UNDERMARGINED CAPITAL CHARGES

Chapter 5

General Information

Capital charges for undermargined accounts are not a substitute for the deposit of margin funds. The collection of required margin is essential to proper margin compliance and good internal control.

Undermargined capital charges are based on exchange minimum margin requirements.

If an exchange does not require its members to collect margin from their account holders, the FCM must use the exchange clearing house's margin requirements in determining capital charges.

In calculating undermargined capital charges under the SPAN margin system, the maintenance margin requirement includes only the risk component. The equity component of the SPAN margin system requirement is included in margin equity.

In computing undermargined capital charges, option values of all options contracts are allowed to meet an account's total risk margin requirement.

Identically owned accounts should be combined for margin call/charge purposes within the account classifications of customer segregated, customer secured, or nonsegregated. For further information on combining accounts for margin purposes refer to Chapter 9 - Combined Accounts.

Undermargined capital charges are applicable to accounts trading on both domestic and foreign exchanges.

In determining capital charges, accounts should be reviewed as of the close of business.

Any manual adjustments made to equity system reports to determine an account owner's margin status (e.g. adjustments to margin requirements, margin calls, undermargined charges, etc.) shall be maintained on file.

For capital charges on proprietary positions refer to Chapter 8 - Proprietary Accounts.

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Specific Topics

Accounts Subject to an Undermargined Capital Charge

A capital charge may apply to all accounts which are subject to margin calls for five business days or more for all customers (including exchange members seat owners, and lessees) and four business days or more for noncustomers and omnibus accounts.

If a required margin call was not made to an account, the account is subject to an immediate undermargined capital charge.

If a margin call was made to an account for an amount less than what was required, an immediate undermargined capital charge would apply if the amount of the margin call made plus margin equity was less than the maintenance margin requirement.

Current Margin Calls

A margin call will be considered current only to the extent that it represents a bona fide attempt to obtain funds. A bona fide margin call is demonstrated through an account actually meeting margin calls in a timely manner. Consequently, bona fide margin calls would not remain outstanding an unreasonable period of time.

FCMs may call for additional margin at their discretion. However, any margin call, which has as its primary purpose the avoidance of a capital charge, shall not be considered current.

Margin calls that are older than the time allowed for current call treatment and are merely called again with a more current date of issuance may not be deducted in determining the capital charge.

To determine current margin calls available to reduce the undermargined capital charge of an account, margin calls in the account must be reviewed individually and collectively.

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<u>Individual Margin Calls:</u>

Individual current margin calls are calls, which have been outstanding a reasonable time; that is, less than five business days for customers and less than four business days for noncustomers and omnibus accounts. Note: Days are counted from and include the day the account became undermargined.

In determining current margin calls <u>as of the close of business</u> on the capital computation date, individual calls that are aged five business days for customers (four business days for noncustomers and omnibus accounts) are considered noncurrent. The margin calls have not been met within five business days for customers (four business days for noncustomers and omnibus accounts) as the calls are still outstanding after the close of business.

<u>Total Margin Calls:</u>

To determine an account's current margin calls for capital charge purposes, individual margin calls should be reviewed collectively as of the close of business according to the guidelines set forth below. These guidelines have been written based on the customer undermargined grace period of five business days and should be adjusted accordingly to four business days for noncustomers and omnibus accounts.

- **If an account has <u>no</u> individual margin calls aged to be five business days old or greater, then all margin calls in the account may be considered current.**

- **If an account has <u>one or more</u> individual margin calls aged to be five business days old or greater, then all margin calls in the account are considered noncurrent (i.e. one call noncurrent, all calls noncurrent).**

  The FCM has not collected required margin within a reasonable time. Thus, the issuance of an additional required margin call (presently less than five business days old) does not appear to be a bona fide attempt to collect required margin.

An FCM's records should clearly support the current call treatment of all margin calls used to reduce undermargined capital charges.

For further information on margin calls refer to Chapter 4 - Margin Calls.

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Calculation of Undermargined Capital Charges

If an account is undermargined at the close of business on the capital computation date and the preceding four business days for customers or three business days for noncustomers and omnibus accounts, a capital charge may apply.

The undermargined capital charge is the maintenance margin requirement less credit net liquidating equity, acceptable margin collateral in excess of the amount used to secure deficit equity, and current margin calls.

Undermargined Capital Charge =

> **Maintenance Margin Requirement**
> **(less) Credit NLE**
> **(less) Margin Deposits in Excess of Amounts to Secure Deficits**
> **(less) Current Margin Calls**

The maximum undermargined capital charge for an account is its maintenance margin requirement.

Undermargined capital charges may be calculated using exchange minimum margin requirements. If an FCM computes margin calls based on higher rates, then margin calls should be recomputed as if they were generated using exchange minimums in calculating capital charges based on exchange requirements.

It is acceptable for a firm to calculate undermargined capital charges using higher firm rates provided that the FCM can demonstrate and maintains documentation of the following:

- **Firm's margin rates are higher than exchange minimums,**
- **Margin calls are based on higher firm margin rates, and**
- **This policy is consistently applied.**

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EXAMPLES

Assumptions:

1. All accounts are customer owned.
2. Account balances, margin requirements, and margin call ages are as of the end of business on the date indicated.
3. All securities are indicated at their margin value.
4. Initial and maintenance SPAN margin system requirements are the same.
5. All margin calls are properly issued for the full amount.
6. The account was properly margined on the previous business day (Friday).
7. Current calls are determined as of the close of business. Thus, margin calls indicated as 5 days old for customers are considered noncurrent.
8. The capital computation date is as of the close of business on Friday.

If an account is subject to an undermargined capital charge, the charge shall equal:

MMR - Credit NLE - Margin Deposits in Excess of Amount used to Secure Deficits - Current Margin Calls (CC)

Example #1 - No Current Margin Calls

	Monday	Tuesday	Wednesday	Thursday	Friday
NLE	55,000	55,000	55,000	55,000	55,000
IMR/MMR	60,000	60,000	60,000	60,000	60,000
AMT U/M	5,000	5,000	5,000	5,000	5,000
CALL/AGE	5,000(1)	5,000(2)	5,000(3)	5,000(4)	5,000(5)

The capital charge would be $5,000 as the call was five business days old or more as of the close of business. {$60,000 MMR - $55,000 NLE}

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Example #2 - Current Margin Calls and Daily Wire Transfers

	Monday	Tuesday	Wednesday	Thursday	Friday
LB	30,000	35,000	45,000	49,000	57,000
OTE/NOV	25,000	15,000	11,000	3,000	<8,000>
NLE	55,000	50,000	56,000	52,000	49,000
IMR/MMR	60,000	60,000	60,000	60,000	60,000
AMT U/M	5,000	10,000	4,000	8,000	11,000
CALL/AGE	5,000(1)	10,000(1)	4,000(1)	8,000(1)	11,000(1)

Due to unfavorable market movements, the account was never properly margined as of the close of business. However, all margin calls were met on a daily basis. As all individual margin calls are less than five business days old as of the close of business, all margin calls in the account can be considered current. Thus, the undermargined capital charge would be zero. {$60,000 MMR - $49,000 NLE - $11,000 CC}

Example #3 - Current Margin Calls and Cash Received

	Monday	Tuesday	Wednesday	Thursday	Friday
LB	50,000	50,000	62,000	62,000	62,000
OTE/NOV	<2,000>	<2,000>	<7,000>	<3,000>	<9,000>
NLE	48,000	48,000	55,000	59,000	53,000
IMR/MMR	60,000	60,000	60,000	60,000	60,000
AMT U/M	12,000	12,000	5,000	1,000	7,000
CALL/AGE	12,000(1)	12,000(2)	5,000(1)	5,000(2)	5,000(3)
					2,000(1)

$12,000 cash was deposited on Wednesday. Due to unfavorable market movements, the account was never properly margined as of the close of business. As all individual margin calls are less than five business days old as of the close of business, all margin calls in the account can be considered current. Thus, the undermargined capital charge would be zero. {$60,000 MMR - $53,000 NLE - $7,000 CC}

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Example #4 - Current Margin Calls and Market Movements

	Monday	Tuesday	Wednesday	Thursday	Friday
LB	50,000	50,000	50,000	50,000	50,000
OTE/NOV	10,000	5,000	3,000	2,000	7,000
NLE	60,000	55,000	53,000	52,000	57,000
IMR/MMR	60,000	60,000	60,000	60,000	60,000
AMT U/M	-0-	5,000	7,000	8,000	3,000
CALL/AGE	-0-	5,000(1)	5,000(2)	5,000(3)	5,000(4)
			2,000(1)	2,000(2)	2,000(3)
				1,000(1)	1,000(2)

As all individual margin calls are less than five business days old as of the close of business, all margin calls in the account can be considered current. The undermargined capital charge would be zero. {$60,000 MMR - $57,000 NLE - $8,000 CC} NOTE: Even though the account is only undermargined by $3,000 on Friday, the $5,000 margin call from Tuesday cannot be deleted as the favorable market movement did not bring margin equity up to initial margin requirements.

Example #5 - Current and Noncurrent Individual Margin Calls

	Monday	Tuesday	Wednesday	Thursday	Friday
LB	20,000	20,000	20,000	20,000	20,000
OTE/NOV	35,000	30,000	25,000	20,000	15,000
NLE	55,000	50,000	45,000	40,000	35,000
IMR/MMR	60,000	60,000	60,000	60,000	60,000
AMT U/M	5,000	10,000	15,000	20,000	25,000
CALL/AGE	5,000(1)	5,000(2)	5,000(3)	5,000(4)	5,000(5)
		5,000(1)	5,000(2)	5,000(3)	5,000(4)
			5,000(1)	5,000(2)	5,000(3)
				5,000(1)	5,000(2)
					5,000(1)

As the account has an individual margin call aged to be five business days old or more as of the close of business, all margin calls in the account would be considered noncurrent. The undermargined capital charge would be $25,000. {$60,000 MMR - $35,000 NLE}

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Example #6 - Noncurrent Deficit Equity

	Monday	Tuesday	Wednesday	Thursday	Friday
NLE	<9,000>	<9,000>	<9,000>	<9,000>	<9,000>
IMR/MMR	60,000	60,000	60,000	60,000	60,000
AMT U/M	69,000	69,000	69,000	69,000	69,000
CALL/AGE	69,000(1)	69,000(2)	69,000(3)	69,000(4)	69,000(5)

No collateral or commission holdbacks are available to secure the deficit. The firm would record a $9,000 noncurrent receivable from customer on the balance sheet and the deficit would be excluded from the undermargined capital charge computation. The margin call is five business days old or more as of the capital computation date and is therefore considered noncurrent. Thus, the undermargined capital charge would be $60,000, the account's maintenance margin requirement.

Example #7 - Current Deficit Equity

	Monday	Tuesday	Wednesday	Thursday	Friday
NLE	<9,000>	<9,000>	<9,000>	<9,000>	<9,000>
T-BILL	49,000	49,000	49,000	49,000	49,000
IMR/MMR	60,000	60,000	60,000	60,000	60,000
AMT U/M	20,000	20,000	20,000	20,000	20,000
CALL/AGE	20,000(1)	20,000(2)	20,000(3)	20,000(4)	20,000(5)

The firm would record a $9,000 current (secured by the Treasury Bill) receivable from customer on the balance sheet. The margin collateral value in excess of the deficit can reduce the capital charge. The margin call is five business days old or more as of the capital computation date and is therefore considered noncurrent. Thus, the undermargined capital charge would be $20,000. {$60,000 MMR - $40,000 Excess Collateral ($49,000 T-BILL less <$9,000> NLE)}

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Example #8 - Partially Secured Deficit

	Monday	Tuesday	Wednesday	Thursday	Friday
LB	<1,000>	<1,000>	1,000	1,000	1,000
OTE/NOV	<5,000>	<5,000>	<9,500>	<9,500>	<9,500>
NLE	<6,000>	<6,000>	<8,500>	<8,500>	<8,500>
T-BILL	8,000	8,000	8,000	8,000	8,000
IMR/MMR	5,000	5,000	5,000	5,000	5,000
AMT U/M	3,000	3,000	5,500	5,500	5,500
CALL/AGE	3,000(1)	3,000(2)	1,000(3)	1,000(4)	1,000(5)
			4,500(1)	4,500(2)	4,500(3)

$2,000 cash was deposited on Wednesday. The firm would record an $8,000 current (secured by the Treasury Bill) and $500 noncurrent receivable from customer on the balance sheet. As there is no excess collateral over the deficit, the Treasury Bill cannot be used to reduce the undermargined capital charge. As the account has an individual margin call aged to be five business days old or more as of the close of business, all margin calls in the account would be considered noncurrent. Thus, the undermargined capital charge would be $5,000, the account's maintenance margin requirement.