STA

Security Traders Association
1115 Broadway, Suite 1110
New York, NY 10010
646.699.5996
sta@securitytraders.org
www.securitytraders.org

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

February 12, 2025

Re: 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. Jennifer Piorko Mitchell

The Security Traders Association[1] ("STA") appreciates the opportunity to submit comments on FINRA Regulatory Notice 24-13[2] (the "Notice"), which details FINRA's retrospective review of its day trading requirements to evaluate their effectiveness and efficiency. STA is an organization comprised of individuals involved in the trading of securities in the U.S. and Canada. Our members represent companies spanning various business models within the financial services sector, including retail and institutional brokerage firms, equity and options market makers, liquidity providers, agency-only broker-dealers, and asset owners and managers.

Specifically, FINRA is soliciting public feedback on the continuing efficacy of its (1) Rule 2130; account approval requirements for customers that intend to use day-trading strategies; (2) Rule 2270; requirements to disclose the risks of day trading to non-institutional customers when the member promotes a day-trading strategy; and (3) Rule 4210; pattern day trading margin requirements. STA will limit our remarks to Rule 4210.

Background

---

[1] STA is a trade organization founded in 1934 for individual professionals in the securities industry. STA is comprised of 24 affiliate organizations in North America with individual members who are engaged in the buying, selling and trading of securities. STA is committed to promoting goodwill and fostering high standards of integrity in accord with the Association's founding principle, Dictum Meum Pactum – "My Word is My Bond." For more information, visit https://securitytraders.org/.

[2] https://www.finra.org/rules-guidance/notices/24-13

STA

Security Traders Association
1115 Broadway, Suite 1110
New York, NY 10010
646.699.5996
sta@securitytraders.org
www.securitytraders.org

Rule 4210 was designed in the late 1990s when online day trading became popular. It was intended to protect investors classified as pattern day traders, the firms that manage their accounts, and the markets in which they trade. The U.S. Securities and Exchange Commission (SEC) noted, when approving the NYSE and NASD pattern day trading requirements, that these rules are 'not designed to prevent day trading, but to reduce the risk of financial losses for pattern day traders and their firms.

Rule 4210 defines a "day trade" as the buying and selling, or selling and buying, of the same security in the same day and defines a "pattern day trader" ("PDT") as an individual who makes four or more day trades within five business days, provided these trades make up more than 6% of their total trading activity in that period.

Under Rule 4210, investors deemed to be pattern day traders are required to keep at least $25,000 in equity in their margin accounts. If their account falls below this amount, they are shutout from trading until they bring it back to $25,000 because their Day-Trade Buying Power ("DTBP") is then limited based on the excess margin from the previous day's close.

In a January 2024 letter[3] to FINRA, STA along with a group of exchanges and the Securities Industry and Financial Markets Association, ("SIFMA") highlighted concerns about the outdated method used to calculate margin requirements under Rule 4210 for pattern day traders with accounts holding less than $25,000 in net equity. Our letter urged FINRA to modernize Rule 4210 for such accounts to allow firms to reduce the DTBP to Regulation T levels (2x DTBP) and use dynamic real-time calculations for pattern day trading accounts with less than $25,000 rather than cut these smaller accounts off from accessing the market. It was our view that this solution was pragmatic in that it was within the framework of Rule 4210 and would address the main problem we see as investors with low account balances deemed to be pattern day traders unable to access the markets. As indicated in our letter, the pattern day trading designation under the rule has been a significant source of customer confusion and frustration in recent years as firms focused on self-directed investors, particularly those firms that cater to new investors who may have lower account balances.

Summary Remarks and Recommendations

STA members represent a diverse array of firms, characterized by varied business models. Our members also cater to a wide range of investor types, differentiated by age, investing expertise,

[3] https://securitytraders.org/sta-in-dc/comment-letters/sta-letter-to-finra-on-rule-4210/

Security Traders Association
1115 Broadway, Suite 1110
New York, NY 10010
646.699.5996
sta@securitytraders.org
www.securitytraders.org

risk tolerance, and investment goals. The vast majority of our members believe that Rule 4210 has led to numerous unintended negative consequences, which are detailed later in this letter. Furthermore, our members unanimously agree that technological advancements and shifts in the self-directed investor landscape have made the requirements and definitions under Rule 4210 outdated and counterproductive to its original intent at the time of its design and implementation.

However, there exists different recommendations on how best to modify Rule 4210 to better serve investors, firms, and the markets as a whole. These recommendations range from pragmatic adjustments within the current framework of Rule 4210 to more comprehensive changes, including the elimination of certain key criteria. STA believes these differences are manageable and can be resolved through further dialogue among interested stakeholders. Therefore, STA recommends that, once FINRA completes its review of industry feedback on the Notice, it should proceed with a formal proposal to revise Rule 4210 to better align with today's market dynamics.

It is STA’s view that FINRA’s top priority in updating Rule 4210 should be to address the restrictions placed on investors deemed to be pattern day traders and whose accounts have less than $25,000 in net equity.

STA believes the trade count criterion in determinations on pattern day traders is arbitrary and obsolete and is capturing large amounts of investors never intended to be subject to Rule 4210.

STA recommends that brokerage firms with real-time risk monitoring and the ability to automatically block trades when a client's activity exceeds targeted risk parameters be granted specific flexibilities or exemptions under a revised Rule 4210. Firms such as wealth management advisors that also offer self-directed investment accounts but may lack such capabilities should be allowed to continue operating under the existing conditions and requirements of Rule 4210.

Remarks

1. **New Regulations and Technology Advancements**

There have been significant technological advancements since Rule 4210 was established. Today, firms utilize robust, real-time risk management systems to assess intraday risk and client balances. Many of these technological improvements were responses to regulatory events that necessitated industry-wide enhancements to ensure compliance. These events and their impacts on technology are directly relevant to the Notice.

a. Shortened Settlement Cycle

The settlement of U.S. equity trades moved from T+3 to T+2 on September 5, 2017, and T+2 to T+1 on February 15, 2023. These changes were implemented by the SEC to shorten the time frame for settling trades, aiming to reduce risks in the financial system. To comply with the requirements broker dealers and other market participants had to develop new technology and workflows to process the settlement of transactions efficiently and in a shorter window of time. In financial transactions, the relationship between time and risk is intrinsic, where the longer a transaction extends, the greater the exposure to potential risks and market fluctuations. In addition, the cost of capital or margin for firms carrying unsettled positions increases over time, as they must allocate resources to maintain liquidity and manage potential fluctuations, impacting overall profitability.

b. Rule 15c3-5; Market Access Rule

In 2010, the SEC introduced Rule 15c3-5, commonly known as the Market Access Rule. Rule 15c3-5 applies to broker dealers with access to trading in securities on an exchange or alternative trading system (ATS). The rule requires broker dealers to implement risk management controls and supervisory procedures to ensure that their market access complies with regulatory requirements and mitigates risks to the financial markets. Key provisions of the rule that are relevant to the Notice include:

i. Risk Management Controls: Broker-dealers must establish, document, and maintain a system of controls designed to: prevent the entry of orders that exceed pre-set credit or capital thresholds; prevent the entry of erroneous orders (e.g., fat-finger errors or algorithmic glitches); and prevent the entry of orders that could violate applicable laws, rules, or regulations.

ii. Pre-Trade Controls: The rule emphasizes real-time, pre-trade risk management to prevent the submission of problematic orders that could disrupt the market or violate rules.

iii. Supervisory Procedures: Firms must have documented supervisory procedures to review and ensure the effectiveness of risk management controls. Regular testing and updating of these controls are required to adapt to changing market and operational conditions.

Rule 15c3-5 is especially critical in the context of algorithmic and high-frequency trading, where the speed of execution can amplify risks.

As a result of these two regulatory measures, broker-dealers have developed technology which provides strong pre- and intra-day risk controls and the ability to process the settlement of transactions more efficiently and in a shorter window of time. These technological advancements are applicable to managing risks critical for the protection of customers, firms and the market in general.

2. Democratization of Financial Markets

The term "democratization of the financial markets" became commonly used in the late 1990's and early 2000's, with the advent of the internet and online trading platforms. SEC Chairman Arthur Levitt, in a May 4, 1999[4], speech, discussed the benefits and red flags associated with "online" investing in its nascent days. While Chairman Levitt voiced concerns about what he described as pattern day-trading, he concluded his remarks with the following statement:

"All of us are participants in an extraordinary social phenomena. The democratization of our markets is a desirable development which regulators should not frustrate. Our mission is not to prevent losers or to modulate the sometimes mercurial movement of our markets."

Democratization of financial markets continues to evolve with increased accessibility largely attributed to technological advancements like low-cost trading apps, real time market data, and educational resources, which were previously available only to professional traders or those with significant capital.

Technology has lowered the barrier to entry for investing, making it possible for a broader demographic of investors to engage with the financial markets with minimal capital. Brokerage firms who cater to self-directed investors have transformed from mere transaction facilitators to comprehensive educational resources designed to help new investors make informed decisions, understand market volatility, and learn about different investment vehicles. In addition, the ability to trade in a penny-tick regime with zero commissions and without intermediaries fosters a sense of independence and responsibility among new investors.

[4] https://www.sec.gov/news/speech/speecharchive/1999/spch274.htm

Security Traders Association
1115 Broadway, Suite 1110
New York, NY 10010
646.699.5996
sta@securitytraders.org
www.securitytraders.org

The democratization and easier access of our financial markets has also introduced challenges. New investors require guidance to understand the implications of any investment which underscores the need for continuous education and experience to ensure they are well informed.

3. Unequal Treatment of Pattern Day Traders

Accredited Investor Standards are used by the SEC to define investors who can participate in certain types of securities offerings. Accredited Investors Standards apply a wealth test requiring individuals to have a net worth exceeding $1 million or have had income exceeding $200,000 in each of the last two years ($300,000 with spouse) with reasonable expectations of the same income this year. It is a controversial rule because it treats investors differently based on their financial status rather than their understanding and interest. STA views using wealth as a sole criterion for investment capability as inadequate, and the need for more inclusive definitions that acknowledge knowledge and experience as valuable metrics for investor status.

STA believes there is a correlation between the Accredited Investor Standards wealth test and Rule 4210 which treats pattern day traders with lower account balances differently than pattern day traders with high account balances. This has resulted in those investors with modest account balances being punished and unable to trade based exclusively on their account balance with no regard for their financial literacy and interests. The account net equity minimum under the rule has been a source of customer confusion and frustration for those firms that cater to new investors who may have lower account balances.

STA recommends that if FINRA ultimately determines the need to maintain a Pattern Day Trader standard, brokerages should be allowed to treat all such customers equally, regardless of their account balances.

4. Pattern Day Trader Designation: Trade Count

FINRA Rule 4210 designates an investor as a pattern day trader if the investor executes four or more day trades within five business days and the day trades constitute more than 6% of their total trades in that five-day period. In the current market environment, where investors can trade small notional values with great efficiency, the low trade count threshold for being classified as a pattern day trader poses a risk. It can inadvertently label otherwise inactive investors who have traded actively for a short period as PDTs. The PDT designation remains with an investor unable to meet the $25,000 equity threshold for an indeterminate time which

Security Traders Association
1115 Broadway, Suite 1110
New York, NY 10010
646.699.5996
sta@securitytraders.org
www.securitytraders.org

creates confusion for that investor and the corresponding trade restriction reinforces the perception of an uneven playing field.

The PDT designation also leads to actions that may not be in the investors' best interests. For example, some investors upon being deemed a PDT will open an account at another broker dealer to begin a new trade count. This behavior is commonly referred to as "broker hopping". It is difficult to quantify because it occurs outside the ACAT process to avoid having the PDT designation follow them. Moving trades between margin and cash accounts, commonly referred to as "account churn" is another example. Additionally, the PDT rule has created an environment where investors may take unwanted overnight risk by not closing a position because doing so would deem them a PDT and thus be locked out of the market.

STA recognizes that should FINRA deem it necessary to keep the term pattern day trader it will need criteria for making such determinations. It is our view that regardless of any changes the core issue lies with the designation itself and the resulting restrictions.

Conclusion

STA appreciates FINRA's retrospective review of its day trading rules and the opportunity to provide comments. We look forward to working with FINRA on its staff on a revised version of Rule 4210.

James Toes

President & CEO
Security Traders Association

Security Traders Association
1115 Broadway, Suite 1110
New York, NY 10010
646.699.5996

sta@securitytraders.org
www.securitytraders.org