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January 28, 2025

VIA ELECTRONIC SUBMISSION

Ms. Jennifer Piorko Mitchell
Office of the Corporate Secretary
Financial Industry Regulatory Authority, Inc.
1700 K Street, NW
Washington, DC 20006-1506

Re: SIFMA Comment on the Effectiveness and Efficiency of the Financial Industry Regulatory Authority, Inc. ("FINRA") Requirements Relating to Day Trading (FINRA Regulatory Notice 24-13)

Dear Ms. Mitchell:

The Securities Industry and Financial Markets Association ("SIFMA")[1] appreciates the opportunity to respond to the request for comment by FINRA in Regulatory Notice 24-13 ("Reg Notice 24-13") in which it is conducting a retrospective review of its requirements governing day trading to assess their effectiveness and efficiency. In Reg Notice 24-13, FINRA is soliciting public feedback on the continuing efficacy of its (1) account approval requirements for customers that intend to use day-trading strategies (Rule 2130); (2) requirements to disclose the risks of day trading to non-institutional customers when the member "promotes a day-trading strategy" (Rule 2270); and (3) pattern day trading margin requirements (Rule 4210). SIFMA appreciates and supports this retrospective review of FINRA's day trading rules, particularly as it relates to the pattern day trading margin requirements in Rule 4210. While FINRA is soliciting comments on its account opening and disclosure requirements related to day trading (Rules 2130 and 2270), SIFMA's long-standing concerns with FINRA's day trading requirements primarily have been with Rule 4210.

SIFMA recommends that FINRA update the current rule to avoid unfairly impacting investors with accounts holding equity of less than $25,000. Under the current rule, which was adopted at a time when industry risk management systems monitored securities positions based on trades completed on the prior day, such investors can be prevented from trading and

[1] SIFMA is the leading trade association for broker-dealers, investment banks, and asset managers operating in the U.S. and global capital markets. On behalf of our industry's nearly one million employees, we advocate for legislation, regulation, and business policy affecting retail and institutional investors, equity and fixed income markets, and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. With offices in New York and Washington, D.C., SIFMA is the U.S. regional member of the Global Financial Markets Association (GFMA).

effectively shut out of the markets if they are deemed pattern day traders. As described below, we recommend updates to the rule that would allow such investors to continue to trade subject to current margin limits if the firms where they hold their accounts have appropriate real-time risk monitoring controls in place and the ability to block trades that would create margin deficits. SIFMA believes that these changes to Rule 4210 would modernize the rule consistent with FINRA's investor protection mandate and the advances in technology that have improved risk management frameworks and expanded investor access to the markets, particularly for first-time investors and those with equity below $25,000. SIFMA is not recommending any changes to Rules 2130 and 2270 at this time as further described below.

I. Background

As noted in Reg Notice 24-13, the day trading requirements in Rule 4210 were designed "to protect Pattern Day Traders, the firms where those traders have their accounts, and the markets on which they trade."[2] Like Rules 2130 and 2270, the current requirements in Rule 4210 were adopted in the wake of the dot com boom in the late 1990s and the increased interest in day trading at that time. These requirements were adopted at a time when online retail trading was nascent and self-directed investors faced technological and informational gaps such as slow internet connections and a lack of educational materials. At that time, online retail brokerage commissions were typically $20 or more per trade, and many new and smaller traders were getting involved in the markets for the first time. Additionally, the industry typically used dial-up modems and daily batch-processing at 8:00 p.m. to update position files, and transactions were subject to a T+3 settlement cycle.

As a result of these technology limitations, the pattern day trading requirements adopted in Rule 4210 were designed, in part, to mitigate the overnight settlement risk clearing firms faced by incentivizing traders with accounts with $25,000 or more in equity to "get flat" overnight, and extending margin based on the previous end-of-day excess maintenance margin level at a higher 4x leverage ratio. The requirements also have the effect of preventing accounts with equity below $25,000 from engaging in pattern day trading as defined in the rule.[3]

In particular, Rule 4210 broadly defines a "pattern day trader" as a customer who executes four or more day trades in their margin account within five business days, where the trades make up more than six percent of the customer's total trades during the five day period. A "day trade" consists of buying and selling, or selling and buying, the same security (i.e., opening and closing a position on a given security) on the same day in a margin account. Under the rule, as applied by firms, pattern day traders are required to maintain equity of at least $25,000 in their margin accounts or they are not permitted to open new positions. This is because until a customer designated a pattern day trader brings their account back up to at least $25,000 in equity, their Day-Trade Buying Power ("DTBP") is limited, as it is calculated using the excess margin—the amount of cash and equity in their trading account above the minimum

[2] Reg Notice 24-13, at 8 (quoting the Pattern Day Trading Approval Order, 66 FR at 13617).

[3] As discussed below, for customers with accounts below $25,000 in equity, the rule perversely encouraged carrying open positions overnight to avoid a pattern day trader designation.

requirements—as of the close of business on the previous day. As discussed below, technological advancements during the past 25 years have made the approach taken in Rule 4210 obsolete.

II. Discussion

SIFMA's members have long supported updates to the pattern day trading margin requirements in Rule 4210. For example, in January 2024, SIFMA along with a group of exchanges and the Securities Traders Association submitted a letter to FINRA expressing concerns with the outdated method by which margin requirements are calculated under Rule 4210 for pattern day traders with accounts holding below $25,000 in equity and urging FINRA to modernize the rule for such accounts. As indicated in the letter, the pattern day trading designation under the rule has been a significant source of customer confusion and frustration in recent years at SIFMA member firms focused on self-directed investing, particularly those firms that cater to new investors who may have lower account balances. It has resulted in many first-time investors and investors with modest account balances being unable to trade if they are deemed a pattern day trader. This led SIFMA and the other letter signatories to recommend that FINRA update the rule.

Consistent with our previous suggestions, SIFMA is recommending that Rule 4210 be updated to allow customers designated as pattern day traders with account equity below $25,000 to continue trading utilizing current standard margin requirements if the firm where their account is held has real-time risk management systems and controls in place that allow the firm to track customer trading activity and margin exposures on a real-time basis, and to block a customer from taking on exposures beyond their permitted margin buying power.[4] SIFMA believes these changes will serve to modernize the rule consistent with current risk management systems and the way many new self-directed investors access and understand the markets while continuing to support FINRA's investor protection mandate.

A. Updates to Rule 4210

SIFMA recommends that FINRA retain the current requirements in Rule 4210, paragraphs (b)(4), (f)(8)(B), and (f)(10)(G), and in addition, update the rule for firms that have appropriate risk monitoring and trade prevention controls in place. As discussed in Reg Notice 24-13, market dynamics and broker-dealers' technological and operational capabilities have evolved significantly since the pattern day trading requirements under Rule 4210 were first introduced. We believe these changes should prompt a new approach to monitoring and controlling for the risks associated with pattern day traders for firms that have appropriate real-time tools to do so.

Over the past 25 years, self-directed investor access to the markets has increased exponentially. Advances in technology such as mobile investing platforms have provided self-

[4] We note that many broker-dealer risk management systems already block customer trades beyond certain thresholds, including trades that would exceed a pattern day trade customer's DTBP.

directed investors, and particularly first-time investors who typically have smaller account balances, with greater access to the markets than ever before. Online brokerages provide sophisticated tools and educational materials to clients at the click of a button. Retail orders are routed in milliseconds. Real-time buying power and balance calculations are constantly viewable and applied to transactions immediately. In today's retail trading environment, commissions are typically zero and thus do not raise the churning concerns that existed at the time the 4210 requirements were adopted. In addition, retail clients now have broad ability to trade listed options, where the number of expirations and hedging strategies may require more frequent and technical trading.

Meanwhile, the pattern day trading requirements in Rule 4210 have remained unchanged, impacting investors holding less than $25,000 in their accounts in ways that were not contemplated when the requirements were adopted. For example, the significant increase in the number of self-directed investors participating in the markets has resulted in a larger number of their accounts being designated as pattern day traders, limiting their ability to trade. Moreover, the prospect of being designated a pattern day trader causes investors to take actions that may be against their economic interest to avoid the designation so that they are not blocked from the markets, such as holding positions overnight rather than selling the positions before the end of the trading day. These outcomes are inconsistent with the rule's primary goal of mitigating financial risks, potentially subjecting investors and their firms to greater risks.

Self-directed investors also are often confused regarding the pattern day trading designation, how to determine when they will be considered a pattern day trader, and how the designation will impact their ability to trade. Anecdotally, firms report that questions about pattern day trading perennially are among the most frequent customer contacts via calls and emails, requiring firms to expend significant resources to respond to these questions. This continues to occur despite significant educational efforts from firms, including robust disclosures, in-platform warning messages, and day trade counting tools provided to clients. Moreover, blocking additional trades by investors with smaller accounts subject to the pattern day trading designation contributes to a perception that there is an uneven playing field for them. We also understand that FINRA receives a significant amount of complaints from investors about the pattern day trading requirements in Rule 4210.

Overwhelmingly, retail clients complain that the rules do not protect them, but rather serve only to restrict them from using their own funds. Retail firm experiences show that many clients subject to a pattern day trading designation will simply move their accounts to other firms attempting to avoid restrictions rather than adding equity in their accounts to reach $25,000. In addition, certain requirements in Rule 4210 are ambiguous and complicated, potentially leading to different interpretations.

Firms also have noted that their data shows that very few investors with accounts designated as pattern day traders actually engage in consistent day trading. Rather, most pattern day trader accounts get labeled as such because they engage more actively in markets for a short period of time and then return to making very few day trades. As a result, the current rule applies to vast numbers of retail traders who are traditional buy-and-hold investors. In addition, investors who do not regularly day trade and have been permanently labeled as pattern day traders are very confused and frustrated in situations where they may have significant margin equity or margin excess in their accounts after holding positions overnight or selling an asset intraday but are restricted from using any of those funds because of their limited DTBP, which is calculated based on the account's value at the end of the prior day. Such investors cannot understand how to calculate DTBP, why DTBP does not update throughout the day like regular buying power, how their accounts can become restricted immediately upon being approved for margin in a cash account, or why they can essentially "day trade" in their cash accounts but not on margin.

As noted, advances in technology also have enabled firms to accurately monitor and manage the risks of customer trading activity in real time. Some of these technological advances have been fostered by regulatory requirements. For example, the Commission adopted Exchange Act Rule 15c3-5 in 2010 to require broker-dealers providing market access to establish and enforce risk management controls and supervisory procedures reasonably designed to ensure that prior to submitting customer orders to the market, the orders (i) are within credit and capital thresholds, (ii) not erroneous, and (iii) do not violate any applicable regulatory requirements. In response to these requirements, broker-dealers subject to the rule have implemented robust pre-trade risk management controls. At the same time, these technological advances and a broker-dealer's overall responsibility to manage risks have contributed to many broker-dealers adopting similarly robust pre-trade risk management controls

Most importantly for pattern day trading purposes, risk management systems and controls allow broker-dealers to track customer positions in real time and seamlessly communicate that information to their customers. Rather than wait for a batch-file to run at 8:00 p.m. to understand clients' cumulative daily trading activity as was the case when the requirements were adopted 25 years ago, nearly all online retail brokerage firms now track client positions in real-time and employ real-time systems to prevent clients from exceeding their buying power. The current rule does little to mitigate unknown position settlement risk in an environment where all client positions and margin excess/equity are constantly calculated, known, monitored, and controlled for broker-dealers in real time.

For customers with margin accounts, this information also is incorporated in firms' real-time risk management systems to assess current customer exposures versus their margin requirements.[5] This stands in stark contrast to the pattern day trading margin methodology adopted in Rule 4210 for calculating DTBP, which was based on technology and controls that existed when the rule was adopted nearly 25 years ago, and which continues to be based on the previous day's closing maintenance margin excess. This antiquated approach causes further investor confusion as, unlike regular margin buying power (and other readily available real-time information about account positions, open orders, market data, and the market in general), DTBP balances do not update in real time when investors are viewing their accounts online.

[5] For margin accounts not designated as pattern day traders, Rule 4210(b) and Regulation T require initial margin of at least $2,000 in account equity or 100% of the purchase price of the margin securities and Rule 4210(c) addresses maintenance margin requirements.

Based on these market, technological, risk-management, and operational developments, SIFMA recommends that FINRA adopt an alternative, updated version of the rule that would allow firms to opt into this alterative version if they have appropriate risk controls in place to monitor customer trading and margin exposures on a real-time basis and block customer trading that exceeds their permitted margin buying power. Under this updated version of Rule 4210, for pattern day trading accounts with less than $25,000 in equity, we propose that customer DTBP be updated to utilize the initial and maintenance margin requirements in Regulation T and FINRA Rule 4210 that exist today for overnight buying power, which would appropriately limit trading in these accounts in a way that recognizes firms' ability to identify and block trades that would result in margin deficits in real time.[6] This updated method would represent a significant improvement to the current approach of effectively locking investors out of the markets if they are designated as pattern day traders but have less than $25,000 in account equity without introducing the financial risks Rule 4210 was originally designed to address.

SIFMA proposes that a broker-dealer may use this method if its order entry system calculates margin excess in real-time and blocks any additional orders that would create a margin deficit.[7] Under this method, instead of cutting off access to the markets for these smaller investors with account balances less than $25,000, Rule 4210 would be updated to allow firms to utilize their real-time risk controls to limit the trading that can be done by these investors to two times their excess margin for equities rather than four times, which is what pattern day traders with accounts over $25,000 are permitted to do. We also recommend that FINRA consider allowing firms with such real-time monitoring and control functionality to also use it to calculate buying power for accounts with $25,000 or more in equity rather than relying on the DTBP calculated as of the prior day's close.

For broker-dealers that do not use an order entry system that calculates margin excess in real-time or blocks orders that would create a margin deficit, or any broker-dealers that do not wish to follow this updated method, the current margin requirements in Rule 4210 would continue to apply to pattern day trading accounts. Firms such as ones focused on wealth management that also offer self-directed investing would have the option to continue to comply with current Rule 4210. This approach would allow firms to determine the most appropriate way to mitigate the risks of day trading based on their business models, while maintaining the goals and protections embedded in the pattern day trading requirements under current Rule 4210. While we are not including recommendations on updates to the pattern day trading definition, we recognize that various SIFMA members have recommendations on changes to the definition that we believe FINRA should consider as it moves forward with this retrospective review of its day trading requirements.[8]

[6] Regulation T focuses on initial margin required for margin equity securities. Rule 4210 contains initial and maintenance margin requirements for equities and securities other than equities. SIFMA's proposal is not limited to calculating margin for equity securities, as real-time margin calculations and risk monitoring controls also appropriately mitigate the financial risks associated with such other products.

[7] This approach to the real-time margin calculations and related monitoring for PDT accounts would be similar to the monitoring concepts included in the portfolio margining under Rule 4210(g).

[8] Such recommendations may include shortening or lengthening the timeframe for counting trades, raising the minimum number of trades required to meet the designation, or eliminating the definition altogether.

B. Comments on Rules 2130 and 2270

SIFMA appreciates that FINRA is also seeking comment on Rules 2130 and 2270. As noted in Reg Notice 24-13, Rule 2130 requires members that are promoting a day-trading strategy to approve a customer's account if that customer intends to engage in a day-trading strategy and to provide that customer with the risk disclosure statement set forth in Rule 2270. The rule defines a "day-trading strategy" as "an overall trading strategy characterized by the regular transmission by a customer of intra-day orders to effect both purchase and sale transactions in the same security or securities."

While the rule does not define what "promoting a day-trading strategy" means, it provides guidance on this concept, stating that a "member shall be deemed to be 'promoting a day-trading strategy' if it affirmatively endorses a 'day-trading strategy,' as defined in paragraph (e) of this Rule, through advertising, its Web site, trading seminars or direct outreach programs." The guidance also states that "the fact that many of a member's customers are engaging in a day-trading strategy will be relevant in determining whether a member has promoted itself in this way."[9] The guidance further provides that a member "shall not be deemed to be 'promoting a day-trading strategy' solely by its engaging in the following activities: (1) promoting efficient execution services or lower execution costs based on multiple trades; (2) providing general investment research or advertising the high quality or prompt availability of such general research; and (3) having a Web site that provides general financial information or news or that allows the multiple entry of intra-day purchases and sales of the same securities."[10]

SIFMA members have abided by this guidance since it was initially issued in 2000. The guidance was adopted at a time when firms were promoting day trading as an investment strategy despite the risks involved in engaging in it. SIFMA members note that their current activities fall squarely within the current exception in the rule. In this regard, for example, SIFMA members focused on self-directed investing do not promote day trading, but rather advertise commission free trading and their ability to provide investors with the research and educational services described in (2) and (3) above. SIFMA, however, understands the need for Rules 2130 and 2270 in light of the continuing ability of broker-dealers to promote day trading as an investing strategy. SIFMA members believe it is important to continue to clearly identify those activities that fall well outside the scope of "promoting a day trading strategy" so that compliance requirements are confined to the day trading risks the rule is designed to address. SIFMA also notes that FINRA has a very robust advertising review program designed to make sure firms do not inadvertently become subject to the requirements in Rules 2130 and 2270. Accordingly, SIFMA is not recommending any changes to Rules 2130 and 2270 at this time.

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[9] FINRA 2130.01.

[10] Id.

SIFMA appreciates this retrospective review of FINRA's day trading rules in Reg. Notice 24-13 and the opportunity to comment on it. SIFMA recommends that the pattern day trading margin requirements in Rule 4210 be updated in the manner described above to avoid unfairly impacting investors with accounts holding less than $25,000 in equity. If you have any questions or need any additional information, please contact Ellen Greene at (212) 313-1287 or Joe Corcoran at (202) 962-7383.

Sincerely,

Ellen Greene

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Managing Director
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Joseph P. Corcoran

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