

Learning Module 4: Fixed-Income Markets for Corporate Issuers

Fixed Income

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Initial Margin

$$\text{Initial Margin} = \frac{\text{Security Price}_0}{\text{Purchase Price}_0} \quad (1)$$

- Feature designed to reduce the risk of a collateral shortfall over the contract life
- The feature initial margin is known as the provision of collateral in excess of the cash exchanged

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Initial Margin

```
$$  
\text{Initial Margin} =  
\frac{\text{Security Price}_0}{\text{Purchase Price}_0} \tag{1}  
$$
```

- Feature designed to reduce the risk of a collateral shortfall over the contract life
- The feature initial margin is known as the provision of collateral in excess of the cash exchanged

Haircut

$$\text{Haircut} = \frac{\text{Security Price}_0 - \text{Purchase Price}_0}{\text{Security Price}_0} \tag{2}$$

- A 100% initial margin indicates a fully collateralized loan, while a higher margin indicates even greater initial collateral protection. This is alternatively considered a reduction or haircut of the underlying loan relative to the initial collateral value as shown in formula 2

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Haircut

```
$$  
\text{Haircut} =  
\frac{\text{Security Price}_0 - \text{Purchase Price}_0}{\text{Security Price}_0} \tag{2}  
$$
```

- A 100% initial margin indicates a fully collateralized loan, while a higher margin indicates even greater initial collateral protection. This is alternatively considered a reduction or haircut of the underlying loan relative to the initial collateral value as shown in formula 2

Variation Margin

$$\text{Variation Margin} = (\text{Initial Margin} \times \text{Purchases price}_t) - \text{Security Price}_t \quad (3)$$

- Repos address collateral value changes by granting contract participants the right to request additional collateral (or release existing collateral) to maintain a security interest equal to the original initial margin terms. This variable margin payment (referred to as variation margin)

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Variation Margin

\$\$

```
\text{Variation Margin} = (\text{Initial Margin} \times  
\text{Purchases price}_t) - \text{Security Price}_t \tag{3}
```

\$\$

- Repos address collateral value changes by granting contract participants the right to request additional collateral (or release existing collateral) to maintain a security interest equal to the original initial margin terms. This variable margin payment (referred to as variation margin)