

MEMO# 20893

February 28, 2007

NASD Establishes Portfolio Margin Pilot Program

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TO: FIXED-INCOME ADVISORY COMMITTEE No. 3-07
INST. MONEY MARKET FUNDS ADVISORY COMMITTEE No. 3-07
MONEY MARKET FUNDS ADVISORY COMMITTEE No. 2-07
SEC RULES MEMBERS No. 24-07 RE: NASD ESTABLISHES PORTFOLIO MARGIN PILOT PROGRAM

NASD has issued a Notice to Members regarding a proposed rule change it filed with the Securities and Exchange Commission to amend Rule 2520 relating to portfolio margining. [1] Specifically, the proposal would permit members to margin certain products according to a prescribed portfolio margin methodology on a pilot basis. [2] The proposal makes clear for the first time that shares of money market funds are eligible products for portfolio margin accounts. [3] In addition, NASD Rule 2860 would be amended to require that a disclosure statement and written acknowledgement for use with the proposed portfolio margin program be furnished to customers using a portfolio margin account.

The Notice explains that portfolio margining sets margin requirements for an account based on the greatest projected net loss of all positions in a product class or group based on the same index or issuer. Portfolio margining uses computer modeling to perform risk analysis using multiple pricing scenarios. According to the Notice, a customer benefits from portfolio margining because margin requirements calculated on a position's net risk are generally lower than strategy-based margin methodologies currently in place. In permitting margin computation based on a position's actual net risk, NASD members no longer are required to compute a margin requirement for each individual position or strategy in a customer's account.

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endnotes

[1] NASD Notice to Members 07-11 (February 2007) ("Notice"). The Notice can be found on NASD's website at http://www.nasd.com/RulesRegulation/NoticestoMembers/2007NoticestoMembers/NASDW_018678. The rule change is substantially similar to recent margin rule amendments by the New York Stock Exchange and the Chicago Board Options Exchange. See Exchange Act Release No. 54918, File No. SR-NYSE-2006-13 (Dec. 12, 2006) and Exchange Act Release No. 54919, File No. SR-CBOE-2006-014 (Dec. 12, 2006). The Releases can be found on the SEC's website at <http://www.sec.gov/rules/sro/nyse/2006/34-54918.pdf> and <http://www.sec.gov/rules/sro/cboe/2006/34-54919.pdf>, respectively.

[2] The portfolio margin program is scheduled to operate on a pilot basis beginning April 2, 2007 and ending July 31, 2007, unless the SEC approves an extension of the pilot or adoption of the program on a permanent basis.

[3] Shares of a money market fund would be permitted to be carried in a portfolio margin account provided that (i) the customer waives any right to redeem shares without the NASD member's consent; (ii) the member (or, if the shares are deposited with a clearing organization, the clearing organization) obtains the right to redeem shares in cash upon request; (iii) the fund agrees to satisfy any conditions necessary or appropriate to ensure that the shares may be redeemed in cash, promptly upon request; and (iv) the member complies with the requirements of Section 11(d)(1) of the Securities Exchange Act of 1934 and Rule 11d1-2 thereunder.