What is a margin call?

When you enter into a Forward Contract or an Option Contract with Convera the direction of the spot rate determines whether your contract is:

A. In the money to you (ITM)	**B**. Out of the money to you (OTM)	**C**. At the money (ATM)

This means if the transaction is cancelled at any time it would result in:

A. A gain to you (ITM)	**B**. A loss to you (OTM)	**C**. Breaking even (i.e. neither party would make a loss or a gain) (ATM).

Deposit

You will be asked to pay an upfront deposit (usually a percentage of the notional amount you want to deal) in order to secure Convera against any future financial loss we may incur as a result of entering into a transaction with you.

Credit Line

Alternatively, subject to our internal assessment, we may be able to extend you a credit line. In doing this, we are allowing you to book Forward Contracts or Options Contracts up to a certain amount – your derivatives trading line – without needing to pay any upfront deposit. The size of this line is usually determined by the maximum loss we are prepared to risk by facilitating your trades without having any security for them. This is known as the Out of the Money Limit (OTM).

Mark to Market

Once you have open positions with us, we constantly monitor their market value to determine the difference between the original cost of buying the contract on your behalf, and the present value if we have to sell it back. Known as the 'mark to market value', your net position may be positive ('In the Money') or negative ('Out of the Money').

Margin Call

When your net position with us is Out of the Money we count that against any deposit we hold, or credit line that you have in place with us. If this is insufficient to cover the negative position value, we will seek to remove that risk by requesting a deposit - a specified sum - as security also known as calling for margin, or a Margin Call.

Out of the Money Limits

An OTM limit can be expressed as a percentage of the forward or option trading line. For example, we may extend you an option line with a maximum notional amount of £5,000,000 and a 10% OTM limit (£500,000). If you were to use the full notional amount in one trade, this percentage figure gives you an approximate* idea of how far the market can move before a margin call becomes likely. The lower the percentage limit, the greater the chances of a margin call.

How does this work in practice?

As an example, you may have £100,000 of exposure that you need to convert to US dollars in 9 months' time. You want to hedge this risk using a Knock In Option structure protecting at $1.3000 with a barrier at $1.4000. Instead of a 10% deposit of £10,000, we offer you a £5,000 OTM limit (5%) meaning you pay nothing upfront.

During the life of that contract, we would continue to monitor the market value to ensure that the deposit amount paid remained sufficient to cover the risk.

	Mth 1	Mth 2	Mth 3	Mth 4	Mth 5
Protection rate	1.3000	1.3000	1.3000	1.3000	1.3000
GBP noticed	£100k	£100k	£100k	£100k	£100k
Spot rate	1.2800	1.3200	1.3600	1.3950	
Mark to market value	£1,563	-£ 1,515	-£ 4,412	-£6,810	
Deposit paid	£5,000	£5,000	£5,000	£5,000	
Net position	£2,810	£2,810	£2,810	£2,810	

In this example, the market has moved up to $1.3950 by month 4 and the cost of selling the option now exceeds the OTM Limit. At this point, we would request an additional deposit (Margin Call).

How much will I have to pay and when?

The calculation is straightforward. We will request sufficient funds to cover any amount over the OTM limit plus 20% of the limit. This will be due within 48 hours of notification. In the above example we would request that you deposit £1810 to cover the breach, plus a further £1,000 to bring you back to 80% of your limit.

	Mth 4	Mth 5	Mth 6	Mth 7	Mth 8
Protection rate	1.3000	1.3000	1.3000	1.3000	1.3000
GBP noticed	£100k	£100k	£100k	£100k	£100k
Spot rate	1.3950	1.4100	1.4000	1.3700	
Mark to market value	-£6,810	-£7,801	-£7,143	-£5,109	
Deposit paid	£5,000	£5,000	£5,000	£5,000	
Net position	£2,810	£2,810	£2,810	£2,810	

The reason we ask for more than the amount you are beyond your limit is to avoid repeated margin calls during volatile markets. As shown in the table, by month 5, GBPUSD has risen further to $1.4100, but another margin call is not necessary as the OTM limit plus margin amount is sufficient to cover the risk.

Is this a cost?

No. Continuing with the example above, after month 5, GBPUSD starts to fall back, and we see in month 7 that the net position is now greater than the margin amount. At this point we will either return the margin deposit to you or, on your instruction, we can hold it until expiry at which time it will be deducted from the settlement balance due. In either case, the funds are not lost.

Does the product I use affect my chances of being margin called?

Yes. A Vanilla Option (where you pay a premium) can never have a negative value. Also, a Participator will move out of the money slower than an equivalent Forward Contract, which means the market would have to move further before you were margin called. On the other hand, leveraged options – where the obligated amount is double the equivalent forward – will move out of the money more quickly. Please ask us for more information on this if needed.

What do I need to consider?

- You should always carefully consider how margin calls might impact your cash flows before trading. If your OTM limit is very low – say 1% or 2% – or the market moves significantly, you may well be margin called. This could potentially happen more than once if the market continues in one direction.
- The longer the required duration of your hedges, the greater the risk of your situation changing or the market moving significantly and therefore the chances of a margin call coming at an inconvenient time for your business.
- Option prices are determined by more than just the underlying spot rate. Changes to volatility, for example, will impact the MTM position of your hedge trades and, although unlikely, could trigger a margin call even if the spot rate has not changed.

What if I can't or won't pay?

If a margin call request is not met within the requisite 48-hour period, we will freeze your credit limit with us, prohibiting any new transactions or changes to the maturity/expiry dates of existing deals until payment is received. We may also commence all actions necessary (including any legal procedures) to recover the amounts required from you.

* Option pricing is not linear and the mark to market profile varies from product to product, so applying your OTM limit percentage to the underlying spot rate is not a precise measure. We can provide more specific indications of where you may be margin called on request, either before or after entering into a transaction.

Please refer to the **Product Disclosure Statement** for information on our full range of option structures.

This can be found at **convera.com/en-gb/compliance-legal/compliance/**