from whom a security has been purchased or to whom a security has been sold for the account of the member organization or its customers, or (b) an "exempted borrower" as defined by Regulation T, except for the proprietary account of a broker-dealer carried by a member organization pursuant to NYSE Rule 431(e)(6).

subject to the NYSE Rule 431(e)(6) equity requirements, which prohibit a member from carrying a proprietary account in a deficit equity condition and require that the amount of any deficiency between the equity maintained in the proprietary account and the margin required by NYSE Rule 431 be deducted in computing the net capital of the member carrying the proprietary account.

III. Discussion

After careful review, the Commission finds that the proposed rule change is consistent with the Act and the rules and regulations thereunder applicable to a national securities exchange and, in particular, Section 6(b)(5) of the Act,¹² in that it is designed to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest.¹³

Specifically, the Commission finds, as it has concluded previously,¹⁴ that it is appropriate for the NYSE to apply the existing maintenance margin requirements of NYSE Rule 431(c) to transactions in the new "good faith" account adopted under Regulation T. Although non-equity transactions permitted in the good faith account will not be subject to the initial margin requirements and payment and liquidation time frames of Regulation T, as the NYSE notes, transactions in the good faith account may raise the same safety and soundness concerns with regard to maintenance margin as do transactions in cash and margin accounts. Accordingly, the Commission believes that it is appropriate for the NYSE to apply the existing maintenance margin requirements specified in NYSE Rule 431(c) to transactions in the good faith account. The Commission believes that applying the maintenance margin requirements of NYSE Rule 431(c) to transactions in the good faith account will protect investors and the public interest and help to maintain fair and orderly markets by ensuring that good faith accounts contain adequate margin reserves.

In addition, the Commission believes that it is appropriate for the NYSE to revise the definition of "customer" in NYSE Rule 431(a)(2) to codify the Exchange's position that exempt borrowers will remain exempt from the

requirements of NYSE Rule 431, except for the proprietary account of a broker-dealer carried by a member pursuant to NYSE Rule 431(e)(6). The Commission believes that it is appropriate for the NYSE to continue to apply the equity requirements of NYSE Rule 431(e)(6) to the proprietary accounts of introducing broker-dealers that qualify as "exempt borrowers" under Regulation T if these accounts are carried by another Exchange member. By continuing to apply the equity requirements of NYSE Rule 431(e)(6) to these proprietary accounts, the Commission believes that the proposal will help to ensure that these accounts contain adequate margin, thereby protecting investors and the public interest.

IV. Conclusion

It is therefore, ordered, pursuant to Section 19(b)(2) of the Act,¹⁵ that the proposed rule change (SR-NYSE-98-16) is approved on a permanent basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁶

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-40532; File No. SR-PCX-98-48]

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the Pacific Exchange, Inc. To Amend PCX Rule 6 Regarding the Exchange's Dress Code

October 8, 1998.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder,² notice is hereby given that on September 23, 1998, the Pacific Exchange, Inc. ("PCX" or "Exchange") filed with the Securities and Exchange Commission ("Commission" or "SEC") the proposed rule change as described in Items I, II and III below, which Items have been prepared by PCX. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

¹⁵ 15 U.S.C. 78s(b)(2).

¹⁶ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 204.19b-4.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The Exchange is proposing to modify certain rules on Options Floor conduct, including standards of dress and consumption of food and drink on the Trading Floor. The rule change also modifies the current provisions on order tickets that are used on the Floor for options orders. Proposed new language is italicized; proposed deletions are bracketed.

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¶4733 Admission to and Conduct on the Options Trading Floor

Rule 6.2(a)-(b)—No change.

(c) *Standards of Dress and Conduct*—No change.

(1) *Standards of Dress*—No change.

(A) Personal attire *must* [shall] be neat, clean and presentable.

(B) Men must wear [dress] shirts *with collars* [and neckties or bow ties tied in a conventional manner and worn under shirt collars; clip bow ties must be clipped to both sides of shirt collars. Golf and Aloha shirts are prohibited for both men and women.]

(C) All persons must wear trading jackets and/or suit or sport coats while present on the Trading Floor.

(D) The following are examples of violations of Trading Floor dress code standards:

(i) Blue jeans that are patched, torn, frayed or faded; tie-dyes; tube tops; overalls; military uniforms or fatigues; sweat suits; or trousers that are frayed or torn.

(ii) Bare or stocking feet or thongs.

(iii) Clothing drawing excessive attention, including costumes of any kind, bare midribs, halter tops, sheer blouses, miniskirts, T-shirts, hot pants, shorts, or abbreviated clothing of any kind.

(E) [Waiver of the dress code means only that ties and jackets need not be worn]. *The Options Floor Trading Committee may impose additional standards of dress or otherwise modify these standards of dress by means of a written policy that will be distributed to Options Floor Members.*

(2) *Standards of Conduct.*

(A)—No change.

(B) The entry of food or drink *may be permitted at the discretion of the Options Floor Trading Committee.* [of any kind to the Floor during trading hours is prohibited.] Alcoholic beverages may not be consumed on the Trading Floor at any time [unless this prohibition is waived by a majority of the Options Trading Floor Committee. If a quorum of this Committee cannot be

¹² 15 U.S.C. 78f(b)(5).

¹³ In approving this portion of the proposal, the Commission has considered the proposal's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

¹⁴ See March Approval Order, *supra* note 3, and Partial Approval Order, *supra* note 5.