Online Trading Commissions

Online Trading Commissions Overview

Online trading commissions are one of the most important factors a trader must consider when deciding where to conduct their trading activities. In recent years trading commissions have drastically been reduced as a result of the Internet and the number of brokers in the retail trading industry. As the number of brokers continues to increase in the global economy, this trend of lower commissions will continue.

History of Online Trading Commissions

Online trading took off in the late 1990s with the advent of the Internet. Prior to the Internet, traders would have to phone their broker in order to make a transaction. The high costs associated with making broker assisted trades, prevented traders from taking part in day trading. But with the internet, traders now had access to real-time quotes and charts which previously were only accessible by large banks. As more and more internet sites popped up offering their trading services, so began the battle over online commissions. Prior to the internet, traders were charged a per share fee. The online brokers took the first step in breaking this tradition by offering a flat fee for trades. Many traditional banks quickly followed by setting up trading sites, but were never able to match the speed or efficiency of companies like E-Trade or TD Ameritrade.

Types of Commission Structures

Online brokers offer a muttitude of trading vehicles. These include stocks, options, mutual funds, futures, and forex.

Most retail brokers do not offer access to futures and forex, but this is provided by direct access brokers.

Touchtone Commissions

Touchtone commissions occur when you call into an automated phone system to place an order. This will generally run you 2 to 3 times the flat rate for making an online trade. This should only be an option if you are unable to get to a phone, but do not want to pay the heftier price tag of talking directly to the broker.

Broker Assisted Commissions

A broker assisted commission occurs when you talk directly to the broker to make a trade. This will run about 4 to 5 times the normal rate for making a trade. This should only be an option when you are unable to make the trade online and you do not want to risk the additional time required to place the trade with the automated phone system.

Stock Commissions

Commissions for stocks are generally quoted at a flat rate or on a per share basis. Flat rates can range from $6.99 up to $29.99 and are the staple of retail brokers. The per share structure is offered by direct access brokers, since the majority of their clients are active traders. In this model a trader may pay .006 per share for the first 500 shares. Recently, direct access brokers such as IMB have begun to offer a hybrid commission structure of both flat rates and per share. Active traders are presented the option of selecting which commission structure they would like to use before the start of each day.

Options Commissions

Options are traded on a per contract basis. Each contract represents 100 shares of a stock. Commissions for options can run from $.7 to $1.25 per contract per side.

Mutual Funds Commissions

Mutual funds commissions are broken out into three categories: (1) no-load no-transaction fee, (2) no-koad funds, and (3) load funds. The no-load no-transaction fee is simply that, there are no commissions. The no-load funds have a fee for both opening and closing the trade. The fee for this is generally more expensive than an online equity trade, but is still cheaper than a broker assisted trade. Lastly for the load funds there is no fee to open the transaction, but there is a fee to close the trade. This fee is generally the same commission as a no-load fund trade.

Futures Commissions

Futures has a similar commission structure to options. The commission is charge on a per contract basis. This commission can range from $.2 to $1.20 per futures contract per side. Overall commissions for futures will be much less than stocks due to the fact each contract is worth significant money. Hence, you can trade “big” without paying a “big” commission.

Forex Commissions

With forex there are no trading commissions, you can only execute buys at the ask and sells at the bid. For example, with the EUR/USD, there is a 2 pip spread. So, if you want to buy 1 contract, you will have to buy at the ask. But, if you want to sell the EUR/USD immediately, you have to sell at the bid. For each trade, the broker is making $10 per pip, per contract. While you are not paying commissions in the traditional since, forex retail brokers are still making their money off the spread.

Which Commission Structure is Right for Me

The first step in determining where to open your brokerage account is to categorize yourself as an active trader or an investor. If you are an active trader, the best commission structure is with the direct access brokers, which offer per share commissions. However, if you are trading large sums of money, or only placing a few trades per year, it is better to trade with a traditional retail broker because you will end up saving money with the flat trade rate. Also, all direct access brokers have a platform fee and unless you trade a minimum number of shares, you will incur a monthly platform fee of $100 to $300.