

Mitigating Regulation T violations resulting from Freeriding



Who is being impacted: All RIA users who conduct frequent model trading

Why the change is occurring: Under our new broker-dealer structure, we are examining all trading practices to ensure we are fully compliant with SEC regulations.

What will it look like after the change?: Axos Advisor Services ('AAS') will enforce the "Freeriding" rule during model rebalancing, disallowing certain sell transactions that would be in violation of the rule.

The Federal Reserve Board's Regulation T governs an investor's use of a cash account to purchase securities, authorizing a broker-dealer to use a cash account to purchase a security for an investor if there are "sufficient funds" in the account, or if 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. An investor using a cash account is not allowed to borrow funds from their broker-dealer to pay for transactions and therefore it's important to remember that you can only buy securities in a cash account provided you have sufficient funds in the account.

Freeriding is the practice of buying and selling securities without actually having sufficient cash to cover the trade. In a cash account, a freeriding violation occurs when shares of stock are sold that were purchased with unsettled funds. Regulation T gives an investor a maximum of four (4) days to pay for securities (i.e., settle date plus 2) purchased in a cash account. If the payment exceeds \$1,000 and is not received within this period, the broker-dealer must either liquidate the position or get an extension from FINRA.

For more detailed information: [SEC.gov | Updated Investor Bulletin: Trading in Cash Accounts](#)

Now that AAS is operating under a broker-dealer, this requirement applies to your accounts and, if Regulation T is violated, will result in AAS applying a "freeze" that restricts the accounts purchasing power for 90 days. Accounts with this restriction can still trade but cannot purchase stocks with unsettled sale proceeds (stocks take two days to settle). In practice, this means that you must wait for the sale of a stock to settle before you can use the proceeds to make a purchase.

How we will help you mitigate such violations:

1. Effective Friday, October 8, when balancing accounts using the Model Process trading feature in Liberty, AAS will present to you error messages indicating which accounts were unable to participate in sell trades due to unsettled shares. Manual trade entry will still be possible to sell positions.
2. Over the next few weeks, we will be modifying Block Trading, divesting, trade upload, and all trade building options other than manual trade entry to help you mitigate such trading violations. We will also be implementing the ability to restrict an account for 90 days in the event a freeriding violation should occur.

Similarly, if there's a cash deposit to an account, securities purchased based on that deposit, and the deposit is then reversed (such as due to insufficient funds), then the resulting transaction must be resolved same day, or

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next day if overdraft was incurred after market close – funds need to be wired to the AAS account immediately or trade corrections performed with trade losses at the responsibility of the firm. If not mitigated, then the account will be restricted for violating Regulation T.

As always, if you have any questions, please contact your Client Service Advocate.