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## Haircut Snippets

March 2010  
Volume 12, Issue2

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## Let Me Introduce You to SALLIE...

*Len Bole*

When we name a product, I like to be able to pronounce the name. Our venture into the world of 3-3 stock allocation provided me with an opportunity to personify the product. Our Stock Allocation Information Engine goes by the acronym SALLIE.

Working with firms as development partners and using feedback from a number of other interested clients, we have built a Windows based application to perform the stock allocation functions required in the reserve formula calculation. We have incorporated as many of their suggestions as we could and we believe that what we have to offer will be competitive with anything on the market.

Prior to pairing off positions according to the allocation hierarchy, the system will:

- 1) Allow stock records from MULTIPLE back office systems to be loaded
- 2) Scan imported data and report discrepancies such as missing prices, multiple prices, unassigned accounts
- 3) Create Out of Balance (OOB) entries for any CUSIPS whose total longs DO NOT equal the total shorts
- 4) Generate reports summarizing exceptions and providing totals and details for all data loaded into SALLIE

After perusing the import information and exception reports, the user may:

- 1) Enter stock record amending entries that will correct any improper data within SALLIE. The amendment process will see to it that all entries remain in balance.

- 2) Alter any system tables, such as the allocation hierarchy, prices, security master, and account master
- 3) Maintain and run using multiple allocation hierarchies for comparison and analysis

After calculation, the user has access to:

- 1) Allocation reports, both summary and detail, by account, CUSIP and allocation category
- 2) Audit trail reports summarizing all changes to system tables and, in a separate report, all Stock Record Amendments
- 3) Reconcile reports comparing import data + amended data to allocated data + unallocated data + netted positions
- 4) Pertinent data in Comma Separated Value files

The architecture of the system allows users to easily monitor exposure AT ANY TIME. The system performs a Dynamic Allocation of securities, explicitly following the user defined hierarchy rather than exhausting a CUSIP within a given category before moving on to another category.

In addition, users may move their end of month data into an EOM area to allow them to more carefully examine stock record data for FOCUS while continuing to run weekly calculations.

LDB has delivered its first set of reports to a client for examination and feedback. We expect to be able to deliver Beta copies of the system in March and to introduce SALLIE to the general public in early spring.

Please contact [Len Bole](#) for further information and pricing.

## Basket Making 101

What the Risk Based Haircut (RBH), Risk Based Margin (RBM) and Basket Weaver™ products do with respect to baskets is unique within the industry. Given the proper data by the user, these applications will verify that:

- 1) All basket stocks are part of the index
- 2) Basket stocks are in their proper proportions
- 3) Baskets are properly capitalized
- 4) Baskets are properly hedged.

In Basket Making 101, we will examine #4: proper hedging.

The basket composition report indicates how many baskets for each index are created. In order to be properly hedged, there must be futures, options and/or ETFs on the opposite side of the market to hedge the baskets. LDB systems determine hedging by calculating the hedge potential of hedging securities and making certain the systems do not allow baskets in excess of that hedging potential. Short baskets are hedged by long calls, short puts, long futures, long ETFs and short inverse ETFs. Long baskets are hedged by short calls, long puts, short futures, short ETFs and long inverse ETFs.

The Special Data file in the Maintain menu and the fields SHARES PER CONTRACT (AKA: SPC, multiplier), MINI LEAP DIVISOR (DIV) and MMAF in the position file are the keys to determining the hedging potential of a given portfolio.

The system maintains default values of 100 for SPC and 1 for both DIV and MMAF. If the fields in the position file contain non zero data, the system uses the position file data. If the fields are empty, the system looks for the symbol in Special Data and uses what it finds there. If it finds no symbol match in Special Data, the defaults are used.

A typical index option has an SPC value of 100 and can hedge 100 baskets. The SP future has a multiplier of 250; the E Mini ES future has an SPC of 50. They can hedge 250 and 50 baskets respectively.

With the SPX index trading at 1000, the SPY trades at 100 or 1/10<sup>th</sup> of the underlying index. DIV allows the systems to recognize these smaller hedgers and makes certain that they only hedge their proportionate share of baskets.

Ultra Leveraged ETFS may hedge multiple baskets. An inverse ETF hedges a basket on the same side of the market, i.e., a long inverse hedges a long basket. The MMAF field informs the systems how many and which baskets these ETFS may hedge.

After considerable analysis, we discussed the issue of DIV for leveraged ETFS with regulators. It was agreed that **the proper Mini Leap Divisor for any leveraged ETF should be 1.** This contradicts what we said in our last newsletter, but after consultation, we feel this is the best approach.

In the tradition of GIGO (garbage in, garbage out), the determination of proper hedging relies on valid user supplied data. It is imperative that the values for SPC, DIV and MMAF are as accurate as possible or results may be incorrect.

How many baskets can a security hedge? The equation is simply:  $QUANTITY * SPC * MMAF / DIV$ .

To Be Continued: see the next newsletter for Basket Making 102. Who knows: there may be Basket making certification???

LDB Contact: [Len Bole](#)

## Is There a Manual For This Product?

Believe it or not some people actually ask us if we have manuals for our products. Yes, they are in the minority, but the good news is WE DO HAVE MANUALS.

The manuals are available to users in three distinct locations:

- 1) In the Help Menu of the application
- 2) In the Help Directory for the application
- 3) On our web site

Click on <http://www.ldbci.com/regulatoryfinance/>, select the product whose manual you want and then, when sent to the specific product page, click on the manual link. All of our manuals are PDF documents. LDB Contact: [Chris Kemper](#)

## No Wooden Nickels: A Tip or Two

### Keeping Abreast of New Baskets

When appropriate the Options Clearing Corp (OCC) identifies new baskets eligible for relief in RBH and RBM. They publish updated lists of baskets that include additional information

such as product, class, required capitalization, offset, etc. If you trade baskets, we highly suggest someone at your organization subscribe to these notifications. Application for inclusion on their mailing list can be made at: <http://www.theocc.com/webapps/email-alerts>. LDB Contact: [Charlie Greiner](#)

### ABSCONSERVATIVE Setting in Fixed Income INI

The July 2001 Cheryl Kallem no action letter provides relief to asset backed securities based on issuance size and ratings. The question remains: how to treat asset backed securities whose issuance size and ratings do NOT qualify them for this relief.

Use of the ABSCONSERVATIVE switch in the INI file determines how these securities are treated. By default it is set to N. If the bonds lack the ratings and/or issuance size to qualify for the Kallem relief, the bonds will be treated like any other non investment grade corporate bonds.

By setting the switch to Y, the non-qualifying securities are haircut as unrated securities using the user defined rates for long and short non investment grade bonds (100% and 40% by default).

Determine what treatment you deem as proper and set this switch accordingly. LDB Contact: [Charlie Greiner](#)

## Email Lists for LDB Products

LDB maintains contact email lists by product. These lists are used to disseminate product specific announcements such as new versions, things to watch, regulatory changes, etc. In order to stay current with what is happening with the products you have licensed and to assist you in getting the most you can out of our offerings, we encourage you to give the names and email addresses of those at your organization who should be included in these emails.

LDB uses Constant Contact to send out these emails. The Constant Contact interface provides many features to us and allows you to indicate that you would like to be excluded from future emails. LDB Contact: [Len Bole](#)

## Old Email Addresses for Len Bole

If you have an old email address for Len that includes WORLDNET.ATT.NET, please **DROP** WORLDNET and use ATT.NET. As of 4/1, ATT will no longer recognize the WORLDNET addresses.



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