



Haircut Snippets

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And From the OCC We Have...

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TIO on the Internet! As of August 16, daily P/L files are available via the Internet at <http://tio.theocc.com>. The old method of accessing TIO is still available, but from what I have heard from those who have used the Internet to obtain files, the new access method is a VAST improvement!

In addition, the OCC has altered the format requirements of both the P/L and position files. The changes have to do with the proper handling of SPDR products, both sector SPDRs and the broad based index SPDRs (SPY, DIA and MDY).

The product field in the P record in the P/L file **and the basket ID field in the position file may now contain alphabetical characters**, such as 1XLK and 1QQQ. In addition, you must NOW use a security type S for SPY, DIA and MDY rather than F as you have in the past.

Because of these changes, there is now...

A New Version of RBH

These changes require alterations in the RBH and Weaver modules. For the first time, positions containing a security type of 'S' will be legitimate hedges for baskets. In addition, all data base fields containing basket IDs must be altered to allow alphabetical characters. Version 3.32a of both RBH and the Weaver are available as an upgrade to Version 3.32.

This latest RBH/Weaver also contains changes involving the identification of naked stock and in determining how many baskets a position represents. These additions are discussed in the next 2 sections.

TARGET2

Given a group of stocks identified as a basket, RBH faces the challenge of determining the number of baskets represented by these stocks. This number is important in determining capitalization and proper hedging and in identifying extra stock.

In addition to the traditional method of counting baskets, version 3.32a of the Weaver now recognizes the TARGET2 = Y switch in the INI file. TARGET2 allows the Weaver to potentially create more baskets (and also to consume more hedging securities). This approach may help reduce your haircut charge.

Naked Stock

RBH has traditionally identified naked stock for proprietary accounts by first netting calls and puts and then applying the remaining options as hedges against a stock position. Any stock in excess of the netted option positions was identified as naked and placed in the Naked Stock Report.

In response to suggestions from users, the NAKEDMETHOD parameter has been added to the INI file in version 3.32a. The procedure described in the preceding paragraph is Method 1.

Method 2 uses gross options to hedge stock and results in less naked stock.

Method 3 uses the greater of gross calls or gross puts to hedge stock. This method represents a philosophical middle ground between the other two approaches.

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Fixed Income, V 2.0

The Fixed Income haircut program has now been dramatically modified by increasing the scope of eligible securities that it will haircut and by providing users with an interface to the Bloomberg Data License product. There is now an additional report (Unhedged Residual Report) which lists all corporate and government bonds NOT hedged against another security.

New Security Types

In addition to government and non-convertible corporate bonds, the system will now haircut short and long term municipal bonds, Canadian debt, certain Municipal Bond Trusts and Liquid Asset Funds, Commercial Paper, Bankers Acceptances and Certificates of Deposit, as defined in paragraphs (c)(2)(vi)(B) through (E).

BLOOMBERG Data License

A Ratings menu has now been added to the fixed income system. It is designed to save users time in identifying proper haircut rates for corporate bonds.

The Ratings menu is currently designed to interface with the Bloomberg Data License product, an offering of Bloomberg LP. The Ratings interface obtains the following data from the Data License product: ratings from S&P, Moody's, Duff & Phelps and Fitch; the original issuance amount; and 144A indicators. Previously downloaded data are retained and used to compare to the latest information to identify new securities and securities whose information has changed.

The system counts the number of rating services that rate the security in the top 4 investment grades and how many services rate the security C or better. If there are at least two services that rate the security in the top 4 investment grades, the security qualifies for hedging with other corporate and government securities.

If there are NOT 2 ratings in the top 4 investment grades, the system determines if the bond is a 144A issue.

If it is, the long haircut rate is set to 100% and the short rate is set to 40%. If the bond is not a 144A issue and it is rated by at least two rating services, its haircut rate is determined by its issuance size. Otherwise its long rate is set to 100% and the short rate to 40%.

The user may alter any of the haircut rates for the latest historical date. These changes will override the system's computed rates.

Information about Bloomberg Data License may be obtained by contacting Brian Okupski, Sales Manager – Data License, 212-318-2151, bokupski@bloomberg.net

RBH File Maintenance

RBH users must remember to periodically review and update the Minimum Hedge file and the Special Data file.

When new baskets are added to the RBH milieu, entries MUST be added to the Minimum Hedge file IF your firm has positions in the new baskets.

When new futures and securities that hedge baskets are included in RBH AND they have nonstandard values for Shares Per Contract and Mini Leap Divisor, users must include this information in the Special Data file so that proper basket hedging can be computed.

How about a Users' Group?

I have been considering establishing an informal users' group open to clients using any of the haircut software: RBH, Weaver or Fixed Income.

If you want to participate, please provide me with your email address. If there is sufficient interest, I will provide all interested parties with the email address of all other interested parties.

Please let me know what you think.

Thank you to...

Dave DeArme and Charles Sax who both suggested ways to remove the unwanted third page from the electronic version of this newsletter. As with most things in my life, this handy solution is an illustration of not WHAT I know, but WHOM I know. THANK YOU BOTH!

Electronic Newsletter

I would prefer to disseminate this newsletter electronically and to send it to all those who may derive benefit from it.

Please let me know what your email address is and I will email further issues to you rather than sending them via snail mail. If there are others in your organization who ought to receive this missive, please provide their email addresses to me.

You can email me at: LDB-LENBOLE@worldnet.att.net

To Unsubscribe

Please email, write or phone me and I will gladly remove you from my mailing list.

In Case You Forgot:

LDB Consulting's capital computation products include:

RBH: computes derivative haircuts according to the SEC's Risk Based Haircut methodology.

Weaver: nets positions and identifies qualified baskets from the remaining stock positions. Typically lowers haircut charges.

Fixed Income: computes haircut charges for government and corporate bonds, hedging them where allowable. Now handles additional fixed income products (See section on Fixed Income, V 2.0).

