

October 26, 2000

Elisse B. Walter, Esq.
Chief Operating Officer
NASD Regulation, Inc.
1735 K Street, N.W.
Washington, D.C. 20006

Re: NASDR/NYSE Margin Rules for Day Traders

Dear Ms. Walter,

The Securities Industry Association (“SIA”)¹ is writing to express its concern about the operational and compliance burdens that will result from approval of the above-referenced rules. In its previous comment letter on this proposal, SIA expressed support for the goal of reducing a day trading customer's exposure to risk by strengthening the margin rules applicable to day trading, but took issue with the intended scope of the rule.² The Securities and Exchange Commission has estimated that, as a whole, day traders represent about 1/10th of 1% of all individuals buying and selling stocks.”³ SIA does not believe that the current version of the rule is appropriately tailored to the scope of concern as identified by the GAO and SEC.

Under the proposed plan, the previous five days of trading activity in every margin account throughout a firm would have to be analyzed every day to identify day traders. Moreover, a series of separate margin regimes would have to be applied to each account so identified over a very short period of time, with the possibility

¹ The Securities Industry Association brings together the shared interests of more than 740 securities firms to accomplish common goals. SIA member-firms (including investment banks, broker-dealers, and mutual fund companies) are active in all U.S. and foreign markets and in all phases of corporate and public finance. The U.S. securities industry manages the accounts of more than 50-million investors directly and tens of millions of investors indirectly through corporate, thrift, and pension plans. The industry generates more than \$300 billion of revenues yearly in the U.S. economy and employs more than 600,000 individuals.

² See letter to Jonathan Katz, Secretary, SEC, from Robert P. Mazzarella, Chairman, Discount Brokerage Committee, and Michael L. Michael, Chairman, Ad Hoc Committee on Technology and Regulation (March 14, 2000).

³ General Accounting Office (“GAO”), “Day Trading Requires Continued Oversight” (February 24, 2000). The GAO Report further states that “day traders *all* did their trading at specialized day trading firms,” and that “the SEC estimated that there are about 100 day trading firms operating, with hundreds of offices around the country, *which is a small part of the nearly 8,000 registered broker-dealer firms.*” (emphasis added)

that some accounts may alternate between margin regimes on a daily basis. Surely, there is a less burdensome and operationally efficient method of identifying true day traders to whom the special margin requirements may be applied.

SIA respectfully offers the following recommendations for changes to the rule:

Reduce the number of accounts that must be reviewed for pattern day trading and the frequency of these reviews.

Given the statistical evidence for the number of day trading accounts and the disproportionate number of non-day trading accounts that will have to be reviewed, SIA strongly urges revisions to the rule that will reduce the number of accounts to review and the frequency of these reviews. We believe the industry and the regulators should work together to craft a more efficient means of defining the scope of the rule.

For example, the NASDR Day Trading Margin Advisory Task Force had previously recommended that the increased 4-to-1 margin be made available only upon a customer's request and only after meeting the \$25,000 minimum equity requirement. SIA supports such an approach because it recognizes that customers are in a much better position than their firms to determine how they plan to trade and how much they can afford to borrow. In addition to reducing the burden on the approximately 7900 firms with few or no day trading customers, this would allow firms that don't want day traders as customers to inform customers up front and allow other firms to impose the heightened borrowing requirements before any borrowing issues arise.

Alternatively, a notification requirement from customers coupled with a less burdensome spot check of trading activity by the firm would still represent a better balancing of burdens. From a capacity and programming standpoint, an end-of-month check would be less intensive than an end-of-week check (both of which could use weekend processing time), which would itself be far less intensive than running five days of data each and every business day. A change from a rolling five-day check to a weekly check with a ten-day look-back could provide a more accurate and efficient method of detection.

Moreover, the rule ought to calibrate the number of roundtrip trades that trigger the rule with the available data evidencing the actual number of such trades that are executed by day traders. The rule as proposed currently lacks any evidentiary foundation for the threshold of four roundtrip trades over a five-day period.

Finally, we note that the SIA's earlier suggestions for adding specific types of trades and strategies to the enumerated exceptions to day trading were not addressed by the NASDR in their recent response to comments. SIA had recommended revising the definition of day trading to specify that the following types of trades and strategies (which are suggested but not made explicit by the current language) fall within the purview of the exception:

- (1) Exercising a profitable option position
- (2) Reopening a long option position that had been closed out earlier the same day;
- (3) Reopening a short option position that had been closed out earlier the same day.
- (4) The purchase of a security by a customer and the sale of the same security by the customer in a repurchase or other financing transaction.

Exempt institutional accounts.

In the recently approved day trading account-opening rules⁴, NASDR took the view that institutions are not day traders and applied the rule only to non-institutional accounts. Similarly, the current NASDR proposal to require members to deliver a margin disclosure statement applies only to non-institutional customers.⁵ The only similarity between the kind of sophisticated trading strategies that institutions employ and day trading by individual investors is that both may involve frequent intra-day trading. Furthermore, the use of such trading strategies by institutions predates electronic day trading, which arose only in the past few years with the advent of electronic access to markets by individual investors. The concern for the borrowing habits of individual investors, who only recently gained high-speed access to the market, cannot logically be extended to cover institutional trading behavior. This is not a sufficient basis on which to extend the day trading margin rules and is inconsistent with the stated aims of the NASDR and its prior rules.

Eliminate or revise the operationally burdensome temporary restrictions that apply during the five-day margin call period.

The prospect of applying three or more sets of separate margin calculations and restrictions on an account – prior to classification as a day trader, post-classification, after a margin call, and upon meeting or not meeting the margin call - will be a tremendous burden on programming and processing resources. Moreover, it will lead to great confusion on the part of customers trying to understand their account balance and available credit. It would be far more efficient to impose just one set of long-term restrictions on an account when the customer fails to meet the call or when the customer exceeds day trading buying power. Another alternative would be to allow a customer two days to meet a day trading margin call prior to the imposition of the two times maintenance margin excess and "time and tick" restrictions. Similarly, it would be

⁴ Exchange Act Release No. 43021 (July 10, 2000); 65 FR 44082.

⁵ Exchange Act Release No. 43441 (October 12, 2000); 65 FR 63275.

significantly less burdensome if the temporary restriction included only the two times excess restriction on buying power and not the time and tick restriction.

NASDR need not worry that narrowing the scope of these rules will result in any reduced vigilance on the part of firms in promoting responsible borrowing practices. Although not advocates of day trading, SIA member firms have been proactive in curbing the amount of money they will lend to customers beyond that which is required by applicable regulations. As NYSE Chairman Richard Grasso and NASD Chairman Frank Zarb observed in a letter to member firms on the subject, "we understand that many member organizations generally maintain higher house maintenance margin requirements on equities than 25%, and have imposed still higher maintenance requirements on specific stocks and market segments."⁶

We would welcome the opportunity to discuss these and any other ideas you may have for improving the rule. If you have any questions, or would like to discuss this further, please contact Scott Kursman, Assistant General Counsel, at 212-618-0508.

Very truly yours,

Stuart J. Kaswell
Senior Vice President & General Counsel

cc: Annette Nazareth, Director, Division of Market Regulation, SEC
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Albert Lucks, Director, NYSE

⁶ Joint Statement by NYSE & NASD on the Continuing Growth in Investors Margin
Dept (http://www.nasdr.com/joint_state.htm; February 24, 2000).