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February 3, 2025

Jennifer Piorko Mitchell
Office of the Corporate Secretary
FINRA
1700 K Street, NW
Washington, DC 20006-1506

Re: Regulatory Notice 24-13 – Retrospective Rule Review: Day Trading FINRA Requests Comment on the Effectiveness and Efficiency of its Requirements Relating to Day Trading

Dear Ms. Mitchell:

Charles Schwab & Co., Inc.[1] ("Schwab") appreciates the opportunity to express its views on FINRA's rules governing day-trading and their effectiveness and efficiency as intended to meet investor-protection objectives.

Schwab supports FINRA's initiative to retrospectively review the day-trading rules and shares FINRA's belief that it is appropriate to look back at certain rules to determine whether the existing rules are meeting their intended objectives in light of industry changes. Schwab believes this review offers an important opportunity to consider modifications to the rules with the intent of avoiding undue administrative and expense-related burdens on member firms while still achieving investor protection.

Executive Summary

FINRA's top priority in updating its day trading rules should be to address the punitive effects caused by restricting activity in customer pattern day trader accounts with less than $25,000 in net equity.

Schwab further recommends that for firms that can demonstrate the ability to calculate real time buying power, FINRA should allow such firms to establish their own risk-based criteria for designating accounts as pattern day traders. Such a change would avoid the limitations and

[1] The Charles Schwab Corporation (NYSE: SCHW) is a leading provider of financial services, with over 36 million active brokerage accounts and over $10 trillion in client assets, as of December 31, 2024. Through its operating subsidiaries, the company provides a full range of wealth management, securities brokerage, banking, asset management, custody, and financial advisory services to individual investors and independent investment advisors.

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burdens of the arbitrary triggers as defined in the definition of "pattern day trader" (*i.e.*, four day-trades within five business days) as well as improve operational risk by calculating a customer's day-trading buying power on a real time basis rather than on the net equity in the customer's account at the close of the previous trading day.

Finally, Schwab recommends that FINRA withdraw the rules that establish unique account approval and disclosure requirements for firms that "promote" day trading strategies.

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The day trading rules are two distinct rule sets. One rule set establishes special maintenance margin requirements for customers that engage in pattern day trading. The other focuses on account approval and disclosure requirements for firms that are "promoting a day trading strategy."

Pattern Day Trader Margin Requirements

Pattern day trader margin requirements were designed to ensure that day traders have sufficient equity for the potential losses that may be incurred from sudden and substantial adverse price movements. The margin requirements were designed to protect day traders, firms, and the markets as a whole.

FINRA defines "pattern day trader" generally as any customer who executed four (4) or more day trades within five (5) business days. A "day trade" is defined as purchasing and selling or selling and purchasing the same security on the same day in a margin account.[2]

The classification of an account as a pattern day trader has several implications. First, the account becomes subject to FINRA's "day-trading buying power" limits, which for equity securities is generally up to four times the maintenance margin excess as of the close of business of the prior trading day. Maintenance margin excess is the amount by which the equity in the margin account exceeds the required margin.

Second, a pattern day trader account becomes subject to a minimum net equity requirement of $25,000. If an account falls below that threshold, it is restricted to trading on a cash basis only. Moreover, in certain cases the account could be restricted *to closing transactions only*, thus depriving an account holder of any new investment opportunities.[3] By contrast, a margin

[2] Rule 4210(f)(8)(B)(ii). If the number of trades is six percent or less of total trades for the five business day period, the customer will not be considered a pattern day trader.

[3] Typically, the restriction to closing transactions only would occur when a pattern day trading account makes a single day trade when the net equity falls below $25,000. At that point, and until the account regains a minimum net equity of at least $25,000, the account becomes essentially moribund.

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account that is not classified as a pattern day trader is subject to a minimum net equity requirement of $2,000.

Despite being well intentioned, the regime as it exists today is unduly punitive towards smaller investors. In particular, restricting a pattern day trader account to trading on a cash basis (or to closing transactions only) appears to serve no regulatory purpose yet is a substantial pain point among retail investors and the firms that serve them. Pattern day trader accounts with less than $25,000 minimum net equity do not pose any unique risks to firms or our financial markets.

Additionally, day traders themselves are not protected by virtue of having their accounts restricted to trading on a cash basis or closing transactions only. Indeed, further restricting trading beyond the prudential limits established under Regulation T serves only to reinforce a perception that less affluent retail investors do not have equivalent access to the markets as those with higher levels of wealth. In some cases, the current rule deters clients from managing risk in order to avoid getting flagged as a pattern day trader. For example, they may leave an option in their portfolio through expiration or hold onto a stock they might otherwise have reasons to sell.

Schwab believes that with one single change, the most undesirable effects of the current day trading rules can be removed. A pattern day trader account with minimum net equity less than $25,000 should be entitled to the buying power under Regulation T, *i.e.*, two times the maintenance margin excess. This change would alleviate the punitive effects on smaller investors whose accounts are designated as pattern day traders.

Schwab's further thoughts on the pattern day trading margin requirements are as follows.

Assuming the elimination of cash trading only restrictions on pattern day trader accounts below $25,000, Schwab supports retaining the minimum net equity requirement. Schwab believes that the existing level is reasonable, particularly in relation to the $100,000 minimum net equity requirement for accounts with portfolio margin. However, Schwab strongly recommends eliminating the cumbersome and inefficient mechanism for designating a pattern day trader account.

The current definition of four round trips in five business days creates confusion and imposes substantial operational costs. Many self-directed investors are surprised to learn that buying and selling stocks on the same day (regardless of the amount of such transactions) can have the effect of designating them as a pattern day trader. Firms such as Schwab must deal with several thousand calls each week that arise from customers who learn for the first time that they have new restrictions placed on their account.[4] While there are provisions to remove pattern day trader status for good faith reliance on a written representation from a customer that they do not intend to use the account to engage in a day-trading strategy, these require manual intervention and become costly.

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[4] Schwab receives approximately 2000 calls per week from clients with questions about their pattern day trader designation and estimates that the cost incurred to service these client inquires exceeds $2 million per year.

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In addition, the current definition imposes substantial operational costs on firms who must build and maintain systems to identify on a real-time rolling basis activity that constitutes a day trade. Day trades take many forms – they are not simply opening and closing a position in a stock on the same day. Tracking activity that constitutes a day trade when customers have positions from a previous day, or enter a series of buy and sell orders in varying amounts during the day, or that result from multi-leg options strategies can be challenging. Such methods can also vary from firm to firm.[5] Moreover, further confusion and operational complexity is likely to be introduced when 24 hours trading becomes more widespread particularly if the trading day does not align with the calendar day. In short, as our markets have evolved and continue to evolve, the costs of designing, implementing, and maintaining systems to administer the pattern day trading rules vastly exceed any regulatory benefit; in fact, Schwab believes the rules often harm investors.

A regime in which firms that can demonstrate the ability to calculate real-time buying power are able designate accounts as pattern day traders in accordance with their own risk tolerances is far preferable to altering rigid, industry-wide trading thresholds. While shortening the five business day window may reduce the number of customers swept into the rule, it would not eliminate the operational burdens of maintaining systems to count trades.

Moreover, increasing the number of required trades to become a pattern day trader would paradoxically *increase* the burdens under the rule. Often, when a customer exceeds four day trades within five business days, they contact Schwab to understand what happened. Typically, the representative will explain the rule and then identify each of the day trades. Increasing the thresholds will prolong the call as a representative may need to review each trade that led to the pattern day trading designation. Explaining which trades were counted as day trades is further complicated as industry practices vary from firm to firm and may not align with the customer's expectations.

Additionally, Schwab recommends that a customer's day-trading buying power be calculated on a real time basis rather than on the net equity in the customer's account at the close of business on the previous trading day. Using real time prices is sounder from a risk perspective and aligns with the approach used when extending margin generally as well as portfolio margin. In its FAQs on portfolio margin, FINRA has stated "member firms that have the capability to charge the required margin at the time an order is entered and prohibit the trade from being executed if an account does not have enough maintenance excess, are not required to calculate any day trading requirements pursuant to NYSE Rule 431 and [FINRA Rule 4210]."[6] Adopting a similar posture here would avoid the need for Schwab to issue day trade calls when

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[5] See, e.g., FINRA Notices 10-45 and 21-13 (identifying alternative methods for counting round-trip trades).

[6] FINRA Portfolio Margin FAQs at https://www.finra.org/rules-guidance/key-topics/portfolio-margin/faq.

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real-time buying power exceeds day trading buying power and a customer subsequently elects to close out a position intra-day.[7]

Account Approval and Disclosures

Schwab believes that FINRA should withdraw the rules that establish unique account approval and disclosure requirements for firms that "promote" day trading strategies. As a threshold matter, Schwab does not believe any firm promotes day trading as it was envisioned when the rule was first adopted. Firms such as All-Tech Direct and Investment Street are gone.[8]

When the rule was adopted, the ability to "day trade" required access to special trading platforms. Today, advances in technology have made the types of services and market access that were previously unique to firms promoting day trading strategies commonplace. The report prepared by the U.S. Senate's Committee on Governmental Affairs, Permanent Subcommittee on Investigations, which formed a basis for the day trading rules, observed that:

> Day trading firms provide a fundamentally different service than traditional brokerage houses and even on-line discount brokerage firms, such as E*Trade and Charles Schwab. Neither discount on-line brokerage firms nor traditional full-service firms offer customers direct electronic access to the stock market, as do day trading firms. Online brokerage firms generally do not offer immediate stock order execution to their customers. Rather, online brokerage firms generally refer customer orders to other entities – such as market makers – for execution. The other basic difference between day trading firms and on-line firms is that day trading firms generally promote active trading by their customers and, in most instances, cater primarily to persons seeking to trade for a living.[9]

Statements such as this highlight why it is no longer necessary or appropriate to have separate day-trading account approval and disclosure rules. The presence of these rules – even if they are broadly inapplicable – impose unnecessary regulatory burdens as firms must still maintain

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7 The current use of end of day prices means in some cases a customer's real-time buying power will exceed their day-trading buying power. Because it is impossible to identify, for example, whether a particular stock trade is part of a day trade at the time a position is established, Schwab defaults to applying the real-time buying power under Regulation T. It is only after a customer closes the position intra-day does it become a day-trade and subject to lower buying power limits and thus necessitate a margin call.

8 All-Tech Direct was expelled by FINRA in June 2002 (https://brokercheck.finra.org/firm/summary/13992), and Investment Street terminated its registration in November 2002 (https://brokercheck.finra.org/firm/summary/30779).

9 Day Trading, Case Studies and Conclusions, at 15, July 27, 2000 (footnotes omitted).

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policies and procedures and consider the imprecision around what constitutes a day trading firm.[10]

To the extent that FINRA believes that the disclosures in the current day-trading risk disclosure statement are necessary, Schwab recommends that they be combined with the existing disclosures for margin trading. Indeed, there is already substantial overlap. Additionally, some of the day-trading risk disclosures, such as those addressing the impact of commissions, are anachronistic and outdated.

Lastly, Schwab believes that withdrawing the account approval and disclosure rules will not create a pathway for firms to begin misleading customers about day trading as the continued application of the rules on communications with the public would be sufficient to deter such conduct and would provide a basis for FINRA to pursue violative conduct.

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Schwab appreciates FINRA's willingness to undertake a retrospective review of its day trading rules and thanks the staff for its consideration of the points raised in this letter. Please feel free to contact the undersigned with any questions or to discuss our comments in more detail.

Sincerely,

Mike Whipple
Managing Director, Trading and Margin Services
Charles Schwab & Co., Inc.

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[10] Supplemental Material .01 to FINRA Rule 2130 expands on when a firm is deemed to be – and not to be – "promoting a day-trading strategy." However, changes in business models and the static nature of the supplementary material create unnecessary and unintended burdens on firms that have never been the focus of the day-trading rules.