Good Faith Violation

1) What is Good Faith Violation?

If a security purchased in your cash account is sold prior to being paid for with settled funds in the account, a good faith violation has occurred. The reason it is referred to as a good faith violation is that trade activity is giving the appearance that sales proceeds are being used to cover buy orders when there is insufficient settled cash to cover these purchases. Basically, trade activity indicates that a good faith effort to deposit additional cash into the account will not happen.

Good faith violation example 1:
Cash available to trade = $0.00

On Monday morning, a customer sells Y stock netting $5,000 in cash account proceeds.
On Monday afternoon, the customer buys X stock for $5,000.
If the X stock is sold prior to Wednesday (settlement date of the Y sale), a good faith violation would be charged as the X stock is not considered fully paid prior to sale.

Good faith violation example 2:
Settled cash = $5,000

On Monday morning, a purchase was made for $5,000 of X stock.
On Monday mid-day, the customer sells the X stock for $5,500.
Near market close, the customer purchases $5,500 of Y stock.
At this point no good faith violation has occurred because the customer had sufficient funds for the purchase of X.
If Y is sold prior to being paid for (settlement) then a good faith violation will have occurred.

Good faith violation example 3:
Cash available to trade = $10,000 minus cash credit from unsettled activity = $5,000 (proceeds from a sale of stock the prior Friday – trade settles on Tuesday)

On Monday morning, the customer purchases $15,000 of Y stock.
A good faith violation occurs if this customer sells the Y stock on Monday.
The purchase is not considered fully paid for because the $5,000 proceeds are not considered sufficient funds until they are settled on Tuesday.

2) What happens to GFV accounts and trades?

Accounts with three good faith violations in a 12-month period will be restricted to purchasing securities with only settled cash for a period of 90 days. Further, any trades executed that exceed either 3 violations or $1,000 may be canceled.