SEC
Office of Investor Education and Advocacy

Trading in Cash Accounts:

Beware of the 90-Day Freeze under Regulation T

The SEC's Office of Investor Education and Advocacy is issuing this Investor Bulletin to help educate investors regarding the rules that apply to trading securities in cash accounts and to highlight the 90-day account freeze which may arise with certain trading activities in these type of accounts.

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What is a cash account?

A cash account is a type of brokerage account in which the investor must pay the full amount for securities purchased. An investor using a cash account is not allowed to borrow funds from his or her broker-dealer in order to pay for transactions in the account (trading on margin).

The credit extension provisions of the Federal Reserve Board's Regulation T govern an investor's use of a cash account to purchase securities. In particular, Regulation T authorizes a broker-dealer to use a cash account to purchase a security for an investor if:

REGULATION T

- There are "sufficient funds" in the account; or
- The broker-dealer accepts in good faith the investor's agreement that the investor will promptly make "full cash payment" for the security before selling it and does not contemplate selling the security prior to making such payment.

What type of trading is permitted in a cash account?

Some examples of trading that would be permitted in a cash account include:

A. An investor has $10,000 in cash and no securities in a cash account. The investor buys $10,000 worth of ABC stock on Monday and sells it the same day.

These transactions are permissible since the investor purchased the ABC stock on Monday with the $10,000 in cash that the investor had in the cash account. Since the investor purchased the ABC stock with cash, the investor may sell this stock at anytime.

B. An investor holds $10,000 of fully paid for and settled ABC stock in a cash account. The investor does not hold any additional cash or securities in the cash account. The investor sells all the ABC stock on Monday. On Friday, the investor buys $10,000 worth of XYZ stock.

These transactions are permissible because an investor can sell a fully-paid for and settled security held in a cash account. The $10,000 proceeds from the sale of the ABC stock would have settled on Thursday. Therefore the investor would have "sufficient funds" in the cash account on Friday to purchase the XYZ stock.

C. An investor holds $10,000 of fully paid for and settled ABC stock in a cash account. The investor does not hold any additional cash or securities in the cash account. The investor sells all the ABC stock on Monday and buys $10,000 worth of XYZ stock the same day. The investor sells the XYZ stock on Friday.

The sale of the ABC stock is permissible because an investor can sell a fully-paid for and settled security held in a cash account. The purchase of the XYZ stock is also permissible. The investor may purchase the XYZ stock with the proceeds from the sale of the ABC stock as long as the investor does not sell the XYZ stock prior to the settlement of the ABC stock sale, which is Thursday. By doing this, the investor will have made full cash payment for the XYZ stock before selling it on Friday.

What are freeriding and freezes?

As noted above, in a cash account, an investor must pay for the purchase of a security before selling it. If an investor buys and sells a security before paying for it, the investor is "freeriding."

The following example illustrates "freeriding:"

An investor holds $10,000 of fully paid for and settled ABC stock in a cash account. The investor does not hold any additional cash or securities in the cash account. The investor sells all the ABC stock on Monday and buys $10,000 worth of XYZ stock on the same day. On Tuesday, the investor sells all of the XYZ stock without adding any additional cash to the account.

The settlement date on the sale of the ABC stock that the investor used to pay for the purchase of the XYZ stock would be Thursday (three business days after the date of the sale). Since the investor used the proceeds from a sale of securities that has not settled yet, to purchase the XYZ stock, the investor cannot not sell the XYZ stock prior to Thursday without adding additional cash to the account to cover the purchase price of the XYZ stock. Since the investor sold the XYZ stock on Tuesday without adding any additional cash to the account, the investor's actions constitute freeriding.

"Freeriding" is not permitted under Regulation T, and requires the investor's broker to "freeze" the investor's account for 90 days. During this 90-day period, an investor may still purchase securities with the cash account, but the investor must fully pay for any purchase on the date of the trade. An investor may avoid having a "freeze" placed on his cash account by fully paying for the securities by the settlement date with funds that do not come from the sale of the securities.

Related Information:

For additional educational information for investors, see the SEC's Office of Investor Education and Advocacy's homepage. For additional information relating to cash accounts, also see:

Regulation T 220.8

Freeriding

Freeze

About Settling Trades in Three Days: T+3

FINRA Rule 4210(f)(9) and FINRA Regulatory Notice 10-45

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