



Educate Yourself - An Initiative by SSL Research Centre

Educate yourself is an educational debate dedicated to the dissemination of stock market related terminologies in the use of fundamental and technical analysis for traders and investors. Market participants can explore self-developed skills to face the growing threats of volatility through Educate yourself.

Educate yourself is a great way to boost your knowledge in general investing lingo and helps you to trade strategically.

**Title of the topic:
"What is Margin Trading Facility (MTF)?"
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A) Introduction

Two friends were having a conversation. One of them had identified a stock with strong potential but did not have sufficient funds to take a larger position. Curious about the alternatives available, he asked his friend for advice.

Rahul: I've just found a stock with huge upside, but I only have ₹12,500. What can I do?

Vinod: That's simple, you can use MTF.

Rahul: What's that?

Vinod: MTF stands for Margin Trading Facility. It's where your authorised broker lends you money to buy delivery-based stocks, in return for interest on the amount lent.

Rahul: Oh, okay. So if I invest ₹12,500, my broker could fund up to ₹37,500 more, and my total investment becomes ₹50,000? And what happens to my profit or loss?

Vinod: Correct, your position becomes ₹50,000. If the stock rises 5%, you make ₹2,500, which is a 20% gain on the ₹12,500 you actually had and you only need to pay back the interest on the borrowed amount.

Rahul: Wow, that's amazing! I should try it.

Vinod: Wait! Before you do, remember MTF is a double-edged sword. If that same stock falls 5%, you lose ₹2,500, which is 20% of your ₹12,500. And on top of any loss, you still have to pay interest on the money your broker lent you.

Rahul: I see. So I have to be willing to accept the higher risk before chasing the higher reward.

Vinod: Exactly.

The above conversation highlights how MTF can help investors increase their market exposure, while also exposing them to higher risks and costs. Let's learn more about it.

B) What is Margin Trading Facility?

Margin Trading Facility (MTF) is a service offered by SEBI-authorised stock brokers that allows investors to buy shares by paying only a part of the total investment amount. The remaining amount is funded by the broker, allowing investors to take a larger position in the market than they could with their own funds alone. MTF is available only on eligible securities. As per SEBI guidelines, equity shares and Equity ETFs classified as Group I Securities qualify for MTF.

For example, if an investor wants to buy shares worth ₹1,00,000 and the required margin is 25%, the investor needs to contribute only ₹25,000, while the broker funds the remaining ₹75,000. This gives the investor exposure to the entire ₹1,00,000 investment while paying interest only on the amount funded by the broker. In return, the broker charges interest on the funded amount. This interest continues to accumulate until the investor either sells the shares or repays the borrowed amount in full.

The shares purchased under MTF are pledged to the broker as collateral. If the share price falls sharply, the value of the collateral also declines, which may reduce the investor's margin below the required level. In such cases, the broker issues a margin call and asks the investor to deposit additional funds or securities. If the investor fails to do so, the broker may sell the pledged shares to recover the funded amount. Thus, MTF enables investors to increase their market exposure with limited capital, but it also involves higher risks and additional costs.

C) Types of Margins in MTF

- **Delivery Margin (Initial Margin):** This is the amount that an investor needs to contribute from their own funds to avail MTF. The remaining amount is funded by the broker.
- **Collateral Margin:** Investors can also pledge eligible shares held in their demat account as margin. These shares act as security for the amount funded by the broker.
- **Maintenance Margin:** Investors must maintain a minimum margin in their account throughout the holding period. If the margin falls below the required level, the broker may issue a margin call.
- **Mark-to-Market (MTM) Margin:** If the price of the funded shares falls significantly, the investor may be required to add more funds or securities to cover the shortfall.

D) Advantages of MTF

The following are the advantages of MTF:

- **Higher Purchasing Power:** One of the most important reasons investors use MTF is the increased exposure it offers. By borrowing from the broker, you can buy more shares than your own money alone would allow.
Example: Suppose you have ₹10,000 and you have your eye on a stock trading at ₹100. With your ₹10,000, you can buy a maximum of 100 shares. But by borrowing an additional ₹10,000 from your broker, you can buy 200 shares and you participate in the gains and bear the losses, on all 200 shares, not just the 100 you could have afforded on your own.
- **Easy to Avail:** Unlike traditional forms of borrowing, which are time-consuming and involve a lot of paperwork, MTF can be activated quickly, often with just a few clicks, provided you meet the broker's minimum eligibility criteria.
- **No Missed Opportunities Due to a Cash Crunch:** Good opportunities often appear suddenly, sometimes when money is already tied up in other investments. MTF keeps the chance from slipping by. Since the broker funds a large part of the purchase, and existing shares can be pledged as margin instead of being sold, the opportunity can still be seized.

- **Diversification:** MTF can help with diversification. With a small amount of capital, an investor can spread the money across several different stocks instead of putting it all into one, which helps balance risk across the portfolio.

E) Risks of MTF

The following are the risks associated with MTF:

- **Higher Exposure, Higher Risk:** Since the broker funds the majority of the amount, the investor's exposure is high, and losses apply to the entire position, not just the margin put in. In a sharp fall, an investor can even lose the whole amount invested.
Example: Suppose an investor puts in ₹5,000 and borrows ₹10,000 from the broker, taking the total position to ₹15,000. If the stock falls 10%, the loss is ₹1,500 which is 30% of the ₹5,000 actually invested, and interest on the borrowed ₹10,000 still has to be paid on top of that.
- **Interest Cost Reduces Returns:** The broker charges interest on the amount borrowed under MTF. This interest is charged daily and continues until the borrowed amount is repaid. As a result, a part of the profit is reduced by the interest cost. If the stock remains stagnant for a long period, the accumulated interest can significantly reduce the overall return.
- **Margin Call Risk:** The shares purchased under MTF are pledged as collateral with the broker. If the stock price falls, the value of the collateral also falls. When the investor's margin drops below the required level, the broker issues a margin call and asks the investor to deposit additional funds or securities. Failure to do so may result in further action by the broker.
- **Forced Sale of Shares:** If the investor does not meet the margin call within the stipulated time, the broker has the right to sell the pledged shares to recover the borrowed amount. Such sales often happen during falling markets, which may result in losses being booked at unfavourable prices.

F) Conclusion

Margin Trading Facility (MTF) is a useful tool that allows investors to increase their market exposure by investing more than their available capital. It can help investors take advantage of investment opportunities, improve purchasing power, and deploy capital more efficiently.

MTF can be beneficial for investors as it provides access to additional capital and enables them to take larger positions in opportunities they strongly believe in. When used prudently, it can enhance potential returns and help investors make better use of available funds.

However, the higher exposure provided by MTF also comes with higher risks. Interest costs, margin calls, and the possibility of forced sale of shares can significantly impact returns, especially during volatile market conditions. Therefore, investors should use MTF carefully and with proper risk management. Before availing of MTF, they should assess their financial position, investment objectives, and ability to withstand potential losses.

Sources: SSL Research Centre, National Stock Exchange

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