



Haircut Snippets

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LDB Consulting, Inc
PO Box 512
Valparaiso, IN 46384-0512
219-477-1928

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What I Did This Summer

Len Bole

If the 21st century is going to be as hectic as the first 9 months of this year, I've got serious troubles. So far this year, LDB Consulting has accomplished the following:

- 1) Developed and released a Customer Option Margin Optimizer
- 2) Developed a Market Maker Reg. T system
- 3) Developed Version 4.0 of RBH
- 4) Developed Version 4.0 of the Basket Weaver™
- 5) Arranged for a consulting group to take over support for my **non-haircut/non-margin** applications.

The next four 'stories' give more details on all these items.

As if that was not enough, the year has been packed on a personal level as well:

- 1) Our first granddaughter, Isabelle Rose, was born in April
- 2) Our first grandson, Charles Fulton, was born in September.
- 3) My first total hip replacement occurred in May. Chromium is a great thing. I'll let you know how airport metal detectors react.

As of now, all products, grand children and appendages are working well.

Margin Systems

Customer Option Margins

The Option Margin Optimizer (OMO) calculates customer margin charges according to NYSE Rule 431, as revised in January 2000. The charges calculated should be the **LOWEST** allowable by the rule for a position. The system will

calculate charges for all the newly allowed spreads including reversals, conversions, collars, boxes, butterflies and hedges.

Market Maker Reg. T

The Market Maker Margin/Reg. T System (MMM) examines open positions and determines how much stock in an option market maker's account is subject to Reg. T and maintenance margin calculations

The system will determine the net stock position and the net number of hedging in and at the money options. Stock resulting from an exercise or assignment is deducted from the net stock position. Net stock in excess of yesterday's hedged stock and today's hedging options is subject to maintenance margin.

If any of the unhedged stock was opened today, hedging option trades will be located. Any unhedged stock opened today in excess of the net hedging options traded today is subject to initial margin

RBH Version 4.0

UBIT™

One of the distinguishing features of RBH has been its ability to take a group of stocks identified as a basket and to assure that the basket is properly hedged and capitalized. When analyzing stock baskets, RBH has historically taken the stock holding with the greatest market value and used that stock to determine the target number of baskets contained in a position. Although the resultant baskets were properly hedged and capitalized, some securities may have been rolled out of the basket needlessly.

RBH now allows the user to select the Universal Basket Identification Technique (UBIT™) and to use it as the

method for determining a position's target number of baskets.

UBIT™ will keep the largest number of stock shares within the basket. Although this may NOT generate the lowest haircut, it will most closely comply with the basket identification employed by the user in populating the position file. UBIT™ may be selected via the Switch submenu in the Maintain menu.

Decimal Strikes

Anticipating a switch to decimal strike fractions within the next year, RBH report formats have been altered to support the eventual migration by OCC.

And More

Users will be able to use the Non-Standard RBH file to define special haircut rates for **convertible securities**. The Non-Standard security type may then be added to the convertible file, where the rates will be used to haircut unconverted securities and to make the decision as to whether conversion is economically sound.

In addition to providing long and short haircut percentages for Non-Standard RBH securities, **the Non-Standard file will now provide for per share charges** as well. It is anticipated that these fields can be used on futures that are otherwise ineligible for RBH.

RBH will allow accounts to be combined into **Groups** for haircut purposes. Users may haircut the entire position file, groups only or selected accounts.

Basket Weaver™ 4.0

ETFs

Exchange Traded Funds (ETFs) have become increasingly popular as an investment and hedging tool. Examples of these products include Spiders, Diamonds, Qubes, Holders and iShares.

These products may be **created** by converting a basket of stocks into an ETF or **redeemed** for a basket of stocks. Fees are involved and the

baskets required for creation must be EXACT.

It would appear that an ETF and a basket are both securities which are "exchangeable for or convertible into the underlying security within a period of 90 days. "

Version 4.0 of the Basket Weaver™ will now analyze positions and perform the creation and redemption of ETFs, charging the appropriate fees and any loss on conversion. These strategies may result in significant haircut savings.

Version 4.0 of both RBH and the Basket Weaver™ will be available later this year.

A Source for Tech Resources

It became obvious to me late last year that the time requirements of supporting my haircut and margin related business made it impossible for me to properly support my general consulting clients.

I was fortunate to find Steve Stepanek and the SJS Group. Steve and his staff possess state of the art tech skills (C++, VB, and SQL) as well as the ability to support older technology. Steve has been in the options business for the last 15 years.

He and his people are available to assist you in designing, developing and implementing tech projects. I highly recommend him as a tech problem solver with front office and back office experience.

You may reach Steve at 815-464-2733 or at sjs@sjsgroup.com.

OCC and RBH

I would again like to urge you to get on the OCC email list regarding the addition and deletion of basket IDs and other RBH information. OCC is quite good about keeping us up to date on the ever-changing environment. Avail yourself of this information.

Changes to the **Special Data File**: R and RQ should have SPC of 500. QQQ should have Mini Leap Divisor of 40. R and RQ should also be added to the **OCC Download Symbols**. Many of the new ETF products which hedge baskets, especially iShares, will require entries in the Special Data file. At this point, I do NOT know enough specifics to suggest proper values.

The following Basket IDs should be added to the **Minimum Hedge File**. The first three require 50% capitalization; the others, sector baskets, require 95%.

- 10015 Russell 3000
- 10017 Russell 1000
- 10500 MDY SPDR
- 1BDH Broad Band Holder
- 1BHH B2B Internet Holder
- 1IAH Internet Architecture Holder
- 1IIIH Internet Infrastructure Holder
- 1PPH Pharmaceutical Holder
- 1RKH Regional Bank Holder
- 1SMH Semiconductor Holder
- 1TTH Telecom Holder
- 1UTH Utility Holder

The following basket IDs should be **removed** from the **Minimum Hedge File**: 10058, 10061, 10069, 10086 and 10090.

Electronic Newsletter

If you can receive this letter via email, please provide me with your email address. If there are others in your organization that ought to receive this missive, please provide their email address to me as well.

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