

March 14, 2000

Jonathan G. Katz
Secretary
U.S. Securities and Exchange Commission
450 Fifth Street, NW
Washington, D.C. 20549

Re: Securities Exchange Act Release No. 34-42418; File No. SR-NASD-00-03;
Amendments to Rule 2520; Margin Requirements for Day Trading Customers.

Dear Mr. Katz:

The Discount Brokerage Committee and the Adhoc Committee on Technology & Regulation (the "Committees") of the Securities Industry Association ("SIA")¹ appreciate the opportunity to comment on NASDR's proposed amendments to Rule 2520 relating to margin requirements for day trading customers.² SIA supports the goal of reducing a day trading customer's exposure to risk by strengthening the margin rules applicable to day trading. An overleveraged customer creates risks for himself and his firm and restrictions on borrowing are a prudent method of limiting those risks.

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 recent 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."³

While SIA supports tightening the margin rules, the proposed rule change should be revised to ensure that firms are not unduly burdened by unrealistic and unworkable margin compliance requirements.

GENERAL COMMENTS

The Committees believe that the rule will place an unfair burden on firms that do not promote day trading. Many SIA member firms offer their customers an

electronic means of entering orders to buy and sell securities and some offer tools for faster delivery of orders and more in-depth information about current market conditions. However, virtually no member firm affirmatively promotes the use of its online service for repeated buying and selling in order to take advantage of moment-to-moment discrepancies in the price of a particular security. In the proposed day trading account opening rules, the NASDR sought to reduce the burden for firms that do not promote day trading by exempting them from the requirements of the rule. The Committees believe that the same logic should permit NASDR to provide similar exemptive relief in the margin context.

To the degree that any new regime is adopted, the Committees request that ample time be factored in to the implementation timetable. The proposed regulation will require firms to build the means to detect a specific pattern of trading (four inter-day purchases and sales of the same security over a five day period) in thousands, and perhaps millions of accounts on a constant basis. Once identified as a pattern day trader, an account may become subject to several different sets of margin rules, each with its own formula, and additional restrictions based on the account's ability to comply. The date chosen for implementation of the rule should reflect the amount of time that will be required to design, test and implement the necessary system changes. To this end, the Committees request an implementation date that is at least 180 days after the date the final rule appears in the Federal Register.

SPECIFIC COMMENTS

Definitions of Day Trading and Pattern Day Trader Rule 2520 (f)(8)(B)(i,ii)

The exception to the definition of "Pattern Day Trader" is not sufficient to cover institutional activities. Given the NASDR's stated goal of avoiding including institutions under this rule, it is surprising that the rule as drafted could still apply to institutions that trade four or more times in five business days (unless day trading activities exceeded 6% of total trading activity). Just programming and monitoring the 6% guideline to be eligible for the exemption will prove terribly burdensome for most institutions. The easiest way to achieve the NASDR's goal of exempting institutions from the rule is to borrow from what they have proposed in their day trading account opening procedures rule. In that rule proposal, the first paragraph of rule text makes clear that the rule applies only to "non-institutional customers" which are defined according to NASD Rule 3110(c)(4).

The exceptions to the definition of “Day Trading” should be revised 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.

Formula for Calculating Day Trading Buying Power (Rule 2520(f)(8)(B)(iii))

The Committees have no objection to the proposed formula.

Special Maintenance Margin requirement (Rule 2520(f)(8)(B)(iii))

The Committees have no objection to this requirement. However, firms that act as prime brokers which settle and clear transactions for customers that may execute trades at other firms, are responsible for ensuring that the customer’s account is in compliance with the relevant margin rules. A prime broker would not have access to records showing the time and tick of each trade executed “away” at another firm. Under the proposed rules, these records are necessary in order for a firm to use the “highest open position” method of calculating maintenance margin excess. The rule should be revised to provide prime brokers with another alternative to special maintenance margin calculation requirement. The Committees note that the NASD formula for calculating maintenance margin excess would allow for more leveraging than Regulation T formula for calculating excess.

\$25,000 Minimum Equity requirement for Pattern Day Traders (Rule 2520(b)(4) and (f)(8)(B)(4)a.)

The Committees have no objection to the minimum equity amount. However, the Committees are opposed to the provision imposing the minimum when a firm “knows or has reasonable basis to believe that customer will engage in pattern day trading.” The Committees think that this inappropriately shifts to the firm the burden of “predicting” whether a customer will engage in day trading. Of course, there is no way to predict such a thing. Moreover, what defense would a firm have against a customer who claims at a later date that the firm failed to pick up on an ambiguously conveyed intention to day trade? We think it is a far sounder

approach to impose the minimum equity amount when the customer has indicated in writing his or her intention to day trade.

Restriction on Pattern Day Traders who trade in excess of Day Trading Buying Power (Rule 2520 (f)(8)(B)(iv)b., c., e.)

The Committees believe that the restrictions should be streamlined. The rule would require a firm to immediately restrict a day trader's buying power to two times maintenance margin excess and remove the use of "time" and "tick" once the customer exceeds day trading buying power. Failure to meet the resulting day trading margin call within five days would require the firm to further reduce the customer's day trading buying power for 90 days or until the client satisfies the call. The system enhancements that will be required to monitor all accounts for trading in excess of day trading buying power, apply the required reduction in buying power during the five day period, and roll back or impose further restrictions on the account will be significant, complicated and costly. Furthermore, penalizing a customer during the margin call period is inconsistent with existing margin call regulations and practices, including both Regulation T and current SRO rules.

Revising or eliminating the restrictions that apply *during* the five day period would significantly reduce the cost and compliance problems faced by member firms. From a compliance standpoint, it would be far more efficient to impose just one set of long-term restrictions on an account once a customer exceeds day trading buying power. To the degree that the SEC disagrees with this position and retains any of the temporary restrictions in the final rule, it would be appropriate to give 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.

Requirement to deposit funds to meet Minimum Equity and Margin Maintenance requirements (Rule 2520(f)(8)(B)(iv)e.)

The Committees believe the SEC or NASDR may wish to clarify the kind of capital charge that a firm must take if a customer fails to meet the five day requirement. The NASDR should also define the term "cash available basis" for purposes of the rule.

Prohibition of cross-guarantees for Pattern Day Traders (Rule 2520(f)(8)(B)(iv)d.)

The Committees have no objection to the prohibition, but believe that the rule requires clarification as to when it trumps the right of a party to privately contract for a cross-guarantee.

CONCLUSION

The Committees support the goal of limiting the amount a leveraged day trading customer can borrow from his or her firm. We support many of the provisions proposed by the NASD as designed to serve that goal. However, we strongly believe the rules could be streamlined to reduce the technical and compliance burdens on member firms.

We also believe that in the interest of fairness and consistency, a firm that does not promote day trading should not be burdened by a separate margin regime for those customers that voluntarily choose to trade actively.

If we can provide any further information or clarification of the points made in this letter, please contact Scott Kursman, SIA Assistant General Counsel, at 212-618-0508.

Respectfully submitted,

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