# UNDERMARGINED AND IN DEBIT TRADING

**Chapter 6**

**General Information**

**Capital charges for undermargined and in debit accounts are not a substitute for margin funds. Margin functions as financial protection for the marketplace. The collection of margin funds within a reasonable time is essential to proper margin compliance and good internal control.**

**A reasonable time refers to the number of days deemed acceptable for the collection of required margin calls. Currently, a reasonable time is defined to be less than five business days for customers and less than four business days for noncustomers and omnibus accounts. Note: Days are counted from and include the day the account became undermargined.**

**Thus, if an account is subject to an outstanding margin/equity call which is aged to be five business days old or more for customers or four business days old or more for noncustomers and omnibus accounts, then the account is deemed to be undermargined/in debit an unreasonable time. The age of the margin call is determined as of the close of business.**

**For undermargined and in debit trading policy purposes, all non-member accounts should be treated identically (retail customer, institutional, commercial, hedge, noncustomer, etc.).**

**For information on undermargined and in debit trading policies for individual member accounts, contact the appropriate exchange.**

**FCMs are responsible for reviewing the trading activity of accounts undermargined and in debit to monitor the receipt of margin and the acceptability of orders.**

**Specific Topics**

**<u>Types of Trading</u>**

**The addition of a position is the establishment of a futures or options position which may or may not impact an account's risk margin requirement.**

**The liquidation of a position is the closure of an established futures or options**

**position which may or may not impact an account's risk margin requirement.**

**A day trade is the establishment and closure of a futures or options position on the same trading day.**

**A risk neutral trade is the establishment of futures or options positions which does not impact an account's risk margin requirement (e.g. establishing both legs of a spread position which may require no margin.)**

**A risk increasing trade is the establishment or closure of a futures or options position which increases an account's risk margin requirement (e.g. closing one leg of a spread position).**

**A risk reducing trade is the establishment or closure of a futures or options position which reduces the risk of existing positions in the account (e.g. adding a spread position to a naked position).**

**Non-Member Policies:**

**Allowable Trading Activity - Undermargined Accounts**

**An account may trade as long as it is properly margined or margin is forthcoming within a reasonable time.**

**Accounts undermargined an unreasonable time are not allowed to day trade.**

**If an account is undermargined an unreasonable time, an FCM may only accept orders that serve to reduce the risk of existing positions in the account; that is, an FCM may only accept orders for risk reducing trades. Refer to the matrix below.**

**If an account that is undermargined an unreasonable time liquidates all of its positions resulting in a debit balance, the firm may not accept orders for the account until sufficient funds equal to or in excess of the debit amount are deposited.**

# UNDERMARGINED AND IN DEBIT TRADING

**Allowable Trading Activity**
**Undermargined an Unreasonable Time**

| ACCOUNT TYPE | UNREASONABLE TIME DEFINED | RISK INCREASING | RISK NEUTRAL | DAY TRADING | RISK REDUCING |
|---|---|---|---|---|---|
| Customer | ≥ 5 business days | No | No | No | Yes |
| Noncustomer/ Omnibus | ≥ 4 business days | No | No | No | Yes |

## Allowable Trading Activity - In Debit Accounts

**An account in debit is an account with a free debit balance, i.e. holding no open futures or options positions.**

**Accounts in debit an unreasonable time are not allowed to day trade.**

**A firm may not accept any orders for accounts in debit an unreasonable time.**

**Notwithstanding the foregoing, if an account in debit holds acceptable noncash margin deposits (such as securities, warehouse receipts, letters of credit, etc.), the account may trade provided there is positive margin equity; that is, ledger balance plus the applied margin value of acceptable margin deposits is greater than or equal to zero.**

## Miscellaneous

**For non-member accounts, a firm cannot reclassify a trading debit/deficit to a note receivable in order to allow an account to trade while undermargined or in debit an unreasonable time.**

# UNDERMARGINED AND IN DEBIT TRADING

**Examples**

**Assumptions:**

1. **The accounts are customer retail accounts.**
2. **All accounts are undermargined or in debit, as appropriate, for an unreasonable time.**
3. **All margin/equity calls are properly issued and aged for the full amount.**
4. **Initial and maintenance SPAN margin system requirements are the same. The British Pound futures margin rate is $1,800 per contract. The spread rate for British Pound futures is zero.**

**Example #1 - Undermargined Account**

**Open Positions:**

| Long | Short | Month/Year | Commodity |
|---|---|---|---|
| 10 | | March, 1995 | British Pound Futures |
| | 5 | June, 1995 | British Pound Futures |

| | | | | |
|---|---|---|---|---|
| LB | $ 1,000 | MMR | $ 9,000 | {$1,800/contract} |
| OTE | $ 3,000 | AMT U/M | $ 5,000 | {$9,000 MMR - $4,000 NLE} |
| NLE | $ 4,000 | | | |

**Risk Increasing Trade/Liquidation of Positions:**

**Customer buys five June, 1995 British Pound futures contracts. Assuming the positions P&S'd at the previous day's settlement (i.e. no effect on the account's NLE), the maintenance margin requirement would increase to $18,000 {$1,800 MMR/contract * 10 Positions} and the undermargined amount would increase to $14,000 {$18,000 MMR - $4,000 NLE}. Even though positions were liquidated, the risk margin requirement increased as one leg of a spread position was closed. Therefore, this would not be an acceptable trade.**

# UNDERMARGINED AND IN DEBIT TRADING

**Risk Reducing Trade/Liquidation of Positions:**

**Customer sells two March, 1995 British Pound futures contracts. Assuming the positions P&S'd at the previous day's settlement (i.e. no effect on the account's NLE), the maintenance margin requirement would decrease to $5,400 {$1,800 MMR/contract * 3 Positions} and the undermargined amount would decrease to $1,400 {$5,400 MMR - $4,000 NLE}. The risk margin on existing positions decreased as two naked positions were closed. Therefore, this would be an acceptable trade.**

**Risk Increasing Trade/Addition of Positions:**

**Customer sells 25 June, 1995 British Pound futures contracts. Assuming no change in OTE, the maintenance margin requirement would increase to $36,000 {$1,800 MMR/contract * 20 Positions} and the undermargined amount would increase to $32,000 {$36,000 MMR - $4,000 NLE}. Therefore, as the risk margin requirement increased, this would not be an acceptable trade.**

**Example #1 - Undermargined Account (continued)**

**Open Positions:**

| Long | Short | Month/Year | Commodity |
|---|---|---|---|
| 10 | | March, 1995 | British Pound Futures |
| | 5 | June, 1995 | British Pound Futures |

| | | | | |
|---|---|---|---|---|
| LB | $ 1,000 | MMR | $ 9,000 | {$1,800/contract} |
| OTE | $ 3,000 | AMT U/M | $ 5,000 | {$9,000 MMR - $4,000 NLE} |
| NLE | $ 4,000 | | | |

**Risk Reducing Trade/Addition of Positions:**

**Customer sells five June, 1995 British Pound futures contracts. Assuming no change in OTE, the account would become properly margined as all the positions would be spread and there would be no risk margin requirement. As the trade has reduced the risk of existing positions, this would be an acceptable trade.**

**Day Trading:**

**Customer establishes and closes ten March, 1995 British Pound futures contracts. Day trading is not allowed. The risk of existing positions has not been reduced. Therefore, this would not be an acceptable trade.**

# UNDERMARGINED AND IN DEBIT TRADING

**Deposit of Funds to Delete Call/Risk Increasing Trade/Addition of Positions:**

**Customer deposits $5,000 in the account, thereby eliminating the margin call. On the same day, the customer buys 5 March, 1995 British Pound futures contracts increasing their margin requirement to $18,000 {$1,800 MMR/contract * 10 Positions}. Assuming no change in OTE, the account would be undermargined by $9,000 {$18,000 MMR - $9,000 NLE}. As funds were received to delete the $5,000 outstanding margin call, the $9,000 margin call is a current call (Day 1). Therefore, this would be an acceptable trade.**

**Deposit of Funds to Reduce Call/Risk Increasing Trade/Addition of Positions:**

**Customer deposits $2,000 in the account, thereby reducing the outstanding margin call to $3,000. On the same day, the customer buys 5 March, 1995 British Pound futures contracts increasing their margin requirement to $18,000 {$1,800 MMR/contract * 10 Positions}. Assuming no change in OTE, the account would be undermargined by $12,000 {$18,000 MMR - $6,000 NLE}. As the $3,000 margin call has been outstanding five business days or more (i.e. an unreasonable time), this would not be an acceptable trade.**

**Example #2 - In Debit Account**

**Open Positions:**

| **None** | | | |
|---|---|---|---|
| **LB** | **$ <8,000>** | **MMR** | **$ -0-** |
| **OTE** | **$ -0-** | **DEBIT** | **$ 8,000** |
| **NLE** | **$ <8,000>** | | |
| **Note: Account has no other acceptable margin deposits.** | | | |

**Day Trading:**

**Customer establishes and closes ten March, 1995 British Pound futures contracts. Day trading is not allowed for accounts in debit an unreasonable time. Therefore, as funds were not received to cover the debit, this would not be an acceptable trade.**

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**Addition of Positions:**

**Customer buys ten March, 1995 British Pound futures contracts and sells ten June, 1995 British Pound futures contracts, creating a spread position. Although the risk margin requirement remains at zero, this trade would not be acceptable as funds were not deposited to cover the debit balance. NOTE: Accounts which have been in debit an unreasonable time are not allowed to trade until sufficient funds equal to or in excess of the debit amount are deposited.**

**Deposit of Funds to Delete Equity Call/Risk Increasing Trade/Addition of Positions:**

**Customer deposits $10,000 in the account. On the same day, the customer buys 5 March, 1995 British Pound futures contracts. Assuming the new positions create no OTE and the maintenance margin requirement increases to $9,000 {$1,800 MMR/contract * 5 Positions}, the account would be undermargined by $7,000 {$9,000 MMR - $2,000 NLE}. However, as the account met its equity call (i.e. sufficient funds were received to cover the debit), the trade is acceptable. The account has become undermargined (Day 1) and has a reasonable time to meet the margin call.**

**Deposit of Funds to Reduce Equity Call/Risk Increasing Trade/Addition of Positions:**

**Customer deposits $5,000 in the account. On the same day, the customer buys 5 March, 1995 British Pound futures contracts. Assuming the new positions create no OTE and the maintenance margin requirement increases to $9,000 {$1,800 MMR/contract * 5 Positions}, the account would be undermargined by $12,000 {$9,000 MMR - <$3,000> NLE}. As the account only partially met its equity call, the trade is not acceptable.**

**Assumptions:**

1. **All accounts are customer retail accounts.**
2. **All margin calls are properly issued and aged for the full amount.**
3. **Initial and maintenance SPAN margin system requirements are the same.**
4. **The account was properly margined on the previous business day (Friday).**

# UNDERMARGINED AND IN DEBIT TRADING

**Allowable Trading Activity Abbreviations:**

**All:** **All trading activity is allowed as the account is not undermargined an unreasonable time.**

**RR:** **Only risk reducing trades are allowed as the account is undermargined an unreasonable time.**

# UNDERMARGINED AND IN DEBIT TRADING

**Example #3 - Unreasonable Time: Deletion of Margin Calls**

**Week 1**

| | Monday | Tuesday | Wednesday | Thursday | Friday |
|---|---|---|---|---|---|
| LB | 35,000 | 35,000 | 35,000 | 35,000 | 35,000 |
| OTE/NOV | 30,000 | 20,000 | 20,000 | 20,000 | 20,000 |
| NLE | 65,000 | 55,000 | 55,000 | 55,000 | 55,000 |
| IMR/MMR | 60,000 | 60,000 | 60,000 | 60,000 | 60,000 |
| AMT U/M | -0- | 5,000 | 5,000 | 5,000 | 5,000 |
| CALL/AGE | -0- | 5,000(1) | 5,000(2) | 5,000(3) | 5,000(4) |
| TRADING | All | All | All | All | All |

**Week 2**

| | Monday | Tuesday | Wednesday | Thursday | Friday |
|---|---|---|---|---|---|
| LB | 35,000 | 35,000 | 35,000 | 35,000 | 36,000 |
| OTE/NOV | 20,000 | 20,000 | 19,000 | 22,000 | 24,000 |
| NLE | 55,000 | 55,000 | 54,000 | 57,000 | 60,000 |
| IMR/MMR | 60,000 | 60,000 | 60,000 | 60,000 | 60,000 |
| AMT U/M | 5,000 | 5,000 | 6,000 | 3,000 | -0- |
| CALL/AGE | 5,000(5) | 5,000(6) | 5,000(7)<br>1,000(1) | 5,000(8)<br>1,000(2) | -0- |
| TRADING | All | RR | RR | RR | *All |

- **Cash was deposited on Friday of Week 2 of $1,000. Favorable market movements occurred on Thursday of Week 2 of $3,000 and on Friday of Week 2 of $2,000. Unfavorable market movements occurred on Tuesday of Week 1 of $10,000 and on Wednesday of Week 2 of $1,000.**

- **As of the close of business on Monday of Week 2 the margin call was five business days old or more, and the account became undermargined an unreasonable time. Thus, only risk reducing trading activity was allowed as of Tuesday of Week 2.**

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* On Friday of Week 2 the account became properly margined. Once the account becomes properly margined, all trading activity would be allowed on the following Monday

**Example #4 - Unreasonable Time: Reduction of Margin Calls**

**Week 1**

| | Monday | Tuesday | Wednesday | Thursday | Friday |
|---|---|---|---|---|---|
| LB | 25,000 | 25,000 | 25,000 | 25,000 | 25,000 |
| OTE/NOV | 25,000 | 25,000 | 25,000 | 20,000 | 20,000 |
| NLE | 50,000 | 50,000 | 50,000 | 45,000 | 45,000 |
| | | | | | |
| IMR/MMR | 60,000 | 60,000 | 60,000 | 60,000 | 60,000 |
| AMT U/M | 10,000 | 10,000 | 10,000 | 15,000 | 15,000 |
| CALL/AGE | 10,000(1) | 10,000(2) | 10,000(3) | 10,000(4) | 10,000(5) |
| | | | | 5,000(1) | 5,000(2) |
| TRADING | All | All | All | All | All |

**Week 2**

| | Monday | Tuesday | Wednesday | Thursday | Friday |
|---|---|---|---|---|---|
| LB | 25,000 | 35,000 | 35,000 | 38,000 | 38,000 |
| OTE/NOV | 20,000 | 20,000 | 22,000 | 18,000 | 21,000 |
| NLE | 45,000 | 55,000 | 57,000 | 56,000 | 59,000 |
| | | | | | |
| IMR/MMR | 60,000 | 60,000 | 60,000 | 60,000 | 60,000 |
| AMT U/M | 15,000 | 5,000 | 3,000 | 4,000 | 1,000 |
| CALL/AGE | 10,000(6) | 5,000(4) | 5,000(5) | 2,000(6) | 2,000(7) |
| | 5,000(3) | | | 2,000(1) | 2,000(2) |
| TRADING | RR | All | All | RR | RR |

# UNDERMARGINED AND IN DEBIT TRADING

- **Cash was deposited on Tuesday of Week 2 of $10,000 and on Thursday of Week 2 of $3,000. Favorable market movements occurred on Wednesday of Week 2 of $2,000 and on Friday of Week 2 of $3,000. Unfavorable market movements occurred on Thursday of Week 1 of $5,000 and on Thursday of Week 2 of $4,000.**

- **As of the close of business on Friday of Week 1 the margin call was five business days old or more, and the account became undermargined an unreasonable time. Thus, only risk reducing trading activity was allowed as of Monday of Week 2.**

- **On Tuesday of Week 2 the account deposited funds which reduced the margin call. After the deposit of margin funds, the only remaining margin call on Tuesday of Week 2 was less than five business days old, thus all trading activity in the account would be allowed. The account had demonstrated a good faith effort to deposit required margin and has a reasonable time to meet the remaining margin call.**

- **As of the close of business on Wednesday of Week 2 the margin call was five business days old or more, and the account became undermargined an unreasonable time. Thus, only risk reducing trading activity was allowed as of Thursday of Week 2.**