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Morgan Stanley

February 11, 2025

Via E-Mail to pubcom@finra.org

Jennifer Piorko Mitchell
FINRA, Office of the Corporate Secretary
1735 K Street, NW
Washington, DC 20006-1506

Re: Financial Industry Regulatory Authority ("FINRA") 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:

Morgan Stanley Smith Barney LLC ("Morgan Stanley")[1] appreciates the opportunity to comment on the effectiveness and efficiency of the financial requirements relating to day trading or pattern day trading ("PDT"). Like other commenters, Morgan Stanley notes the significant technological and market structure changes that have occurred since the PDT rules were last amended in 2001 and strongly supports reform, particularly with respect to the PDT margin requirements under FINRA Rule 4210. Morgan Stanley believes that the overnight settlement and investor protection concerns that the current rules were designed to mitigate no longer pose the same risks they did over two decades ago, given advances in real-time risk monitoring systems and steep reductions in self-directed trading commissions.

Accordingly, similar to proposals put forth by other commenters, Morgan Stanley supports modernizing the PDT rules to permit broker-dealers with proven intraday risk monitoring programs to "opt out" of enforcement of the PDT requirements and instead subject clients to the regular Rule 4210

[1] Morgan Stanley operates leading wealth management and institutional franchises that facilitate a broad and deep range of investors' access to U.S. equity, listed options and fixed income markets. In particular, our wealth management franchise supports millions of client relationships through our advised, self-directed and workplace channels, including the E*TRADE from Morgan Stanley-branded self-directed channel ("E*TRADE"). Morgan Stanley's retail and institutional clients execute a significant volume of transactions in the U.S. equity, listed options, and fixed income markets each business day.

Morgan Stanley operates two primary service channels for its wealth management clients, including the Full-Service Channel and E*TRADE. Clients of the Full-Service Channel receive services from Morgan Stanley relating to the operation, servicing, and administration of their Morgan Stanley brokerage or advised accounts and the generation of orders for such accounts, including the services of a Financial Advisor. Conversely, customers of E*TRADE generally generate and enter orders themselves for their brokerage accounts based upon their own investment decision-making and without the benefit of the services of a Financial Advisor. Self-Directed Channel orders in Regulation National Market System ("NMS") equities are subject to E*TRADE's $0 commission policy, pursuant to which customers generally do not pay base commissions for order handling and execution of their E*TRADE NMS equities orders. Morgan Stanley maintains the accounts of thousands of PDTs on E*TRADE.

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non-PDT margin requirements. To the extent that the current rules remain in place in some form, Morgan Stanley supports changes to the rules to increase the number of "day trades" required to become designated a PDT, allow for dynamic intraday updates to day trading buying power calculations, decrease the minimum equity requirements, and clarify the PDT rules in the ways recommended below.

Background

FINRA Rule 4210(f)(8) defines "day trading" to mean the purchasing and selling or the selling and purchasing of the same security on the same day in a margin account except for positions held overnight and defines a PDT as a brokerage client who executes four-or-more day trades within five business days. Margin customers designated as PDTs who do not maintain at least $25,000 in equity in their accounts must be restricted from day trading until the minimum equity requirement of $25,000 is restored. PDTs may trade up to four times their maintenance margin excess as of the close of business of the previous day for equity securities but may not utilize the current intraday maintenance margin excess in their accounts beyond that held at the close of business the previous day (hereinafter referred to as day trading buying power ("DTBP")). If a PDT exceeds their DTBP limitation, the PDT's broker must issue a day trading margin call and the account must be restricted.

The current PDT rules were adopted in 2001 to stem risks to retail investors who were increasingly entering the markets through new online technologies in the dot.com stock trading era. The rules were designed to protect traders from high commissions and wide bid/ask spreads and to mitigate the overnight settlement risk inherent in a system supported by daily batch-processed position files and a three-day settlement cycle. The rules set minimum equity requirements to try to ensure that investors could sustain high commission charges and intraday losses in accounts that may be frequently "churned" or in which positions may be traded in and out of at high velocity. The rules further encourage high velocity traders to close their positions each day to stem overnight settlement risks by limiting the amount of trading that a PDT can do with equity from positions held overnight to previous end-of-day excess maintenance margin (but permitting a higher four times end-of-day margin excess leverage ratio than would otherwise be extended under Rule 4210 in an effort to encourage traders to reduce or eliminate overnight position risk).

Changes in Market Structure and Technology Over the Past Two Decades Warrant Change

- Reduced Settlement Risk and Diminished Need for Minimum Equity Requirements

The market structure and technology risks that the PDT rules were designed to mitigate in 2001 when the current PDT rules were adopted are largely no longer present in 2025. Whereas in 2001, brokers were essentially "blind" to changes in their clients' equity and positions until they received a net position file hours after the close of trading, advances in risk management systems and technology now allow brokers to track their clients' equity and positions in real-time and manage the associated risk intraday. Brokerages such as Morgan Stanley with self-directed online retail platforms such as E*TRADE now rely on tested automated real-time buying power systems that prevent investors from trading into margin calls and account deficits and employ risk management controls to exit or reduce client positions that pose outsized risk to clients, the firm, or the markets during market hours. Accordingly, the current rules seem to do little to mitigate unknown position and settlement risk in an

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environment where clients' positions and their margin equity and excess are constantly calculated, known, monitored, and controlled for by their brokers in real-time.

Further, the investor protection risks that the current rules were intended to mitigate have also largely subsided due to significant changes in online self-directed trading markets over the past 20 years. Whereas in 2001, online retail brokerage commissions were typically $20 or more per trade and retail investors had no access to the information or types of tools previously only available to institutional market participants, the proliferation or sophisticated online trading platforms and $0 retail trading commissions no longer require minimum equity requirements to protect investors. Online brokerages now make sophisticated tools and education materials readily available to clients. Retail orders route in milliseconds. Real-time buying power and balance calculations are constantly viewable and applied to transactions "in platform." Moreover, in the current environment of low to no trading commissions and ready access to markets, retail investors may have more legitimate strategic reasons than ever to day trade in certain circumstances, for example, to support dollar cost averaging their cost basis commission free, or to hedge short-term volatility using complex products and short-term expiring options intended for intraday use, among other reasons.

- Disparate Effects on Smaller Equity Account Holders, Investor Confusion, and Potential Thwarting of Rules' Original Purpose

Overwhelmingly, retail clients complain that the PDT rules do not protect them, but rather serve only to restrict them from using their own funds. As other commenters have noted, rates of inactivity, defunding, and account attrition among PDT accounts that enter minimum equity calls are exponentially higher than they are with respect to any other type of call in any other type of account. Both anecdotally and in fact, clients are dismayed at their inability to access their own funds in ways that they otherwise could in either a Federal Reserve Board Regulation T ("Regulation T") cash account or non-PDT margin account. Clients frequently complain that the rules restrict smaller equity account holders' access to the markets and ability to control their own financial decisions. Data show that as much as or more than 40% of self-directed clients designated PDT are immediately placed into minimum equity calls at Morgan Stanley for having less than $25,000 in equity in their accounts, and that in many cases, rather than meeting minimum equity calls, clients in minimum equity calls will simply move their accounts to other firms to reset their PDT designated status and access the equity in their accounts.

Moreover, consistent with fears expressed by the industry Task Force formed at FINRA's (formerly the NASD) recommendation in 2000 to evaluate the proposed day trading rules, anecdotal evidence suggests that the current rules may even encourage retail traders to unnecessarily increase overnight position risk, with some retail traders holding positions overnight to avoid closing a fourth day trade and being permanently designated a PDT.[2] To the extent that the rules may cause retail traders to incur additional overnight position risk to avoid their application, the PDT rules may thwart one of the primary risks they were originally intended to mitigate.

[2] *See* Exchange Act Release No. 34–44009, 66 FR 13608, 13613 (Mar. 6, 2001) (New York Stock Exchange, Inc., and National Association of Securities Dealers, Inc.; Order Approving Proposed Rule Changes Relating to Margin Requirements for Day Trading).

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The current rules are also seemingly overbroad in their application and confusing to retail investors. Despite robust disclosures, readily available educational materials, and in-platform "day trade counters" and rule application warning messages, Morgan Stanley's self-directed retail clients express significant confusion and dissatisfaction about the PDT rules. PDT clients frequently do not understand how they became designated PDTs and why their accounts may be restricted. Many PDT clients similarly do not understand the nuances of how to calculate DTBP, how their DTBP may be less than the available intraday buying power reflected in their accounts, why DTBP does not update throughout the day like regular buying power, or why the same funds that could otherwise be freely used in a cash account cannot be used in a margin account because of a lack of DTBP. Furthermore, the restrictive, complex, and in certain places ambiguous nature of the current rules has seemingly led to account transfers as PDTs move firms to remove their otherwise permanent PDT designations and forum shopping for disparate applications of the rules.

Data also show that very few PDTs actually engage in consistent day trading, which indicates that the current rules may be overbroad in their application. Overwhelmingly, the vast majority of self-directed PDTs at Morgan Stanley are designated PDT after they engage more actively in markets for a short period of time and then return to trading less regularly. As a result, the current rule applies to large numbers of retail traders who would more aptly be considered buy-and-hold investors and whose long-term overnight held positions restrict their ability to access margin or efficiently use the equity in their accounts. PDT clients who do not regularly day trade and have been permanently labelled PDTs are confused in situations where they may have hundreds of thousands of dollars in margin equity or margin excess in their accounts after holding positions overnight and/or selling an asset intraday but are restricted from using any of those funds because of their limited DTBP.

Proposal

Consistent with statements of other commenters, Morgan Stanley respectfully believes that the current PDT rules are outdated and in need of reform given market and technological developments over the past two decades since the current rules were adopted.[3] Morgan Stanley supports other commenters' calls for an alternative, updated version of the PDT rules that would allow firms with appropriate risk controls to forgo application of the current PDT rules on "opt out" basis.[4]

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[3] *See, e.g.,* Fidelity Investments comment letter to FINRA Regulatory Notice 24-13 - FINRA Requests Comment on the Effectiveness and Efficiency of its Requirements Relating to Day Trading (Jan. 28, 2025) (stating that "Fidelity strongly supports FINRA's retrospective review of the Rules given the dramatic changes to technology, the market environment, and brokerage customer behavior since the Rules were last updated more than two decades ago. In their current form, the Rules are outdated, unnecessarily complex, and more specifically, lead to investor confusion and operational inefficiencies without commensurate benefits."); Cboe Global Markets, Inc. comment letter to FINRA Regulatory Notice 24-13 - FINRA Requests Comment on the Effectiveness and Efficiency of its Requirements Relating to Day Trading (Jan. 28, 2025) (stating that "considering the technological advancements that allow firms to utilize real-time risk controls, the current Rule 4210 margin requirements for accounts that are deemed pattern day traders have become outdated. These requirements are no longer consistent with their original intent of protecting investors and clearing firms and fail to recognize that brokers now have robust, real-time risk control capabilities to block certain trades and limit risk.").

[4] *See, e.g.,* Charles Schwab & Co., Inc. comment letter to FINRA Regulatory Notice 24-13 - FINRA Requests Comment on the Effectiveness and Efficiency of its Requirements Relating to Day Trading (Feb. 3, 2025).

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Similar to other programs under Rule 4210 that allow firms that show appropriate controls to offer certain margin products,[5] the rules could permit firms that demonstrate effective controls for monitoring client trading and margin exposures on a real-time basis and for blocking client trading that exceeds permitted margin buying power on an intraday basis to opt out of imposing the PDT rules. Under this updated version of Rule 4210, firms could choose to forgo extending four-times clients' previous day end-of-day maintenance margin excess permitted under the PDT rules in favor of utilizing the initial and maintenance margin requirements in Regulation T and FINRA Rule 4210 that exist today for overnight buying power. Morgan Stanley believes that this alternative rule application would alleviate many of the issues with the current PDT rules raised above, particularly with respect to smaller equity account holders, while also mitigating the risks the PDT rules were intended to guard against. For firms without the ability to monitor client position risk intraday in the manner described above, the PDT rules would still apply.

Regardless of whether FINRA pursues an "opt out" amendment to the Rule 4210 PDT rules or not, Morgan Stanley would propose the following updates to the rules in light of market and technological developments since the current rules were adopted:

- Increase the Number of Day Trades Needed to Qualify for PDT Status: As noted above, data show that the current PDT rules apply to large numbers of retail traders who are not aptly classified as "pattern day traders." Rather, data show that the vast majority of day trades are made in PDT accounts that day trade frequently or as many as 11 times or more in their accounts in a given five trading day span. Accordingly, Morgan Stanley suggests that the number of day trades needed to become designated a PDT be raised from four in a given five-trading day span to 11, representing one more than two day trades per day on average over a five-trading-day span. Morgan Stanley believes this would reduce the number of designated PDTs by as much as 90% and focus the rules on accounts that actually engage in high velocity trading.

- Allow for Real-Time Intraday Adjustments to DTBP: To the extent that the current PDT rules stay in place, firms should at least be able to calculate position changes in real-time as they apply to DTBP such that clients can use their FINRA excess in the same way that other non-PDT margin clients can.

- Define Day Trade: With the prospect of more widespread 24-hour trading directly on the horizon, FINRA should, at a minimum, take steps to better define what constitutes a trading day for day trading purposes and better define a day trade should it elect to maintain the current PDT rules.

- Lower Minimum Equity Requirements: Morgan Stanley believes that changes to the current PDT rules are needed to alleviate restrictions on smaller account holders that no longer serve to mitigate the systemic and personal economic risks the PDT rules were intended to quell. Accordingly, consistent with the positions of other commenters and, in particular, individual public commenters, Morgan Stanley believes that the minimum equity

[5] *See, e.g.,* FINRA Rule 4210(b)(4) regarding Portfolio Margin Accounts.

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requirements ought to be reduced to permit smaller equity self-directed PDT account holders to use more of their own funds to control more of their own financial decisions.

- Clarify Rule Application: To the extent that the current PDT rules lack clarity in how firms must restrict PDT accounts in minimum equity calls, issue intraday DTBP calls, and other areas, FINRA should clarify the rules and ensure uniformity in their application.

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Morgan Stanley appreciates this retrospective review of FINRA's day trading rules and the opportunity to comment on Regulatory Notice 24-13. For the reasons set forth above, Morgan Stanley respectfully recommends that the pattern day trading margin requirements in Rule 4210 be updated in the manner described herein.

Sincerely,

Signed by:
Chad Turner
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Chad Turner
Managing Director, Wealth Management Administration
Morgan Stanley Smith Barney LLC