



Margin Demystified

Capital-Efficient Freight Hedging



What Is Margin?

A refundable performance deposit — not a cost of trading

The Common Misconception

- "I don't want to tie up cash in margin" — this is the #1 objection from physical participants new to futures
- Margin is not a fee, not a premium, and not lost capital — it is a deposit returned when you close

How It Works

- When you open a futures position, you deposit initial margin with your clearing broker
- Each day, Euronext Clearing marks your position to market — profits/losses flow via variation margin
- When you close the position or it expires, your initial margin is returned in full

Think of margin like a security deposit on a rental: it guarantees performance, then comes back to you.



Initial Margin Explained

How much capital do you need to open a CFF position?

Calculation

- Initial margin is set by Euronext Clearing based on historical volatility — typically 10-20% of notional
- Contract notional = price x 5 FEU. At \$3,000/FEU: notional = \$15,000 per contract
- Initial margin per contract: approximately \$1,500-\$2,250 (varies with market conditions)

Example: Hedging 500 FEU/Month

- $500 \text{ FEU} \div 5 \text{ FEU per contract} = 100 \text{ contracts needed}$
- Initial margin: $100 \times \$2,000 = \$200,000$ — to hedge \$1.5M of freight exposure
- That is ~13% of notional value — 87% of your capital remains available for operations
- In practice, most participants use an existing credit line with their bank or clearing broker to cover margin — no need to set aside cash from your operating budget

Margin is recalibrated regularly. Your broker provides real-time margin requirements before each trade.



Variation Margin: Daily Cash Flows

How daily mark-to-market keeps your position transparent and counterparty-risk-free

How Variation Margin Works

- Every business day, your position is re-valued at the Daily Settlement Price (DSP)
- If the market moves in your favour: cash is credited to your account
- If the market moves against you: cash is debited — you must maintain the margin balance

Why This Matters for Hedgers

- Variation margin losses on futures are offset by gains on your physical freight position
- Example: if rates rise \$500, you pay \$500/FEU variation margin but save \$500/FEU on physical freight
- The key is cash flow timing: futures margin moves daily, physical freight costs settle at shipment
- Most participants cover daily margin flows via a credit line with their bank or broker — no impact on working capital

Your broker can model worst-case margin scenarios to help plan your treasury buffer.



The Real Cost of Hedging vs. Not Hedging

Compare the capital cost of margin to the P&L hit of unhedged freight exposure

Cost of Hedging (Margin Capital)

- 1,000 FEU/month hedge: ~\$400,000 initial margin (at ~\$2,000/contract x 200 contracts)
- Opportunity cost of margin capital at 5% p.a. = ~\$20,000/year
- Broker commissions: typically \$1-\$3 per lot — negligible relative to notional

Cost of NOT Hedging (Rate Spike)

- A \$2,000/FEU rate spike on 1,000 FEU/month = \$2,000,000/month in unplanned freight costs
- Over a 6-month peak season: \$12,000,000 in budget overrun
- Plus: margin erosion, customer price increases, and potential earnings warnings

The cost of margin is a rounding error compared to the cost of being unhedged in a volatile market.



Capital Efficiency Tools

Techniques to reduce the margin capital required for your hedge

Portfolio Margining

- Positions across correlated routes (e.g., FENE + NEFE) can offset each other, reducing total margin
- Euronext Clearing applies netting across your portfolio — you don't pay full margin on each leg

Calendar Spread Margin

- Long/short positions in different months of the same route receive reduced margin treatment
- Ideal for rolling hedges: near-month close + next-month open as a single calendar spread trade

Non-Cash Collateral

- Some clearing brokers accept letters of credit, government bonds, or bank guarantees as margin collateral
- This means you can hedge without committing cash — freeing working capital for operations

Ask your clearing broker about eligible collateral types to minimise cash requirements.



Margin vs. The Alternative

A side-by-side: capital tied up in margin vs. capital lost in a rate spike

Scenario: 1,000 FEU/Month Shipper on FENE

- Current rate: \$3,000/FEU. Annual freight budget: \$36,000,000

If You Hedge (Cost of Margin)

- Initial margin: ~\$400,000 (refundable deposit)
- Opportunity cost: ~\$20,000/year at 5% interest
- Commissions: ~\$5,000/year
- Total annual hedging cost: ~\$25,000 (0.07% of freight spend)

If You Don't Hedge (Cost of a Spike)

- Rates spike to \$5,000/FEU for 6 months: \$12,000,000 budget overrun
- That is 480x the annual cost of hedging

The question is not "can we afford to hedge?" — it is "can we afford not to?"



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