Security Futures Margins

Questions & Answers

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This Q&A has been prepared to provide basic information regarding the special margin requirements that apply to single stock futures contracts and futures on narrow-based stock indices. The information that follows contains answers to many commonly asked questions about those requirements, including the margin offsets that may be available to investors under certain circumstances and other margin-related matters. Investors should be aware that this material describes minimum margin requirements and discusses offsets that are permissible under CFTC/SEC guidelines and OneChicago's rules. ***The margin requirements applicable to a particular investor's account may vary.*** *For example, a clearing firm may choose to require higher margin deposits than the minimums permitted under the rules. Investors, therefore, are encouraged to discuss the margin requirements for their accounts directly with their broker.*

Document Highlights

- The basic margin requirement for security futures is 20% of the underlying value of the contract (initial and maintenance margin).

- Portfolio margining is available for qualifying securities accounts (and sub-accounts) pursuant to New York Stock Exchange Rule 431(g) and Chicago Board of Options Exchange Rule 12.4. These Rules permit margin requirements to be calculated on a "portfolio" basis. The program is available for stocks, listed derivatives, OTC derivatives and security futures.[1] Prior approval of the NYSE or the CBOE is required.

- This 20% minimum may be reduced for certain types of futures market positions, such as calendar and basket spreads, and for stock options and for certain offsetting positions in stock options and cash securities, provided the security futures are held in securities accounts (or sub-accounts).

- Margin requirements can be satisfied with cash, margin securities, and open trade equity in other futures accounts.

- Certain industry professionals (such as qualified market makers) are exempt from these requirements.

- True risk-based margining (e.g. SPAN margining) is not permitted for customer positions in security futures. Clearing firms will nonetheless continue to receive SPAN files that reflect the appropriate minimum margin requirements.

Security Futures Margins: Questions & Answers

Why are there special margin requirements for single stock futures?

Single stock futures contracts and futures on narrow-based stock indices ("security futures"), are subject to regulation as both securities and futures contracts.

Persons carrying customer's security futures accounts, therefore, have to be registered with the Securities and Exchange Commission ("SEC") as broker-dealers and the Commodity Futures Trading Commission ("CFTC") as futures commission

[1] See Securities Exchange Act Release No. 34-54918 (December 12, 2006). This program became permanent effective August 1, 2008. *See* Securities Exchange Act Release No. 58236 (July 30, 2008)

merchants ("FCMs").[2] In addition, regulations adopted by the SEC and CFTC require broker-dealer/FCMs who trade security futures on behalf of customers to comply with special margin (performance bond) requirements for these products ("Margin Rules"). As a result, the applicability of the Margin Rules differs in some cases depending on whether a trade or position is carried in a securities account or a futures account.

What do the Margin Rules cover?

The Margin Rules establish requirements relating to, among other things, the amount of margin (performance bond) that a broker-dealer/FCM must collect from customers who trade security futures, the valuation and form of any such margin deposits, the means by which a customer's account equity is to be determined for margin purposes, the treatment of undermargined accounts and the circumstances in which customers may make withdrawals from their accounts.

What is the required margin for a customer account?

A customer trading a security futures product is subject to a minimum 20% initial and maintenance margin requirement. More precisely, the Margin Rules require that customers who trade security futures must provide and maintain, on a daily basis, cash or other eligible assets (discussed below) the value of which is equal to 20% of the "current market value" of the security future. The Margin Rules for security futures establish a minimum 20% requirement for both buyers and sellers and for both initial and maintenance margin. The 20% minimum margin requirement is subject to reduction for certain strategy based offsets (see below). The margin requirements prescribed by the rules are minimums, the required customer margin levels may exceed 20% when appropriate based on the risk of the postion. A broker-dealer/FCM that is carrying a customer's account can establish greater requirements. Under the Margin Rules, the "current market value" of a security future is equal to the product of the daily settlement price of the security future and the applicable number of shares per contract (for single stock futures) or the contract multiplier (for narrow-based stock index futures).

How is the equity in a customer's account computed under the Margin Rules?

In addition to the specific provisions of the Margin Rules, the calculation of the equity in a security futures account will be based on the rules of the self-regulatory organization(s), including OneChicago, of which the broker-dealer/FCM is

[2] An existing broker-dealer only needs to notice register with the CFTC as an FCM for the purpose of transacting in security futures; likewise, an existing FCM only needs to notice register with the SEC as a broker-dealer for the purpose of transacting in security futures. Notice registration information for broke-dealer can be found at http://www.nfa.futures.org/NFA-registration/templates-and-forms/notice-form7r.HTML; notice registration information for FCMs can be found at http://www.nfa.futures.org/NFA-registration/templates-and-forms/SEC-notice-form-bd-n.HTML.

a member, and will be affected by whether the customer's security futures trades and positions are carried in a securities or a futures account. Cash or positions in a "cash account" as described by Regulation T[3] (or any other Reg T account other than a margin account) will not be counted unless they are transferred to the margin account in which the security futures position is carried. By comparison, a customer who maintains multiple segregated futures accounts with the same broker-dealer/FCM can consolidate those accounts for purposes of determining whether the accounts are undermargined, even if some of those accounts do not contain security futures positions. For these purposes, the equity in a futures account includes the account's net liquidating equity plus the collateral value of margin securities, exempted securities and other acceptable margin deposits.

Are there reductions for spreads, conversions and other types of offsetting positions?

Yes. The Margin Rules permit the exchanges to reduce the required initial and maintenance margin for certain offsetting positions involving security futures (provided the offsets are consistent with existing offsets for exchange-traded options). Some of the more significant margin reductions are described below; a complete list of the permitted reductions is set forth in the attached table.

- For calendar spreads, the required maintenance (and initial) margin is 5% of the greater of the current market value of the long security future and the short security future.

- For spreads between narrow-based index futures and a basket of security futures contracts based on and in the same proportion to the securities underlying the index, the required initial and maintenance margin is 5% of the current market value of the long or short position, whichever is greater.

- For basket spreads between a futures contract on a broad-based stock index and a basket of narrow-based security futures contracts based on and in the same proportion to the securities underlying the broad-based index, the required initial and maintenance margin is 5% of the current market value of the basket of security futures.

- For collars, long security futures, long puts, and long calls all on the same security, where the put exercise price is below the call exercise price, the required maintenance margin would be the lesser of: (x) 10% of the aggregate exercise price of the put plus the aggregate put out-of-the-money amount; or (y) 20% of the aggregate exercise price of the call plus the aggregate call in-the-money amount.

[3] See, CFR Part 220 –Credit by Brokers and Dealers (Regulation T) §220.8 – Cash Account (Reg T)

- For hedged positions in which a customer is long (short) a security futures contract and short (long) the underlying security, the required maintenance margin would be equal to 5% of the position with the higher current market value.

- For positions that are market-neutral and involve combinations of security futures and securities options (for example, conversions and reverse conversions), the required maintenance margin would be 10% of the aggregate exercise price of the options plus the in-the-money amount of the short option.

- For short positions in security futures that are covered by long positions that are convertible into the underlying security without the payment of money (such as convertible bonds), the required maintenance margin would be 10% of the current market value of the convertible security.

These and other offsetting positions, including strategies based on stock baskets and narrow-based indices, are summarized in the attached table. It should be noted that the referenced strategy-based offsets are permitted only in a customer's securities account. In other words, a customer account that is carried as a futures account on the books of a broker-dealer/FCM will not be entitled to these reductions.

What kinds of collateral can be used to satisfy security futures margin requirements?

Cash (including freely convertible foreign currency).
Margin securities as defined in Reg T (in essence, equity securities traded on an exchange)
Any debt security.
Certain OTC and foreign securities (as determined by the broker-dealer)
Mutual fund shares, and debt securities that are convertible into margin-eligible securities).
Exempted securities (including U.S. government, agency and municipal debt).

Variation margin that is payable by or to a customer at the close of trading on any day is to be treated as a credit or debit to the account. Thus, all gains or losses on futures positions in the course of a day (and not merely amounts giving rise to a maintenance margin call) will be credited or charged, as the case may be, to the customer's account for this purpose.

The Margin Rules do not permit letters of credit to be used to satisfy security futures margin requirements, but do permit a broker-dealer/FCM to accept money market mutual fund shares as margin if there is a three-way agreement among the broker-dealer/FCM, the customer, and the money market mutual fund or its transfer agent that allows the brokerdealer/FCM (but not the customer) to redeem the shares promptly. Letters of credit and other forms of margin (such as warehouse receipts) can be held in a futures account, however, and can be used to satisfy margin requirements for other types of futures contracts as long as there is sufficient acceptable collateral or other equity in the account that can be allocated to security futures margin requirements.

Can a margin equity security be used for security futures margin?

Yes, although its value for margin purposes depends on whether it is being used to satisfy initial or maintenance margin requirements. In effect, the Margin Rules provide that a margin equity security (effectively defined in Reg T to mean a "margin security" other than a debt security) is to be valued at 50% of its current market value to the extent that initial margin is required for new trades or positions that create or increase a margin deficiency. For purposes of calculating maintenance margin requirements, however, 75% of the value of a margin equity security may be treated as equity in the account.

What is the collateral value of exempt securities and non-equity securities that are deposited as margin?

The answer depends on whether the security futures trades and positions are being carried in a futures or a securities account. If they are carried in a futures account, exempt securities and nonequity securities deposited as margin for security futures will receive their current market value minus the haircuts imposed under the SEC's net capital rule, consistent with the practice that is currently followed by the futures exchanges. If, however, the security futures are carried in a securities account, exempt securities and nonequity securities will be valued at the lesser of Reg T "good faith" margin requirements and the amounts permitted under the rules of Financial Industry Regulatory Authority ("FINRA") and/or the New York Stock Exchange.

Is open trade equity included in the calculation of the equity in a customer's security futures account?

Yes. As noted above, the Margin Rules provide that variation settlement receivable or payable by a customer at the close of trading must be treated as a credit or debit to the account.

Can SPAN® be used to calculate customer margin requirements?

The SEC and CFTC will not permit risk-based portfolio margining systems such as SPAN (or OCC-STANS, which is used by OCC to calculate clearing member margin requirements) to be used to calculate customer margin requirements for security futures until a similar methodology has been approved for exchange-traded stock and index options. SPAN, therefore, will calculate margin levels for customer positions at a minimum of 20%.

Will the SPAN file contain margin levels for security futures?

Yes. The minimum customer margin levels will be in the daily SPAN/OFRA file published by OCC. The customer margin levels may exceed 20% when appropriate based on the risk of the postion. A firm remains free to establish higher margin levels for some or all of its customers as appropriate.

What about cross-margin accounts?

The CFTC and SEC have not approved cross-margining for customers who are not "market professionals" (exchange members, broker-dealers and FCMs). Accordingly, security futures (or other positions) carried in a futures account may not be used to offset or reduce margin requirements for security futures (or other positions) in a customer's securities account. This limitation should not affect "market professionals" (such as market makers, specialists and floor traders) to the extent that they are carrying security futures positions in a securities account or are participating in cross-margining programs that have been approved by the SEC and CFTC, such as the cross-margining program that is currently in place between OCC and the CME.

What is the collateral value of a guarantee of a security futures account?

The Margin Rules provide that a guarantee of a customer's account will be given effect as and to the extent provided in the rules of the applicable self-regulatory organizations. Thus, SRO rules relating to the use of guarantees as collateral will remain effective under the Margin Rules.[4]

What are the time periods for the collection of margin for security futures?

The Margin Rules do not specify a uniform time period for the collection of margin. In addition, the Margin Rules do not require that an undermargined security futures position be liquidated (although the carrying broker-dealer/FCM will have to take a charge to net capital as required under applicable SEC or CFTC rules). A broker-dealer/FCM must liquidate that position, however, if the account would liquidate to a deficit.

Can a broker-dealer/FCM or its affiliate advance funds to a customer or arrange margin financing for a customer?

Yes, the broker-dealer/FCM can advance funds to meet a margin call as long as it does so in the ordinary course of business and issues a margin call for the funds advanced. A broker-dealer/FCM can also arrange for a margin loan to be

[4] For example, FINRA Rule 4210 provides generally that an account guaranteed by another account may be consolidated. In such a case, the margin requirements for those accounts would be determined on the basis of the net positions in the two (consolidated) accounts.

made to the customer, provided that it does not willfully violate Federal Reserve Board Regulations T (extensions of credit by broker-dealers), U (extensions of credit by persons other than brokers or dealers), or X (foreign securities credit).

Do the Margin Rules restrict the ability of a customer to make withdrawals from its own account?

In general, the Margin Rules permit a customer to withdraw cash, securities or other assets from its account as long as the remaining equity is sufficient to satisfy the customer's margin requirements for security futures and any related positions.

Do the Margin Rules restrict the ability of a broker-dealer/FCM to make withdrawals from a customer's account?

In general, no. The Margin Rules permit a broker-dealer/FCM to deduct certain payments and charges from a customer account to satisfy the customer's obligations to the broker-dealer/FCM and third parties. For example, a broker-dealer/FCM may deduct commissions, interest and service charges without regard to whether those deductions create a margin deficiency in the account.

The Margin Rules establish requirements for customer accounts. Is everyone who has a security futures account a "customer"?

No. The regulations exempt certain market participants, most of which are market professionals from the customer margin rules. The non-customer margin levels are not dictated by CFTC or SEC regulations. Rather, non-customer margins should be at reasonable levels satisfactory to both the firm and the non-customer. OCC's Customer Portfolio Margining sysem or similar margining systems levels would be appropriate Please note that the carry firm is generally required to deduct fron Net Capital any difference between the equity in the account and the haircut requirements outlined in SEC's Rule 15c3-1. See CFTC Rules 41.42 through 41.49 or SEC Rules 400 through 406.

These exceptions, and the conditions that have to be satisfied before they become applicable, are described below.

Exchange Members: Exchange members trading for their own accounts are exempt from the Margin Rules in connection with the trading of their own accounts if they (a) are registered as a floor trader or floor broker with the CFTC or as a dealer with the SEC; (b) hold themselves out as willing to buy and sell security futures for their own accounts on a regular or continuous basis; (c) maintain records sufficient to demonstrate compliance with this exemption; and (d) are subject to disciplinary action if they fail to comply with applicable exchange rules.

"Exempted Persons": The Margin Rules also do not apply to transactions made by an "exempted person" for its own account. Under the Margin Rules, an "exempted person" is effectively defined to mean a member of OneChicago (or another national securities exchange), a broker-dealer or an FCM that: (a) maintains at least 1,000 active stock, futures or option accounts for customers other than broker-dealers, FCMs, floor brokers or floor traders ("professional traders") trading securities, futures or commodity options; or (b) earns at least $10 million in gross revenues on an annual basis from transactions in securities, futures or commodity options with persons other than professional traders; or (c) earns at least 10% of its gross revenues on an annual basis from transactions in securities, futures or commodity options with persons other than professional traders. A brokerdealer/FCM does not have to comply with the Margin Rules to the extent that its customer is an exempted person (so that, for example, a carrying broker is not required by the Margin Rules to collect 20% margin from another broker if that other broker is an "exempted person"). This exception does not excuse an exempted person from collecting margin from, or otherwise enforcing the Margin Rules in respect of, its own customers.

Foreign Transactions: The Margin Rules also do not apply to transactions in which a foreign person is trading foreign futures on an exchange outside the United States (whether effected through the U.S. or foreign offices of a broker-dealer/FCM or its affiliates). No such exemption is available, however, for U.S. persons trading securities futures on foreign markets or for non-U.S. persons trading security futures products on U.S. markets.

Clearing House Margin: The Margin Rules do not apply to the margin requirements established by The Options Clearing Corporation for their respective clearing members.

This material has been prepared for general informational purposes only. Information contained herein has been obtained from sources believed to be reliable, but is in no way warranted as to accuracy or completeness and is subject to change without notice. Any opinions herein reflect the judgment of OneChicago as of the date hereof. Market participants should consult their own advisors regarding the tax, accounting, regulatory and other legal implications of trading security futures products.

Appendix

Security Futures Margins Table

	DESCRIPTION OF OFFSET	UNDERLYING SECURITY	INITIAL MARGIN REQUIREMENT	MAINTENANCE MARGIN REQUIREMENT
1	**Long security future (or basket of security futures) and long put option on the same underlying security (or index).**	Individual stock or narrow-based security index	20% of the current market value of the long security future, plus pay for the long put in full.	The lower of: (1) 10% of the aggregate exercise price of the put plus the aggregate put out-of-the-money amount, if any; or (2) 20% of the current market value of the long security future.
2	**Short security future (or basket of security futures) and short put option on the same underlying security (or index).**	Individual stock or narrow-based security index	20% of the current market value of the short security future, plus the aggregate put in-the money amount, if any. Proceeds from the put sale may be applied.	20% of the current market value of the short security future, plus the aggregate put in-the money amount, if any.
3	**Long security future and short position in the same security (or securities basket) underlying the security future.**	Individual stock or narrow-based security index	The initial margin required under Reg T for the short stock(s).	5% of the current market value (as defined in Reg T) of the stock(s) underlying the security future.
4	**Long security future (or basket of security futures) and short a call on the same underlying security (or index).**	Individual stock or narrow-based security index	20% of the current market value of the long security future, plus the aggregate call in-the money amount, if any. Proceeds from the call sale may be applied.	20% of the current market value of the long security future, plus the aggregate call in-the money amount, if any.
5	**Long a basket of narrow-based security futures that together track a broad-based index and short a call on the same index.**	Narrow-based security index	20% of the current market value of the basket of narrow-based security futures, plus the aggregate call in-the money amount, if any. Proceeds from the call sale may be applied.	20% of the current market value of the basket of narrow-based security futures, plus the aggregate call in-the money amount, if any.
6	**Short a basket of narrow-based security futures that together track a broad-based security index and short a put on the same index.**	Narrow-based security index	20% of the current market value of the basket of narrow-based security futures, plus the aggregate put in-the money amount, if any. Proceeds from the put sale may be applied.	The lower of: (1) 10% of the aggregate exercise price of the put, plus the aggregate put out-of money amount, if any; or (2) 20% of the current market value of the basket of security futures.

	DESCRIPTION OF OFFSET	UNDERLYING SECURITY	INITIAL MARGIN REQUIREMENT	MAINTENANCE MARGIN REQUIREMENT
7	**Long a basket of narrow-based security futures that together track a broad-based security index and long a put on the same index.**	Narrow-based security index	20% of the current market value of the basket of narrow-based security futures, plus pay for the long put in full.	The lower of: (1) 10% of the aggregate exercise price of the call, plus the aggregate call out-of-the-money amount, if any; or (2) 20% of the current market value of the basket of security futures.
8	**Short a basket of narrowbased security futures that together track a broad-based security index and long a call on the same index.**	Narrow-based security index	20% of the current market value of the short basket of narrow-based security futures, plus pay for the long call in full.	The lower of: (1) 10% of the aggregate exercise price of the call, plus the aggregate call out-of-the-money account, if any; or (2) 20% of the current market value of the basket of security futures.
9	**Long security future and short security future on the same underlying security (or index).**	Individual stock or narrow-based security index	5% of the greater of the current market value of the long security future or the short security future.	5% of the greater of the current market value of the long security future or the short security future.
10	**Conversion: Long security future, long put option and short call option on the same underlying security, with the put and call having the same exercise price.**	Individual stock or narrow-based security index	20% of the current market value of the long security future, plus the aggregate call in-the-money amount, if any, plus pay for the put in full. Proceeds from the call sale may be applied.	10% of the aggregate exercise price, plus the aggregate call in-the-money amount, if any.
11	**Collar: Long security future, long put option and short call option on the same underlying security, with the put exercise price below the call exercise price.**	Individual stock or narrow-based security index	20% of the current market value of the long security future, plus the aggregate call in-the-money amount, if any, plus pay for the put in full. Proceeds from the call sale may be applied.	The lower of: (1) 10% of the aggregate exercise price of the put plus the aggregate put out-of-the-money amount, if any; or (2) 20% of the aggregate exercise price of the call, plus the aggregate call in-the-money amount, if any.
12	**Short security future and long the same security (or securities basket) underlying the security future.**	Individual stock or narrow-based security index	The initial margin required under Reg T for the long stock or stocks	5% of the current market value (as defined in Reg T) of the long stock or stocks.
13	**Short security future and long a security immediately convertible into the same security future without restriction, including the payment of money.**	Individual stock or narrow-based security index	The initial margin required under Reg T for the long security	10% of the current market value (as defined in Reg T) of the long security

	DESCRIPTION OF OFFSET	UNDERLYING SECURITY	INITIAL MARGIN REQUIREMENT	MAINTENANCE MARGIN REQUIREMENT
14	**Short security future (or basket of security futures) and long call or warrant on the same underlying security (or index).**	Individual stock or narrow-based security index	20% of the current market value of the short security future, plus pay for the call in full.	The lower of: (1) 10% of the aggregate exercise price of the call, plus the aggregate call out-of-the-money amount, if any; or (2) 20% of the current market value of the short security future.
15	**Reverse Conversion: Short security future, short put option and long call option on the same underlying security, with the put and call having the same exercise price.**	Individual stock or narrow-based security index	20% of the current market value of the short security future, plus the aggregate put in-the-money amount, if any, plus pay for the call in full. Proceeds from put sale may be applied.	10% of the aggregate exercise price, plus the aggregate put in-the-money amount, if any.
16	**Long (short) a basket of narrow-based index futures that together track a broadbased index and short (long) the broad based-index futures contract.**	Narrow-based security index	5% of the current market value of the long (short) basket of security futures.	5% of the current market value of the long (short) basket of security futures.
17	**Long (short) a basket of narrow-based index futures and short (long) the narrow based-index futures contract.**	Individual stock and narrow-based security index	5% of the greater of the current market value of the long security future or the short security future.	5% of the greater of the current market value of the long security future or the short security future.
18	**Long (short) a security futures and short (long) an identical security future traded on another market.**	Individual stock and narrow-based security index	3% of the greater of the current market value of the long security future or the short security future.	3% of the current market value of the long security future or the short security future.