# R.M. Stark & Co., Inc.

**Margin Account Disclosure Form**

"Margin" is borrowing money from your broker to buy a stock and using your investments as collateral. Investors generally use margin to increase their purchasing power so that they can own more stock without fully paying for it. But margin exposes investors to the potential for higher losses. Here's what you need to know about margin.

*Understand How Margin Works*

Let's say you buy a stock for $50 and the price of the stock rises to $75. If you bought the stock in a cash account and paid for it in full, you'll earn a 50 percent return on your investment. But if you bought the stock on margin – paying $25 in cash and borrowing $25 from your broker – you'll earn a 100 percent return on the money you invested. Of course, you'll still owe your firm $25 plus interest.

The downside to using margin is that if the stock price decreases, substantial losses can mount quickly. For example, let's say the stock you bought for $50 falls to $25. If you fully paid for the stock, you'll lose 50 percent of your money. But if you bought on margin, you'll lose 100 percent, and you still must come up with the interest you owe on the loan.

In volatile markets, investors who put up an initial margin payment for a stock may, from time to time, be required to provide additional cash if the price of the stock falls. Some investors have been shocked to find out that the brokerage firm has the right to sell their securities that were bought on margin – without any notification and potentially at a substantial loss to the investor. If your broker sells your stock after the price has plummeted, then you've lost out on the chance to recoup your losses if the market bounces back.

*Recognize the Risks*

Margin accounts can be very risky and they are not suitable for everyone. Before opening a margin account, you should fully understand that:

**You can lose more money than you have invested;**

**You may have to deposit additional cash or securities in your account on short notice to cover market losses;**

**You may be forced to sell some or all of your securities when falling stock prices reduce the value of your securities; and**

**Your brokerage firm may sell some or all of your securities without consulting you to pay off the loan it made to you.**

**You can protect yourself by knowing how a margin account works and what happens if the price of the stock purchased on margin declines. Know that your firm charges you interest for borrowing money and how that will affect the total return on your investments. Be sure to ask your broker whether it makes sense for you to trade on margin in light of your financial resources, investment objectives, and tolerance for risk.**

*Read Your Margin Agreement*

To open a margin account, you must sign a margin agreement. The agreement may be part of your account opening agreement or may be a separate agreement. The margin agreement states that you must abide by the rules of the Federal Reserve Board, the New York Stock Exchange, the National Association of Securities Dealers, Inc., and the firm where you have set up your margin account. Be sure to carefully review the agreement before you sign it.

As with most loans, the margin agreement explains the terms and conditions of the margin account. The agreement describes how the interest on the loan is calculated, how you are responsible for repaying the loan, and how the securities you purchase serve as collateral for the loan. Carefully review the agreement to determine what notice, if any, your firm must give you before selling your securities to collect the money you have borrowed.

*Know the Margin Rules*

The Federal Reserve Board and many self-regulatory organizations (SROs), such as the NYSE and NASD, have rules that govern margin trading. Brokerage firms can establish their own requirements as long as they are at least as restrictive as the Federal Reserve Board and SRO rules. Here are some of the key rules you should know:

<u>Before You Trade – Minimum Margin</u>

Before trading on margin, the NYSE and NASD, for example, require you to deposit with your brokerage firm a minimum of $2,000 or 100 percent of the purchase price, whichever is less. This is known as the "minimum margin." Some firms may require you to deposit more than $2,000.

<u>Amount You Can Borrow – Initial Margin</u>

According to Regulation T of the Federal Reserve Board, you may borrow up to 50 percent of the purchase price of securities that can be purchased on margin. This is known as the "initial margin." Some firms require you to deposit more than 50 percent of the purchase price. Also be aware that not all securities can be purchased on margin.

Amount You Need After You Trade – Maintenance Margin

After you buy stock on margin, the NYSE and NASD require you to keep a minimum amount of equity in your margin account. The equity in your account is the value of your securities less how much you owe to your brokerage firm. The rules require you to have at least 25 percent of the total market value of the securities in your margin account at all times. The 25 percent is called the "maintenance requirement." In fact, many brokerage firms have higher maintenance requirements, typically between 30 to 40 percent, and sometimes higher depending on the type of stock purchased.

> Here's an example of how maintenance requirements work. Let's say you purchase $16,000 worth of securities by borrowing $8,000 from your firm and paying $8,000 in cash or securities. If the market value of the securities drops to $12,000, the equity in your account will fall to $4,000 ($12,000 - $8,000 = $4,000). If your firm has a 25 percent maintenance requirement, you must have $3,000 in equity in your account (25 percent of $12,000 = $3,000). In this case, you do have enough equity because the $4,000 in equity in your account is greater than the $3,000 maintenance requirement.
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> But if your firm has a maintenance requirement of 40 percent, you would not have enough equity. The firm would require you to have $4,800 in equity (40 percent of $12,000 = $4,800). Your $4,000 in equity is less than the firm's $4,800 maintenance requirement. As a result, the firm may issue you a "margin call," since the equity in your account has fallen $800 below the firm's maintenance requirement.

*Understand Margin Calls – You Can Lose Your Money Fast and With No Notice*

If your account falls below the firm's maintenance requirement, your firm generally will issue a margin call to ask you to deposit more cash or securities into your account. If you are unable to meet the margin call, your firm will sell your securities to increase the equity in your account up to or above the firm's maintenance requirement.

Always remember that your broker may not be required to make a margin call or otherwise tell you that your account has fallen below the firm's maintenance requirement. Your broker may be able to sell your securities at any time without consulting you first. Under most margin agreements, even if your firm offers to give you time to increase the equity in your account, it can sell your securities without waiting for you to meet the margin call.

*Ask Yourself These Key Questions*

- ✓ Do you know that margin accounts involve a great deal more risk than cash accounts where you fully pay for the securities you purchase? Are you aware you may lose more than the amount of money you initially invested when buying on margin? Can you afford to lose more money than the amount you have invested?

- ✓ Did you take the time to read the margin agreement? Did you ask your broker questions about how a margin account works and whether it's appropriate for you to trade on margin? Did your broker explain the terms and conditions of the margin agreement?

- ✓ Are you aware of the costs you will be charged on money you borrow from your firm and how these costs affect your overall return?

- ✓ Are you aware that your brokerage firm can sell your securities without notice to you when you don't have sufficient equity in your margin?

Source: *U.S. Securities and Exchange Commission Office of Investor Education and Assistance*