

from the risk-based capital computation, because such positions currently are included in the calculation of adjusted net capital to the extent that uncovered proprietary positions result in a charge or “haircut” to net capital based on clearinghouse or exchange margin requirements.<sup>12</sup> The proposed computation will hereinafter be referred to as “Risk-Based Capital.”<sup>13</sup>

For purposes of the proposed rule, “customer accounts” would include the account of any customer as defined by Rule 1.17(b)(2), which includes customers as defined by Rule 1.3(k), option customers as defined by Rules 1.3(jj) and 32.1(c), and foreign futures and foreign option customers as defined by Rule 30.1(c), and also would include the accounts of foreign customers trading on foreign commodity exchanges. The term “noncustomer account” would continue to be defined by Rule 1.17(b)(4) as an account that is not included in the definition of either customer or proprietary account in Rule 1.17, and would also include noncustomer accounts for foreign domiciled persons trading on foreign exchanges. The term “noncustomer” generally refers to accounts of entities affiliated with an FCM, including certain employees and officers of an FCM.

Generally, there is no risk to the FCM associated with a long option position because the maximum potential loss is the full option premium, which is required to be paid by the customer at

the inception of the transaction. As previously noted, however, SPAN computes the margin for an account on a portfolio basis and long option positions may hedge other futures and option positions in a portfolio, thereby reducing the total margin requirement on the portfolio. Accordingly, SPAN includes a risk maintenance margin component for long option positions to protect against a decrease in the market value of long options that may be hedging other futures and option positions.

The proposal would permit an FCM to deduct the risk maintenance margin on long options that were not hedging other futures or option positions from the Risk-Based Capital computation. The Commission, however, understands that, under current back office operating procedures, calculating the maintenance margin on specific long option positions included in a portfolio may require a certain amount of manual processing, which some FCMs may wish to forgo if the amount would not materially increase their minimum capital requirement. Accordingly, the rule as proposed would not prohibit an FCM from including the risk maintenance margin for long options that do not hedge other futures and option positions in its Risk-Based Capital computation, if it elected to do so.

The proposal would set the Risk-Based Capital requirement at eight percent of customer risk maintenance margin and four percent of noncustomer

risk maintenance margin, which are the same percentages that have been implemented under the existing exchange and NFA risk-based capital rules. The lower four percent factor applied to risk margin requirements in noncustomers’ accounts is based upon the beliefs of BOTCC, CBT, CME and the NFA that affiliates and employees pose less credit risk to FCMs and the clearing system.

If an FCM cannot determine the risk margin associated with cleared positions, the proposal would require the firm to apply the specified percentages to the total margin required by the exchange, clearing organization, other futures commission merchant or entity for the customer and noncustomer positions carried. This would be consistent with the approach taken by FCMs today for futures and option positions that they carry that are executed on foreign contract markets that do not use the SPAN margining system.

2. Accounts Included in the Risk-Based Net Capital Computation

Calculations of minimum required capital under the current method based on the Segregated Amount and the proposed Risk-Based Capital method would differ with respect to the types of accounts included in the calculation. These differences are summarized in the following table.

Are the following types of accounts factored into the calculation of required net capital?	Current segregated amount capital requirement	Proposed risk-based capital requirement
U.S.-domiciled customers trading on U.S. exchanges .....	Yes .....	Yes.
Foreign-domiciled customers trading on U.S. exchanges .....	Yes .....	Yes.
U.S.-domiciled customers trading on foreign exchanges .....	Yes .....	Yes.
Foreign-domiciled customers trading on foreign exchanges .....	No .....	Yes.
Accounts liquidating to a deficit .....	No .....	Yes.
Accounts with letters of credit for performance bond .....	No .....	Yes.
Noncustomer accounts .....	No .....	Yes.

The proposed Risk-Based Capital computation includes several types of accounts that affect the risk to an FCM inherent in commodity positions carried by its customers and noncustomers, and that are not included in the current Segregated Amount computation. Therefore, the Commission believes Risk-Based Capital may reflect the actual risk to FCMs better than the current Segregated Amount calculation of minimum required capital.

Particularly, the proposed Risk-Based Capital computation would include futures and option positions carried by an FCM for noncustomers trading on U.S. and foreign commodity markets and foreign-domiciled customers trading on foreign futures and options markets, none of which currently are included in the minimum capital computation.

The proposed Risk-Based Capital computation also would include the risk

maintenance margin on open futures and option positions that are carried in customer and noncustomer accounts that liquidate to a deficit. In such situations, an FCM is required to deposit its own funds into the segregated account in order to cover the customer’s deficit. However, the capital requirement that is based upon the Segregated Amount does not reflect the positions of the customer that is in deficit.<sup>14</sup>

<sup>12</sup> See Commission Rule 1.17(c)(5)(x).

<sup>13</sup> The Commission also would amend the financial Form 1–FR–FCM if it were to adopt final rules for Risk-Based Capital.

<sup>14</sup> In computing its adjusted net capital, an FCM is required by Rule 1.17(c)(2)(i) to exclude from