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Our Ref. : AUD/9703001

3 March 1997

**CIRCULAR TO MEMBERS**

Dear Members,

The Exchange has made certain changes to margin requirements on Members' clients. We enclose a copy of the Guidelines on Margin Procedures for the Purpose of Minimum Requirement pursuant to Rule 617 incorporating the changes. The main changes are summarised as follows:-

Day trade margin requirements

A call for initial margin may be cancelled if the positions established during the trading day have been subsequently closed on the same trading day. As such, no margin requirement is required on day trades. It should be noted that this relaxation of day trade margin requirements is only granted to those clients with excellent track records of meeting margin obligations and sound financial positions. However, in cases where these clients exclusively transact day trades, Members are advised to collect intra-day margins from these clients. (paragraphs 2.4, 4.2 and 5.3)

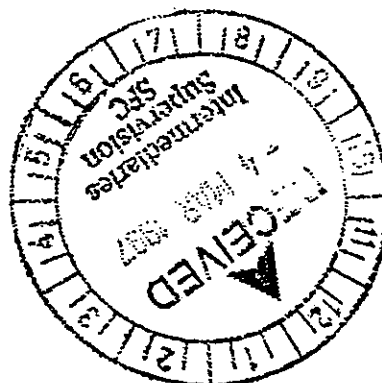
Spread margin for HSI Options

In addition to SPAN, alternative margin calculation methodology is accepted in respect of call (put) spread positions if the amount is based on the maximum possible losses arising from the spread positions. (paragraph 1.2b iv)

The enclosed guidelines take effect from the date of this circular and replace the previous guidelines issued under our circular (Ref. : MEM/CIR/9512057) dated 12 December 1995. Should Members have any queries on the guidelines, please contact the Compliance Department of the Exchange.

Yours faithfully,

Ivers W. Riley  
Chief Executive



# **Guidelines on Margin Procedures for the Purpose of Minimum Requirement pursuant to Rule 617 (March 3, 1997)**

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## **Guidelines on Margin Procedures for the Purpose of Minimum Requirement pursuant to Rule 617 (March 3, 1997)**

The purpose of margin<sup>1</sup> is to safeguard the completion of a contract. Setting margin at a higher level than the stipulated minimum margin, whether generally for all clients or specifically for one client, is entirely at the discretion of the Member. When in doubt, Members are advised to be prudent and adopt a conservative approach to margining. **It should also be noted that the responsibility to fully comply with Exchange requirements rests with Members. Members should ensure that, among others, their operating systems (including systems which may have already been approved by the Exchange) comply with these guidelines.**

### **1. Basis of margin computation**

#### **1.1 Gross margining system**

- a. The method of ascertaining the number of open positions held by a client and the computation of minimum margin required thereon is as follows:-
  - i. The gross open bought positions and the gross open sold positions in each contract month are totalled to establish the total number of open positions in each contract month.
  - ii. The aggregate of the total open positions in all contract months shall be subject to minimum margin requirements at the full rate. (See Example A at Appendix).
  - iii. However, a spread margin rate may be applied to "qualified spread positions". In computing the number of qualified spread positions, every client account must be considered independently. To qualify as a qualified spread position, the position must be an intra-market spread (i.e. comprising a long position in one contract month against a short position in another contract month of the same contract, held by the same client). (See Example B at Appendix). A spread position maintained in an Omnibus Account must be affirmatively claimed by the client. Spread positions maintained in a general client account may be automatically applied by the Member or affirmatively claimed by the client.
- b. A Member may assess the amount of margin required on other bases provided that the amounts so determined will not be less than the amounts assessed in accordance with the above.
- c. The above gross margining method should be applied to all contracts except as specified at 1.2 below.

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<sup>1</sup> The words and expressions "Business Day", "FX Business Day", "haircut", "intra-day margin call", "Market close", "margin", "Omnibus Account", "variation adjustment" and "Interest Rate Cash Adjustment" shall have the same meaning assigned to them under the Rules of the Exchange, ODRCF Regulations, and the Clearing Procedures for ODRCF as the case may be.

## 1.2 Risk based margining system

The amount of minimum margin required for options contracts should be determined as follows:-

### a. Client cash accounts

For clients permitted only to carry long option positions, the full cash value of the purchase price of the option (i.e., the option premium) should be collected on the day of trade.

### b. Client margin accounts

- i. Client margin accounts may only be established by approved Members. At the Member's discretion, a client may carry both long and short options positions in a margin account. Client margins shall be charged by Members on all open positions held in a client margin account, calculated using a margining system or methodology approved by the Exchange.
- ii. Where a client has both futures and options positions in a client margin account, the offsetting risk of futures and options may be considered in computing the combined margin requirement for the entire portfolio in accordance with a margining system or methodology approved by the Exchange. Only those futures and options contracts allowed by the Exchange may be offset for the purposes of calculating the combined margin requirement.
- iii. The Exchange has approved the use of the "Standard Portfolio Analysis of Risk" ("SPAN") margining system for client margin accounts.
- iv. It is accepted that alternative methodology may be applied to "call (put) spread positions". Such methodology is to segregate the call (put) spread positions and to calculate the margin based on the maximum possible losses arising from individual spread positions. The total margins required from clients are therefore the sum of the maximum possible losses of the call (put) spread positions and the margin calculated by SPAN for positions other than call (put) spread positions. In arriving at the margin for call (put) spread positions, every client margin account must be considered independently and separately. A spread position is defined as a portfolio that consists of a long call (put) option together with a short call (put) option held by the same client; in respect of which the expiry days are the same, but the strike prices of the two call (put) options are different. Spread positions maintained in an Omnibus Account must be affirmatively claimed by the client. Spread positions maintained in a general client margin account may be automatically applied by the Member or affirmatively claimed by the client.

- v. A Member may assess the amount of margin required on other bases, provided that the amounts so determined will not be less than the amounts assessed using SPAN and that the basis is approved by the Exchange.

## 2. Initial margin requirements

- 2.1 Initial margin is required on each and every new position established, i.e. any addition to the number of open positions held.
- 2.2 The amount of initial margin required on newly added open positions held would be equal to:-  
A - B only if A is greater than B.  
where:  
A = total initial margin required on all open positions held after establishing the new positions; and  
B = total initial margin required on all open positions held before establishing the new positions.
- 2.3 A client must have adequate margin deposits or sufficient excess net equity in his account to meet the initial margin requirements on a new position prior to establishing the new position.
- 2.4 Subject to 2.6 hereunder, in respect of a client with an established account who has demonstrated a record of consistently meeting margin obligations and maintaining a sound financial position, when the client represents that the funds necessary to fully satisfy his margin obligations will be immediately transmitted, the Member may use his discretion as to whether or not to accept, for a reasonable period of time, this assurance in lieu of cash. In this regard, a call for initial margin must be issued each time a new position is established and the Member must see to it that the initial margin is received, except in respect of day trades<sup>2</sup>, as soon thereafter as practicable on the same Business Day (see footnote 1) but in no event later than the next Business Day in respect of the market to which the initial margin relates. In the case of One-Day Rolling Currency Futures ("ODRCF") accounts, in these guidelines Business Day refers to FX Business Day (see footnote 1), unless otherwise stated.
- 2.5 Members must ensure that, at all times, they have appropriate arrangements in place with clients for settlement of initial margin calls (e.g. when Hong Kong banks are not open for business).
- 2.6 No client shall be permitted to establish new positions if he has outstanding initial margin calls as of the previous Business Day.
- 2.7 In determining whether an account has sufficient excess net equity to meet the initial margin requirements on a new open position established during the day, equity shall be calculated as of the close of business of the previous Business Day on the relevant Market<sup>3</sup>.

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<sup>2</sup> A day trade is the establishment and closure of a futures or options position on the same Business Day.

<sup>3</sup> This is a minimum requirement. Members may, at their discretion, calculate a client's available equity at more frequent intervals.

- 2.8 In the case of an ODRCF account, in determining whether an account has sufficient excess equity for new positions established between 8:00 am and 2:00 pm, equity shall be calculated as of the Market close (see footnote 1) (i.e. 3:00 am or 4:00 am, as the case may be) on the previous FX Business Day. For positions established between 2:00 pm and the Market close (i.e. 3:00 am or 4:00 am, as the case may be), equity shall be calculated as of 2:00 pm on the same FX Business Day (see footnote 3). Where the HKFE Clearing Corporation Ltd (the "Clearing House") Chairman exercises his discretion to waive the 2:00 pm settlement with the Clearing House, Members should calculate the excess equity on an ODRCF account in accordance with paragraph 2.7 above.
- 2.9 For the avoidance of doubt, in calculating the equity of an account Members shall include, inter alia, allowance for any variation adjustment (see footnote 1) and/or Interest Rate Cash Adjustment (see footnote 1) made by the Clearing House.
- 2.10 If a client has a credit in excess of the initial margin requirements on all existing open positions in his account, this excess net equity may be used as part or all of the initial margin required on the newly established open positions. However, credits in excess of maintenance margin but less than initial margin requirement shall not be used to satisfy any part of the initial margin requirement.
- 2.11 When an initial margin call is required, the amount of the call should be equal to the difference between the excess net equity, if any, and the amount of initial margin required on the newly added open positions as computed per 2.2 above.
- 2.12 Where an initial margin call is settled by a client in a currency other than that in which the Clearing House margin is calculated, a haircut (see footnote 1), of a percentage equivalent to or greater than the haircut applied by the Clearing House, may be applied by the Member to the exchange rate used to compute such settlement amount.
- 2.13 A Member may demand from its client such higher level of haircut as the Member deems appropriate. The Exchange believes that Members should take a conservative approach on this matter. Members shall only accept from clients initial margins in currencies accepted by the Clearing House for the collection of Clearing House margins.

### **3. Maintenance margin requirements**

- 3.1 Maintenance margin is required on each and every open position held at the end of each Business Day, except as set out in 3.2.
- 3.2 In the case of ODRCF Contracts, maintenance margin requirements shall be calculated at both 2:00 pm and Market close (i.e. 3:00 am or 4:00 am, as the case may be) on each FX Business Day. Where the Clearing House Chairman exercises his discretion to waive the 2:00 pm settlement with the Clearing House, Members should calculate the maintenance margin requirements at the Market Close and also refer to paragraph 4.1 below.
- 3.3 In determining whether an account has sufficient net equity to meet the maintenance margin requirements, equity shall be calculated as of the close of business on the Business Day.

- 3.4 In the case of ODRCF accounts, in determining whether an account has sufficient net equity to meet the maintenance margin requirements at 2:00 pm, equity shall be calculated as of 2:00 pm on the same FX Business Day. In determining whether an ODRCF account has sufficient net equity to meet the maintenance margin requirements at Market close (i.e. 3:00 am or 4:00 am, as the case may be), equity shall be calculated as of the Market close (i.e. 3:00 am or 4:00 am, as the case may be) on the same FX Business Day. Where the Clearing House Chairman exercises his discretion to waive the 2:00 pm settlement with the Clearing House, Members should calculate the net equity on an ODRCF account in accordance with paragraph 3.3 above.
- 3.5 For the avoidance of doubt, in calculating the equity of an account, Members shall include allowance for any variation adjustment and/or Interest Rate Cash Adjustment made by the Clearing House.
- 3.6 The amount of outstanding initial margin call for the day (see 2.4 above) shall be considered in determining whether the equity in the account is above the maintenance margin level.
- 3.7 In the case of ODRCF accounts, the amount of outstanding initial margin calls made in relation to trading on the previous FX Business Day and between 8:00 am and 2:00 pm on the same FX Business Day shall be considered in determining whether the equity in the account at 2:00 pm is above the maintenance margin level required at 2:00 pm. The amount of outstanding initial margin calls made in relation to trading on the same FX Business Day (only) shall be considered in determining whether the equity in the account at Market close (i.e. 3:00 am or 4:00 am, as the case may be) is above the maintenance margin level required at Market close (i.e. 3:00 am or 4:00 am, as the case may be). Where the Clearing House Chairman exercises his discretion to waive the 2:00 pm settlement with the Clearing House, the amount of outstanding initial margin calls on an ODRCF account should be calculated in accordance with paragraph 3.6 above.
- 3.8 When the net equity in a client's account falls below the maintenance margin level, a margin call must be issued to the client to bring his net equity up to the initial margin requirements.
- 3.9 For the avoidance of doubt, in the case of ODRCF accounts, a separate maintenance margin call must be made for each of the 2:00 pm settlement and the Market close (i.e. 3:00 am or 4:00 am, as the case may be) settlement. Where the Clearing House Chairman exercises his discretion to waive the 2:00 pm settlement with the Clearing House, Members should refer to paragraph 4.1 below.
- 3.10 Members must ensure that, at all times, they have appropriate arrangements in place with clients for settlement of maintenance margin calls (e.g. when Hong Kong banks are not open for business).
- 3.11 When a maintenance margin call is required, the amount of the call should be equal to the difference between the equity (after allowing for outstanding initial margin calls in accordance with 3.6 and 3.7) and the amount of initial margin required on all open positions.

3.12 Where a maintenance margin call is settled by a client in a currency other than that in which the Clearing House variation adjustment is calculated, a haircut of an amount equivalent to or greater than the haircut applied by the Clearing House may be applied by the Member to the exchange rate used to compute such settlement amount.

3.13 A Member may demand from its client such higher level of haircut as the Member deems appropriate. The Exchange believes that Members should take a conservative approach on this matter. Members shall only accept from clients maintenance margins in currencies accepted by the Clearing House for the collection of Clearing House variation adjustment.

#### **4. Intra-day margin calls**

4.1 Subject to 4.2 below, where an intra-day margin call (see footnote 1) is made by the Clearing House (e.g. in the case of ODRCF Contracts at 3:15 pm), Members are advised to consider the collection of intra-day margin from clients. In these circumstances, Members should have regard, inter alia, to the open positions of each client and the effect on the Member's own cash flow. When in doubt, Members are advised to adopt a conservative approach.

4.2 In cases where clients as referred to in 2.4 have historically transacted day trades exclusively, Members are advised to collect intra-day margins amounting to not less than the initial margins from the clients.

#### **5. Settlement of a margin call**

5.1 Once a call for margin is issued, margin deposits must be lodged with the Member on demand.

5.2 Calls for margin can be met by:-

- i. Cash deposits (For this purpose a cheque received by a Member in good faith which the Member has no reason to suspect that it will not be honoured on first presentation may be treated as cash); or
- ii. In respect of maintenance margin calls, a subsequent increase in the equity balance of the account, over and above the corresponding initial margin requirement (i.e. excess net equity).

5.3 An initial margin call as referred to in 2.4 may be cancelled if the positions, to which the initial margin relates, are closed out on the same Business Day (i.e. day trades).

#### **6. Withdrawal by clients**

6.1 No withdrawal shall be allowed if:-

- i. The equity balance of the account is less than the minimum initial margin requirements; or
- ii. There are any outstanding initial margin calls.



- 6.2 Whenever a withdrawal is allowed, the equity on account after the withdrawal shall not be less than the minimum initial margin required on all open positions.

**7. Failure to meet two successive margin calls**

- 7.1 Failures by clients to meet two successive margin calls, or demands for variation adjustment, or Interest Rate Cash Adjustment are required to be reported to the Exchange in accordance with Rule 619(b).

- 7.2 For the avoidance of doubt, in the case of ODRCF accounts, where a Member issues a margin call at 2:00 pm and another margin call at Market close (i.e. 3:00 am or 4:00 am, as the case may be), within the same FX Business Day, both of which were not met by the client on the following FX Business Day, then that client is deemed to have failed to meet two successive margin calls within the meaning of Rule 619(b). Accordingly, the Member must report this situation to the Exchange.

- 7.3 In order to ascertain whether a client has failed to meet two successive margin calls, Members must keep appropriate detailed records to ensure that the case history of each individual margin call can be readily established.

**8. Position limits**

- 8.1 Members should closely monitor the trading positions, whether on their own account or on behalf of clients, in order to comply with the position limits imposed from time to time by the Exchange and/or the Clearing House, or under relevant Ordinances. In this connection, Members should have regard, inter alia, to intra-day positions established as a result of day trades.

- 8.2 To facilitate monitoring of overall position limits imposed on Members, Members are advised to consider imposing individual position limit on any of their clients whom Members deem appropriate.

## Appendix

### Example A - Gross margining system

<u>Contract Month</u>	<u>B</u>	<u>S</u>	<u>Total Open Positions</u>	<u>IM</u>	<u>MM</u>
June	4	0	4		
July	0	6	6		
Sept	7	1	8		
			<u>18 x (FR)</u>	<u>HK\$900,000</u>	<u>HK\$720,000</u>

### Example B - Gross margining system with spread claim

\* Positions same as Example A

<u>Contract Month</u>	<u>Spread</u>		<u>Outright Open</u>			<u>IM</u>	<u>MM</u>
	<u>B</u>	<u>S</u>	<u>B</u>	<u>S</u>	<u>Total</u>		
June	1	-	3	0	3		
July	-	6	0	0	0		
Sept	6	1	1	0	1		
	<u>7 x (SR)</u>				<u>4 x (FR)</u>	<u>HK\$550,000</u>	<u>HK\$440,000</u>
	=				=		

### Assumptions

	<u>Initial Margin (IM)</u>	<u>Maintenance Margin (MM)</u>
(FR) Full Rate = (SR) Spread Rate	HK\$50,000	HK\$40,000

NB: Please note that the figures used above (including the margin rates) are for illustrative purposes only.