Market Talks
EDUCATION CENTER

FOREX · BEGINNER · LESSON 10 OF 15

Leverage and Margin

How a small deposit can control a large position, what margin, free margin and margin level mean, and how margin calls and stop outs close accounts that use too much leverage

13 min read 8 quiz questions with answer key

FOREX · BEGINNER · LESSON 10 OF 15

Leverage and Margin

IN ONE SENTENCE

Leverage lets you open a position much larger than the money in your account. The broker holds part of your money as margin while the trade is open. Leverage makes every pip worth more, in both directions. If losses eat into your equity too far, the broker warns you with a margin call and then closes your trades automatically with a stop out.

What leverage is

In Lesson 4 you saw that even a mini lot of EUR/USD is 10,000 euros, about **$10,850** at a price of 1.0850. Most traders do not have that much money for a single trade. With **leverage**, they do not need it.

Leverage is written as a ratio, such as **1:30** (or 30:1). It means each dollar in your account can control up to 30 dollars of position. To open the $10,850 position at 1:30, the broker only sets aside **$10,850 ÷ 30 = $361.67** from your account. You still gain or lose on the full $10,850, so every pip is worth exactly the same as if you had paid the full amount.

Leverage is not a loan you pay interest on in the usual sense, and it is not free money. It is a deposit system: the broker asks you to keep enough money in the account to cover your possible losses. The amount it sets aside is called **margin**.



Figure 1. With leverage of 1:30, a margin of $361.67 controls a position worth $10,850.

Margin: the deposit for each trade

The **required margin** for a trade is simply:

margin = position value ÷ leverage

The same rule can be written as a percentage, called the **margin requirement**: 1:30 means 3.33%, 1:50 means 2%, 1:100 means 1% and 1:500 means 0.2% of the position value.

So for the same $10,850 position, the margin is $361.67 at 1:30, $217 at 1:50, $108.50 at 1:100 and only $21.70 at 1:500. Higher leverage lets you open bigger positions with the same money. That sounds attractive, but as you will see, it is exactly what makes it dangerous.

Margin is not a fee. It is part of your own money, held aside while the trade is open, and it returns to your free money when you close the trade. What you gain or lose depends only on the price move and the position size.

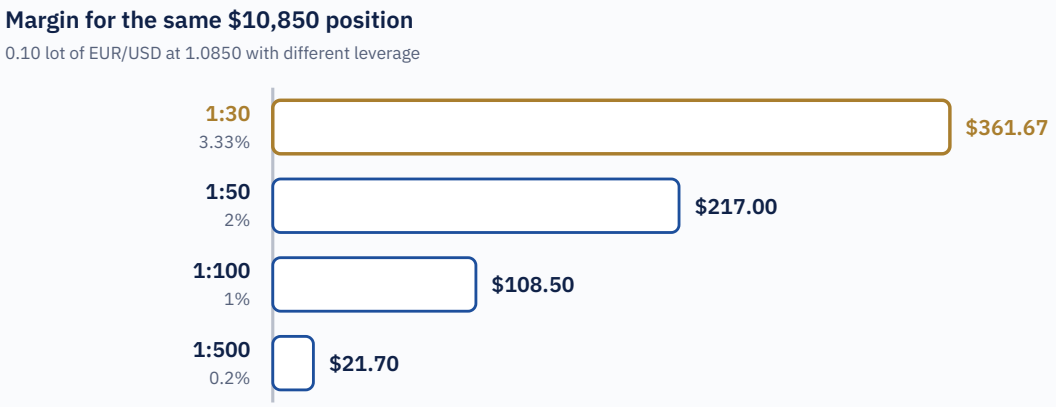


Figure 2. The higher the leverage, the less margin the same position needs.

Leverage multiplies gains and losses

Leverage does not change how far the market moves. It changes how much that move matters compared with the money you put down.

Suppose you use all the leverage available and EUR/USD moves 1% against you, about 108 pips. Compared with the margin you put up:

- At **1:10**, you lose 10% of your margin.
- At **1:30**, you lose 30% of your margin.
- At **1:100**, you lose 100%: the whole margin is gone.
- At **1:500**, you lose five times your margin. A move of just 0.2% wipes out the deposit.

A 1% move in a major currency pair is a normal day, not a crisis. This is why regulators in many countries limit retail leverage, and why most professional traders use far less leverage than their broker allows.

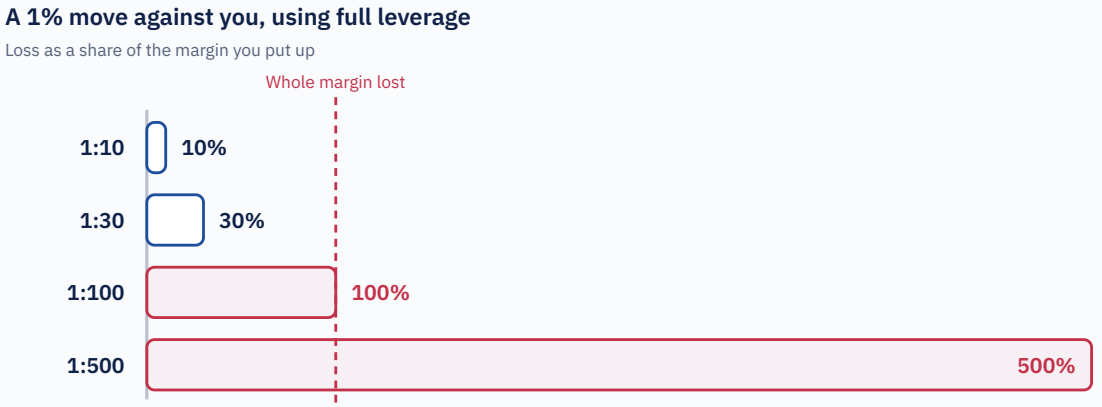


Figure 3. Leverage multiplies the effect of a normal 1% move on the money you put down.

Balance, equity, margin, free margin and margin level

Your platform shows a line of account numbers. You already know two of them from Lesson 5, and three are new:

- **Balance**: your money from deposits, withdrawals and closed trades.
- **Equity**: balance plus or minus the floating profit or loss of open trades.
- **Margin** (used margin): the total margin held for all open trades.
- **Free margin**: equity minus used margin. This is the money still available to open new trades or absorb losses.
- **Margin level**: equity divided by used margin, times 100%. It is the single most important number for the safety of a leveraged account.

Anna has a $2,000 account. She buys 0.50 lot of EUR/USD at 1.0850, a position worth $54,250. At 1:30 leverage, the margin is $1,808.33. Right after opening, her equity is $2,000, her free margin is only $191.67, and her margin level is $2,000 ÷ $1,808.33 × 100% = **110.6%**. She has used almost all her account as margin for a single trade.



Figure 4. Anna's account right after opening 0.50 lot. Almost all her money is used as margin.

Margin call and stop out

When a trade moves against you, your equity falls, and so does your margin level. Brokers set two important levels:

- **Margin call level**, often 100%. When your margin level falls to it, the platform warns you and usually stops you from opening new trades. You can add money or close positions.
- **Stop out level**, often 50%. If your margin level falls to it, the broker starts closing your trades automatically, usually starting with the trade that has the largest loss, until the margin level is back above the limit. In the European Union, the UK and Australia, regulated brokers must close retail positions at 50% at the latest.

For Anna, each pip on 0.50 lot is worth $5. A fall of only **about 38 pips** brings her equity down to $1,808, a margin level of 100%: margin call. A fall of **about 219 pips** brings it to $904, a margin level of 50%: stop out. Her trade is closed with a loss of about $1,096, more than half her account, on a move that EUR/USD can make in a few days.

If Anna had opened 0.05 lot instead, each pip would be worth $0.50. The same 219-pip move would cost about $110, or 5.5% of her account, and she would never come close to a margin call.

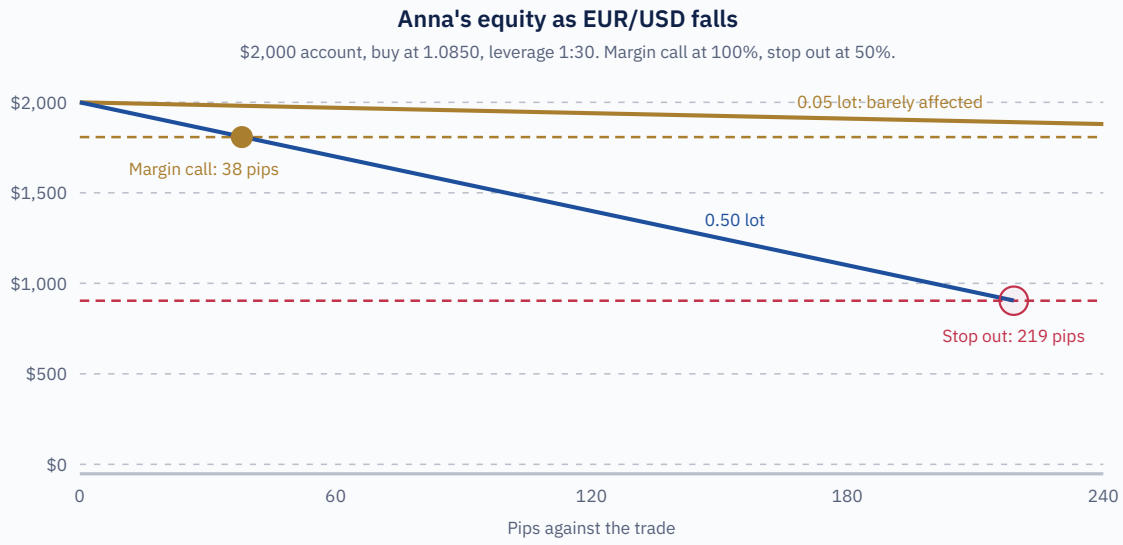


Figure 5. With 0.50 lot, a 38-pip fall triggers a margin call and a 219-pip fall a stop out. With 0.05 lot, the same moves barely matter. Margin is kept fixed for simplicity.

IMPORTANT: LOSSES CAN BE BIGGER THAN YOUR DEPOSIT

A stop out closes trades at the next available price. If the market jumps, for example at a weekend gap or after a shock like the Swiss franc in January 2015 (Lesson 2), the account can fall below zero before the trades are closed. In the European Union, the UK and Australia, regulated brokers must offer retail clients **negative balance protection**, so you cannot lose more than the money in your account. Elsewhere this protection is not always guaranteed. Lesson 14 explains how to check it.

Leverage limits around the world

After many retail traders lost money quickly with very high leverage, regulators in major financial centers set maximum leverage for retail clients. Professional clients and institutions can usually use more.

Region (regulator)	Major currency pairs	Other currency pairs	Gold
European Union (ESMA rules)	30:1	20:1	20:1
United Kingdom (FCA)	30:1	20:1	20:1
Australia (ASIC)	30:1	20:1	20:1
United States (CFTC and NFA)	50:1	20:1	Varies
Japan (FSA)	25:1	25:1	Varies

In the United States, CFDs cannot be offered to retail clients at all. Many brokers outside these regions offer 500:1 or even more. High maximum leverage is not a benefit: it mainly allows traders to take far bigger risks than they realize, often with weaker protections. Leverage limits can also change, so always check the current rules for your broker and your country.

Effective leverage: the number that really matters

The leverage your broker offers is only the maximum. What matters for your risk is how much of it you actually use. This is called **effective leverage**:

effective leverage = total value of open positions ÷ equity

Anna's 0.50 lot position is worth $54,250 on a $2,000 account: effective leverage of about **27 times**. Emma opens 0.05 lot on the same size of account: $5,425 ÷ $2,000, about **2.7 times**. Both use the same broker with the same 1:30 limit, but Emma's account can survive moves that would close Anna's.

A good habit is to ignore the maximum leverage completely and decide your position size from how much you are willing to lose if your stop loss is hit. Lesson 12 shows exactly how to do that.

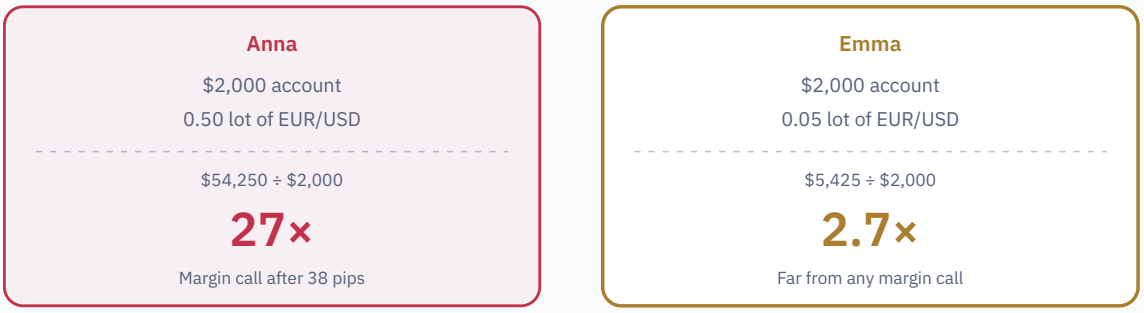


Figure 6. Same account, same broker, very different risk. Effective leverage is what you choose to use.

Why this matters for traders

- **Watch your margin level.** Keep it far above 100%. A margin level near the margin call level means one normal move can close your trades.
- **Use much less than the maximum.** Effective leverage, not the broker's limit, decides your risk. Size positions from your stop loss, not from your free margin.
- **Check your protections.** Know your broker's margin call and stop out levels, and whether you have negative balance protection.
- **Gold and crypto need extra care.** They are more volatile than major currency pairs, so regulators set lower limits for them, such as 20:1 for gold and 2:1 for crypto CFDs under EU rules. The same position size can move your equity much faster.

Key terms

Leverage	The ratio between the size of a position and the money needed to open it, such as 1:30.
Margin	The part of your money the broker holds aside while a leveraged trade is open.
Margin requirement	Margin expressed as a percentage of the position value, such as 3.33% for 1:30.
Free margin	Equity minus used margin: the money available for new trades or to absorb losses.

Margin level	Equity divided by used margin, times 100%. It shows how close an account is to a margin call.
Margin call	A warning when the margin level falls to a set level, often 100%, usually blocking new trades.
Stop out	Automatic closing of positions by the broker when the margin level falls to a set level, often 50%.
Negative balance protection	A rule that stops a retail client from losing more than the money in the account.
Effective leverage	The total value of open positions divided by equity: how much leverage you are really using.
Retail client	An individual trader, who receives more regulatory protection than a professional client.

Key takeaways

1. Leverage lets a small deposit, the margin, control a much larger position; margin = position value ÷ leverage.
2. Leverage multiplies gains and losses: at 1:100, a 1% move against you can wipe out the whole margin.
3. Free margin is equity minus used margin, and margin level is equity ÷ used margin × 100%.
4. When the margin level falls, the broker gives a margin call, often at 100%, and then a stop out, often at 50%, closing trades automatically.
5. Regulators limit retail leverage, such as 30:1 on major pairs in the EU, UK and Australia; what really matters is the effective leverage you choose to use.

Test yourself

Circle one answer for each question. The answer key with explanations is on the next page. You can also take this quiz online at markettalks.info and see your score instantly.

1. What does leverage of 1:30 mean?

A. You can lose at most 30 dollars
B. Each dollar in your account can control up to 30 dollars of position
C. The broker charges 30% interest
D. You can open at most 30 trades

2. A position is worth $10,850 and leverage is 1:30. What is the required margin?

A. $30
B. $108.50
C. $361.67
D. $10,850

3. What is the margin requirement, as a percentage, for leverage of 1:100?

A. 0.1%
B. 1%
C. 10%
D. 100%

4. Using full leverage of 1:100, the price moves 1% against you. How much of your margin is lost?

A. 1%
B. 10%
C. 50%
D. 100%

5. Equity is $2,000 and used margin is $1,000. What is the margin level?

A. 50%
B. 100%
C. 200%
D. 2,000%

6. What happens at the stop out level?

A The broker sends a newsletter
B The broker starts closing your trades automatically
C Your leverage doubles
D Your account is closed forever

7. Anna has $2,000 and opens 0.50 lot of EUR/USD worth $54,250. What is her effective leverage?

A About 2.7 times
B About 10 times
C About 27 times
D About 30 times

8. What is the maximum leverage for retail clients on major currency pairs under EU (ESMA) rules?

A 10:1
B 30:1
C 100:1
D 500:1

Answer key

1 B

Each dollar in your account can control up to 30 dollars of position

At 1:30, the margin is one thirtieth of the position value, so each dollar can control up to 30 dollars of position.

2 C

$361.67

Margin = position value ÷ leverage = $10,850 ÷ 30 = $361.67.

3 B

1%

1:100 means the margin is one hundredth of the position value, which is 1%.

4 D

100%

At 1:100 the position is 100 times the margin, so a 1% move against you equals 100% of the margin.

5 C

200%

Margin level = equity ÷ used margin × 100% = $2,000 ÷ $1,000 × 100% = 200%.

6 B

The broker starts closing your trades automatically

At the stop out level, often 50%, the broker closes positions automatically to stop the losses from growing further.

7 C

About 27 times

Effective leverage = position value ÷ equity = $54,250 ÷ $2,000, about 27 times.

8 B

30:1

EU rules limit retail leverage on major currency pairs to 30:1, and to 20:1 on other pairs and gold.

SOURCES

- ESMA, ESMA agrees to prohibit binary options and restrict CFDs to protect retail investors: https://www.esma.europa.eu/node/84933
- IG Australia, ASIC update: What are the new protections I have as a retail client?: https://ig.com/au/news-and-trade-ideas/asic-update--what-are-the-new-protections-i-have-as-a-retail-cli-210218
- OANDA (US), Spreads and margin requirements: https://oanda.com/us-en/trading/spreads-margin
- Financial Futures Association of Japan, Regulations for customers: https://www.ffaj.or.jp/en/regulation/customers

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Up next: Lesson 11 Order Types: Market, Limit and Stop

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