

Nov 12 Day Trading Rules hosted by Joel Blom

(jblom): Hello, everyone! Today I am going to talk about day trading margin rules. I will also talk about cash accounts, as they are like a special case of day trading accounts.

(jblom): The day trading rules were implemented in late 2001.

(jblom): Both the NYSE and NASD adopted identical rules to "control" day trading.

(jblom): At that time, customers could trade all they wanted to all day long (up to the risk limits imposed by firms) and go home flat without margin calls.

(jblom): On top of this was the environment which saw many equity traders suffer large losses.

(jblom): There were Congressional hearings and there was a general political consensus that some regulations needed to be implemented.

(jblom): The rules adopted in the fall of 2001 were the response.

(jblom): The rules are somewhat confusing and it has taken a while for all of us in the industry to see the implications of them.

(jblom): We recently implemented them on the TOS platform instead of relying on Penson to catch the margin calls.

(jblom): First, we need some definitions:

(jblom): A "day trade" is a trade that is opened and closed during a single trading day.

(jblom): A "pattern day trader" is a trader who makes 4 day trades in a 5 day period.

(jblom): We allow Penson to determine who is a pattern day trader. They send us a file daily with that information.

meo777: Who/what is penson?

(jblom): Penson is our clearing firm -- effectively the "bank" that holds our customers' funds and securities.

(jblom): Once an account is determined to be a pattern day trader, there are some new requirements.

(jblom): In order to continue to day trade, the account must have at least 25,000 of equity.

(jblom): Equity is equivalent to net liquidating value.

(jblom): In other words, once identified as a pattern day trader, a customer can only day trade in an account with over \$25,000 of equity.

tradingguy: are the requirements per account or per person? (i.e. one person can have many accounts with different brokers)

(jblom): The requirements are per account.

(jblom): Once identified as a pattern day trader, there is a limit set as to the total of new opening positions for the trading day.

tradingguy: so if I have 5 accounts with 5 different brokers I can trade once a day with each account and not be a pattern day trader?

(jblom): That is correct. Monitoring is per account.

prospector48: Once identified as a day trader, how long does that designation last? Until the running balance of day trades is below 4 day trades in 5 days?

(jblom): If you carry your positions overnight, they are not day trades. You will be a pattern day trader until it is clear that you are not one. There are no hard and fast rules, but 90 days is about right.

rosebud: How do you know if you have been designated by TOS as a day trader?

ft0502: So let's see; I've traded maybe 50 or 60 thousand contracts in the last 8 months, but because I made 4 day trades this week, I'm now a day trader for the next 90 days?

(jblom): If Penson designates you as a pattern day trader, you will see a Day trading buying power number in the upper left on your trading application.

(jblom): ft0502: That is correct, if Penson's system flags you.

(jblom): The day trading buying power is calculated as 4 times the excess over your maintenance margin.

jackgJAG: So day trader status could in a sense freeze trading in an IRA account?

(jblom): I will talk about cash accounts like IRA accounts later, as they are, in a sense, a special case.

(jblom): I will give some examples:

(jblom): First account: \$25,000 cash

(jblom): Stock buying power: $2 \times 25,000 = 50,000$

(jblom): Day trading buying power: $4 \times 25,000 = 100,000$

(jblom): I will talk about how the two interact after I give a more complex example.

(jblom): Second account: 25,000 cash and 30,000 in marginable stock.

(jblom): Stock buying power: $2 \times 25,000 + 2 \times 15,000 = 80,000$

(jblom): Remember, that we can loan 15,000 on 30,000 of stock.

(jblom): Day trading buying power: $4 \times 25,000 + 4 \times 22,500 = 190,000$.

(jblom): In this case, the maintenance margin on 30,000 of stock is 7,500, so the excess on the stock is 22,500.

(jblom): Given that this is how we arrive at the numbers, here is how they are used:

(jblom): 1) You always have the lesser of the regular buying power and your day trading buying power.

(jblom): 2) Your regular buying power does not change from the calculation you are accustomed to seeing. It goes down as you open positions and up as you close them.

(jblom): 3) The daytrading buying power is fixed before the trading day and only goes down as you open new positions. Closing positions will not affect it during that trading day. It only goes back up the next trading day.

(jblom): That is how your day trading buying power acts as a "governor" on trading. It sets an absolute limit based on size of account and buying power as to total new positions that can be opened.

(jblom): I stated earlier that cash accounts are a special case in these margin rules.

(jblom): You cannot use cash from closing trades to trade with the same day. It cannot be made available for trading until the following trading day.

(jblom): Therefore, we now use the day trading buying power for all cash accounts.

(jblom): It is equal to your option buying power at the start of the day. You can only open new positions up to the total of your beginning buying power in a cash account, no matter how many positions you close that day. The next day the funds are made available. This rule is not new, but we previously used Penson's systems to keep track of it.

(jblom): I know this is confusing, I can take more questions now.

mboenit: What is the calculation of day trade buying power for an IRA account?

(jblom): It is equal to your option buying power at the beginning of the day.

(jblom): It will not go up when you close positions until the next day. That is why we have to keep track of it separately.

yewter: it's the same as the cash account , you mentioned above?

(jblom): That is correct.

mbenoit: The current day trade buying power on my screen is exactly 10,000 less than the cash balance in my account?

(jblom): mbenoit - In a cash account it will be equal to your cash less your margin required at the start of the day.

hrhepner: do these rules apply to option trades or just stocks?

(jblom): These rules apply to both stocks and options.

(jblom): I know it is a pain to watch two buying power numbers, but the rules push us in this direction.

jackgJAG: Is there any consideration among the powers that hand down these rules for any alterations that you are aware of?

(jblom): I know of no changes contemplated to the day trading margin rules - no matter what the industry feels about them.

wacase: rosebud asked about getting day trade status removed. I too got tagged as a day trader. Is there some downside other than the two buyingpower calculations now shown?

(jblom): There is no real downside to being tagged as a pattern day trader, aside from the additional buying power calculation. Most people do not find that it interferes with their trading - unless they are real day traders.

(jblom): It certainly is not considered a negative to your account.

fre023: I have traded a number of butterflies on the same stock. when they are close in the same month, one butterfly cancels out part of another butterfly. Can I now be a Pattern Day Trader .

(jblom): Those trades will not make you a pattern day trader.

yewter: was the real intent of this legislation to derail daytrading and why? Was it for customer protection?

(jblom): At the same time there was a study that showed it was difficult to make money day trading small accounts. The rule is intended to effectively "protect people from themselves".

felixf: OK, but how many of those "less-than \$25,000" accounts started out much larger? Or vice-versa. Seems pretty arbitrary to me...

(jblom): felixf: Congress was originally talking about 50,000 and 25,000 was a compromise

xqz8cg: If I open and close a spread in one day, is it considered as 2 day trades or 4 day trades?

(jblom): Spreads are considered as single trades.

(jblom): I want to make sure to not lose jackgJAG's earlier question on the software.

(jblom): jackgJAG: We have two intermittent issues that can cause issues when legging into a spread.

(jblom): They are difficult to solve because they are intermittent. Sometimes you cannot sell against a long side because it thinks you are opening a new trade.

(jblom): Sometimes a GTC order is not looked at correctly for margin purposes while it is working. As soon as the root cause of both are isolated, we will release a fix.

(jblom): They are difficult to find because they are actually rare.

(jblom): It is easy to fix anything that happens every time.

(jblom): In the meantime you can contact the trade desk to make the trades. Also, we will use those examples to send our developers.

(jblom): I have time for a last question or two.

llangman: for the legging issue, it seems to me that they system always calculates full margin on the short leg initiated after the long one is open. In a taxable account, this is often not a lot more than the spread's margin, but in an IRA it uses of the full cost of the stock , e.g. for puts. Is this what you are referring to?

(jblom): That is what I am referring to, but it happens rarely and never in our test accounts (of course ;-))

wacase: jblom, your statements and answers are very clear and easy to follow. Enjoyed the chat!

jackgJAG: Thanks, jblom

lotz9ez: Thanks for showing us how to become a day trader by default. Very interesting information.

(jblom): Next week I plan to go over covered writes and collars.

(jblom): Good luck trading!

(jblom): Thanks, everyone!