



Welcome

Portfolio Margining

How the Biggest Change in Margin Rules in 40 years is Benefiting Hedge Funds, Proprietary Trading Groups and High Net Worth Investors

**Doug Engmann, Senior Executive Vice President,
Managing Director Equities, Fimat USA, LLC**



This Is a Margin Rule Revolution

To create more competitive markets, in July 2005 the U.S. the SEC approved a “portfolio margining” pilot program to effectively lower margin requirements, beginning with broad-based index options and ETFs.

By July 2006, the SEC expanded the pilot to include individual equity options (excluding the underlying) and single stock futures. Fimat was the first and only U.S. broker that operated under the two pilot programs.

A full portfolio margining program was recently finalized. It expanded to include stocks, OTC derivatives, ETFs, options on narrow-based indices, and single stock futures (no index futures).



How Portfolio Margin Works

Stock and Options Example:

(Prices as of May 31, 2007)

Married Put - Long Stock/Long Put

Long 100,000 Shares IBM @ \$105.63

Long 1,000 Puts IBM OCT 105 @ \$3.80

Traditional Reg T margin:

50% of \$10,560,300 = \$5,280,150

PLUS 100% of put premium, or \$380,000

TOTAL Reg T MARGIN = \$5,660,150 initial margin call

New Portfolio Margin:

Maximum loss down 15% in Stock is \$1,584,045 offset by theoretical gain in Put of \$1,162,000 = \$422,045 net loss

TOTAL PORTFOLIO MARGIN REQUIRED = \$422,045

Source: Portfolio margin and standard margin calculations were made using the CBOE website margin calculator and the OCC CPM website calculator. Supporting data is available upon written request.



How Portfolio Margin Works, cont.

Index Options Example:

(OEX \$701.22 as of June 5, 2007)

Index Options - Long Straddle

Long 1,000 Calls OEX SEP 700 @ \$25.20

Long 1,000 Puts OEX SEP 700 @ \$16.60

Traditional Reg T margin:

100% of call and put premiums = \$4,180,000

New Portfolio Margin:

Gains and losses from the puts and calls in the Straddle are calculated from up 6% and down 8% market moves; Such moves are likely to generate only gains according to theoretical calculations

Portfolio Margin is the Minimum of \$75,000*

***Please note:** The prime broker may require additional margin per the firm's own guidelines. This margin amount indicates the minimum required under existing SEC rules. However, firms including Fimat USA, have their own risk guidelines and may impose higher minimums on its own customer accounts.

Source: Portfolio margin and standard margin calculations were made using the CBOE website margin calculator and the OCC CPM website calculator. Supporting data is available upon written request.



Margin Calculation Risk Points

- **High cap, broad-based index options, ETFs/ETF options (i.e. SPX, OEX. etc.)** - Margin requirements based on market movements up 6% and down 8% and 10 intervals in between.
- **Non-high cap broad-based index options, ETFs/ETF options (i.e. QQQ, Russell, etc.)** - Margin requirements based on market movements up and down 10% and 10 intervals in between.
- **Stocks, stock options, single stock futures, narrow based indices and ETFs and ETF options** - Margin requirements based on market movements up and down 15% and 10 intervals in between

There is a minimum of \$37.50 per contract for each portfolio. Brokers will have higher House margins for riskier positions. All portfolio margin calls are due in three business days, but brokers may restrict activity or require liquidation sooner if uncovered margin calls result from risky positions.



Naked Stock and Un-hedged Options

Un-hedged stock and options positions eligible for lower margins:

- High cap ETFs - down 8% and up 6% risk based margin
- Non-high cap ETFs - 10% risk based margin
- Equities - 15% risk based margin

Brokers may require additional margin beyond the risk-based margin requirements, particularly for positions with naked or uncovered calls or puts, or for concentrated positions, or highly volatile stocks.



Naked Stock, Pairs, Un-hedged Options

Naked Stock

Long 100,000 Shares IBM @ \$93.00

Standard margin is \$4,650,000

Portfolio Margin is \$1,395,000

Short Naked Call

Short 1000 Calls IBM Jul 95 @ \$3.80

Standard margin is \$1,666,000

Portfolio Margin is \$1,060,950

Pairs Trade

Long 100,000 shares ICE @ \$131.00

Short 100,000 shares NMX @ \$126.00

Standard margin is \$12,850,000

Portfolio Margin is \$3,855,000

Source: Portfolio margin and standard margin calculations were made using the CBOE website margin calculator and the OCC CPM website calculator. Supporting data is available upon written request.



Eligibility Guidelines – Experienced Options Traders

Requirements for individual/small fund customers:

- Qualify under the broker's rules on options trading experience and knowledge to trade uncovered calls & puts
- Meet the minimum equity requirements set by the Broker (Fimat USA has established \$500,000 minimum for a fund; \$150,000 for an individual.)
- Sign a portfolio margin risk disclosure
- Meet any other credit or qualification requirements set by the Broker. For example, Fimat requires a personal interview by the risk manager to ascertain that the trader understands all the risks in leveraged options trading.



Potential Benefits for Hedge Funds

A Portfolio Margining Hedge Fund Account can:

- Lower costs for leverage, though offshore financing is still necessary for certain strategies.
- New interest in using derivatives with the potential to increase returns and lower risks.
- Ability to book unlisted derivatives to offset listed positions at the prime broker may change dynamics of OTC options market.



Remaining Issues

- Are the market stress tests adequate and fair to all market participants? Why should customers get better treatment than dealers?
- Is the minimum requirement adequate to deal with risks of decay (Theta), particularly for retail customers?
- When will cross margining with index futures become available, or is the gap between the SEC/SIPC and the CFTC/NFA too wide?
- Can the program be expanded to include relief for offsetting portfolios of unrelated positions (i.e. long-short portfolios) and pairs trading?
- When will some of the stricter qualification requirements be eased to allow retail investors with less options experience to gain advantage of portfolio margining for truly hedged positions (like collars, butterflies)?



Important Disclosures

All of the illustrative examples based on OCC initial margin calculations show how Portfolio Margining, by creating a more accurate reflection of risk, may require less capital in margin collateral for various hedging strategies compared to traditional strategy or product-based Reg T margin calculations. Dramatic day-to-day changes in the implied volatilities are not represented in the risk analysis above. Positions in a portfolio margined account, and the margin requirements relating to such accounts, can change dramatically day-to-day due to changes in market conditions. All examples of option positions under a portfolio margining status are for illustrative purposes only and do not represent any suggestion of how to trade, or which positions to include in your portfolio, or indicate any potential profitability. These are specific examples showing the possible margin relief under portfolio margining rules in comparison to the Reg T margin requirements. Fimat Preferred has no opinion about the profitability or risk associated with the positions shown in any example contained herein. Supporting data for all illustrative examples are available upon written request.

Prior to any trading account being opened, all potential clients wishing to trade under the guidelines of a portfolio margined account will undergo an interview with Fimat USA's Senior Risk Manager in order for the firm to ascertain the client's knowledge of option trading, option strategies, and the risks associated with a portfolio margined account. In addition, all required account documentation is to be completed and reviewed prior to an account approval and opening. Fimat USA reserves the right to approve or not approve an account for portfolio margin status for any reason. Fimat USA also reserves the right to sell out any position at any time in a portfolio margined account.

Portfolio Margining risks do not represent all risks associated with positions in a particular portfolio. Dramatic day-to-day changes in the implied volatilities are not represented in the risk analysis. Margin requirements may be significantly greater than simple Risk based Haircuts (RBH) calculations. RBH is not a Value at Risk (VAR) calculation and does not make a correlation between stocks in a portfolio.

Fimat USA will apply its own risk guidelines and limits to all approved portfolio margined accounts. These guidelines and limits may be more stringent than what is available under portfolio margining rules. Fimat USA may also require additional margin beyond the risk-based margin requirements, particularly for positions with naked or uncovered calls or puts. Please note that current or pending portfolio margining rules, guidelines and requirements are subject to change by the SEC, NYSE or other regulatory entities.



Please note that options are not suitable for all investors and investing in options carries substantial risk. Because of the importance of tax considerations to all options transactions, investors considering options should consult with a tax advisor as to how taxes affect the outcome of contemplated options transactions. Individuals should not enter into options transactions until they have read and understood the risk disclosure document titled "Characteristics and Risks of Standardized Options." To obtain a copy of the Options Disclosure Document contact us at 888-781-0283.

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Note: Multiple leg option strategies, including spreads, will incur multiple commission charges.

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