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Via email to rule-comments@sec.gov  
Ms. Vanessa Countryman  
Office of the Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549

Re: Request for Information and Comments on Broker-Dealer and Investment Adviser Digital Engagement Practices, Related Tools and Methods, and Regulatory Considerations and Potential Approaches; Information and Comments on Investment Adviser Use of Technology to Develop and Provide Investment Advice; File No. S7-10-21

Dear Ms. Countryman:

The St. John's University School of Law Securities Arbitration Clinic (the "Clinic") thanks the Commission for the opportunity to comment on the Digital Engagement Practices ("DEPs") used by Broker-Dealers, and the associated regulatory considerations of these practices. The Clinic is part of the St. Vincent De Paul Legal Program, Inc., a not-for-profit legal services organization. The Clinic represents aggrieved investors with small dollar claims and is committed to investor education and protection.<sup>1</sup> Over the past year, the Clinic has experienced an uptick in intakes from retail investors with issues involving digital trading platforms. Additionally, law students working in the Clinic engage with retail trading apps themselves for their personal investments. Accordingly, the Clinic is uniquely situated to comment on these issues.

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<sup>1</sup> <https://www.stjohns.edu/law/about/places/securities-arbitration-clinic>.

As a society, we are in the midst of a technological revolution where almost any task imaginable can be completed through the convenience of a smart phone, and major innovation centers around “ease of use.” However, we are also living in a time where manipulating the actions of digital “users” has become a billion-dollar industry.<sup>2</sup> It is expected that Broker-Dealers would seek to incorporate convenience by delivering digital platforms that simplify the investment process to retail investors. However, when Broker-Dealers implement strategies to influence how users act while engaging with their digital platforms, they may be subject to regulatory constraints, and must ensure that investors are protected. The current regulatory scheme has strong, effective rules governing the actions and communications of Broker Dealers. From the Clinic’s perspective, the regulators must ensure these regulations are being adequately enforced when firms utilize DEPs.

The use of DEPs has been accompanied by, and is probably driving, a dramatic shift in which most new investors are younger, with lower incomes, than in the past.<sup>3</sup> Younger investors are typically more susceptible to market risks due to their inexperience and lower income investors are less able to withstand economic loss.<sup>4</sup> As a result, although Broker-Dealers are simplifying the investment process, they are engaging users who are less sophisticated and less able to withstand loss. Unfortunately, “[e]ase-of-use doesn’t necessarily translate to easily understanding what you are trading,” particularly for novice investors.<sup>5</sup>

Additionally, the firms also have the ability to heavily influence the investment activity of their users through predictive analytics and machine learning models.<sup>6</sup> Students in the Clinic have observed firms that grant free stock in a random company as a prize for signing up with the platform.<sup>7</sup> This “gift” is a way to get new investors to open an account with the company, and likely triggers the social norm of reciprocity, the

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<sup>2</sup> Eric Vardon, *Five Emerging AI Trend To Watch In 2020*, FORBES (Jan. 13, 2020), <https://www.forbes.com/sites/forbesagencycouncil/2020/01/13/five-emerging-ai-trends-to-watch-in-2020/?sh=6f1e609417ad>; Louis Columbus, *Roundup of Machine Learning Forecasts And Market Estimates, 2020*, FORBES (Jan. 19, 2020), <https://www.forbes.com/sites/louiscolumbus/2020/01/19/roundup-of-machine-learning-forecasts-and-market-estimates-2020/?sh=6d7fd4e5c02>.

<sup>3</sup>FINRA INVESTOR EDUCATION FOUNDATION AND NORC REPORT, *INVESTING 2020: NEW ACCOUNTS AND THE PEOPLE WHO OPENED THEM* (Feb. 2021), [https://www.finrafoundation.org/sites/finrafoundation/files/investing-2020-new-accounts-and-the-people-who-opened-them\\_1\\_0.pdf](https://www.finrafoundation.org/sites/finrafoundation/files/investing-2020-new-accounts-and-the-people-who-opened-them_1_0.pdf)

<sup>4</sup> See Nathaniel Popper, *Robinhood Has Lured Young Traders, Sometimes With Devastating Results*, NEW YORK TIMES (July 8, 2020), <https://www.nytimes.com/2020/07/08/technology/robinhood-risky-trading.html>; Alicia Adamczyk, *Trading apps like Robinhood are having a moment. But users should be careful*, CNBC MAKE IT (Aug. 21, 2020), <https://www.cnbc.com/2020/08/21/robinhood-is-having-a-moment-users-should-be-careful.html>.

<sup>5</sup> Adamczyk, *supra* note 4.

<sup>6</sup> *Id.*

<sup>7</sup> See e.g., Robinhood, *Open an Account, Get Free Stock*, <https://robinhood.com/us/en/support/articles/open-account-get-free-stock/>; Coinbase, *Earn BTC by verifying your new account*, <https://help.coinbase.com/en/coinbase/getting-started/getting-started-with-coinbase/new-customer-incentive>; Firsttrade, *Join Now, Get 2 Free Stocks*, <https://www.firsttrade.com/content/en-us/promos/promotion/>; see generally <https://www.biblemoneymatters.com/how-to-get-free-stock/>.

natural inclination to repay for gifts that have been given to us.<sup>8</sup> This repayment is most obviously satisfied by engagement with the application, and the placing of trades. Another similar prize promotion used to increase many platform's customer bases is the "invite a friend, get free stock" promotion.<sup>9</sup> Due to social spheres, younger, inexperienced investors are most likely to refer other younger, inexperienced investors. Similarly, lower income investors are more likely to refer other lower income investors while also being more susceptible to the allure of free stock.

It is unclear whether younger and lower income investors are engaging with the DEPs because they are more likely to use smartphone applications versus web browsers or because they are being actively solicited to engage with the DEPs through advertisements. Regardless of how the investors get to the DEPs, the result is that the marketing and promotional strategies utilized by firms are targeting inexperienced and vulnerable investors. In some circumstances, firms are actively targeting younger investors. For example, one firm encourages users to "help a student learn to invest, and you could win \$20,000.00" promotion that only works if the person refers someone utilizing a university (.edu) email address.<sup>10</sup>

In addition to utilizing practices to encourage users to sign up for an account, current customers of firms are prompted to make recurring trades on a regular basis to steadily grow the investor's holdings over time. Other features may include animations when a milestone is reached; social networking tools; prizes or rewards for activity streaks; points, badges, and leaderboards; lists of popular stocks; and push notifications.<sup>11</sup>

These DEPs raise significant concerns. Online day trading may be indistinguishable from online gambling, with investors exhibiting many of the same habits as gamblers including the inability to set and stick to limits.<sup>12</sup> Investors may forge ahead, not paying attention to trends, research, or the level of risk to which they are

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<sup>8</sup> See Shana Lebowitz, Allana Akhtar, and Marguerite Ward, *61 cognitive biases that screw up everything we do*, INSIDER (May 5, 2020), <https://www.businessinsider.com/cognitive-biases-2015-10>. See also, FINRA, Avoid Fraud, <https://www.finra.org/investors/protect-your-money/avoid-fraud>.

<sup>9</sup> See e.g., Robinhood, Invite Friends, Get Stock, <https://robinhood.com/us/en/support/articles/invite-friends-get-free-stock/>; Firstrate, Refer Friends Get Free Stocks, <https://www.firstrate.com/content/en-us/promos/freestock>.

<sup>10</sup> Peter Rudegair and Caitline McCabe, *Robinhood Is Going on a College Tour to Recruit Customers*, WALL ST. J. (Sept. 15, 2021), <https://www.wsj.com/articles/robinhood-is-going-on-a-college-tour-to-recruit-new-customers-11631703600>; Robinhood, Robinhood's \$20,000 College Giveaway Sweepstakes, <https://robinhood.com/us/en/support/articles/20k-college-giveaway-sept-2021/>.

<sup>11</sup> See Robert Cook, *Statement Before the Financial Services Committee, U.S. House of Representatives* (May 6, 2021); see also Annie Massa and Tracy Alloway, *Robinhood's Role in the 'Gamification' of Investing*, BLOOMBERG WEALTH (Dec. 19, 2020), <https://www.bloomberg.com/news/articles/2020-12-19/robinhood-s-role-in-the-gamification-of-investing-quicktake>; Mass. Office of the Secretary of the Commonwealth Securities Div., In re Robinhood Financial, LLC, Docket No. E-2020-0047 (Dec. 16, 2020), <https://www.sec.state.ma.us/sct/current/sctrobinhood/MSD-Robinhood-Financial-LLC-Complaint-E-2020-0047.pdf>.

<sup>12</sup> Cyrus Farivar, *Gambling addiction experts see familiar aspects in Robinhood app*, NBC NEWS (Jan. 30, 2021), <https://www.nbcnews.com/business/business-news/gambling-addiction-experts-see-familiar-aspects-robinhood-app-n1256213>.

exposed.<sup>13</sup> Stock trading can be addictive, even without DEPs.<sup>14</sup> By using DEPs, the effects might be heightened.<sup>15</sup> Additionally, the use of DEPs may make investing “fun,” but also cause investors to get in way over their heads because it fails to instill the appropriate level of caution in younger, inexperienced investors.<sup>16</sup> Investors may not fully understand the costs and risks of trading. For example, a 2016 study demonstrated that 80% of day traders lost money over the course of a year, with losses averaging 36%.<sup>17</sup> These losses may be particularly upsetting for young traders. One trader, Alex Kearns, took his own life after he mistakenly believed he owed the brokerage firm over \$700,000 for trading losses.<sup>18</sup>

Further, younger investors are more likely to be influenced by social media. One study from 2017 found that social media influenced the shopping of 80% of Gen Zers and 74% of Millennials.<sup>19</sup> Almost 15% of new investors said they get information from social media when making investment decisions, and 10% said they get information from online chats.<sup>20</sup>

Broker-Dealers utilizing DEPs are incentivized to encourage more trading by their users to boost profitability for the company. In 2020, FINRA began a targeted examination of the practices of firms not charging commissions, including the practice of payment for order flow.<sup>21</sup> FINRA has expressed concerns about whether the “zero-commission” model may adversely affect firms’ compliance with their best execution obligation.<sup>22</sup>

Investors may be negatively impacted by these practices in a number of ways. The Clinic has received intakes from investors who have had negative experiences with online Broker-Dealers utilizing DEPs. For example, investors have not understood that they signed up for margin trading on their account until they engaged in trading which triggered the use of margin. Investors have also engaged in complex options trading

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<sup>13</sup> Kassem Lahham, *How the Next Generation of Investors are Gamifying Investing*, NASDAQ (Dec. 17, 2020), <https://www.nasdaq.com/articles/how-the-next-generation-of-investors-are-gamifying-investing-2020-12-17>.

<sup>14</sup> Nizan Geslevich Packin, *Securities Trading For Children: Sound Investment Education Or An Early Gambling Addiction?*, FORBES (June 8, 2021), <https://www.forbes.com/sites/nizangpackin/2021/06/08/securities-trading-for-children-sound-investment-education-or-an-early-gambling-addiction/?sh=3657b46156ee>.

<sup>15</sup> *Id.*

<sup>16</sup> *Id.*

<sup>17</sup> *Id.*

<sup>18</sup> Sergei Klebnikov and Antoine Gara, *20-Year-Old Robinhood Customer Dies By Suicide After Seeing A \$730,000 Negative Balance*, FORBES (June 17, 2020), <https://www.forbes.com/sites/sergeiklebnikov/2020/06/17/20-year-old-robinhood-customer-dies-by-suicide-after-seeing-a-730000-negative-balance/?sh=2c617c001638>.

<sup>19</sup> Cara Salpini, *Study: 80% of Gen Z purchases influenced by social media*, Retail Dive (July 17, 2017), <https://www.retaildive.com/news/study-80-of-gen-z-purchases-influenced-by-social-media/447249/>.

<sup>20</sup> FINRA/NORC Study, p. 14, *supra* note 3.

<sup>21</sup> FINRA, Targeted Examination Letter on Zero Commissions (Feb. 2020), <https://www.finra.org/rules-guidance/guidance/targeted-examination-letters/zero-commissions>.

<sup>22</sup> FINRA, 2021 Report on FINRA’s Examination and Risk Monitoring Program (Feb. 1, 2021), <https://www.finra.org/rules-guidance/guidance/reports/2021-finras-examination-and-risk-monitoring-program>.

after being encouraged by the firms through their purported educational materials that options trading is easy or has low risk. However, they have ended up facing significant losses because they did not actually understand the risks to which they were exposed by the options strategies utilized. Investors have also experienced service interruptions, either because the firm's platform went down, trading was halted for some reason, or because their account was frozen due to a suspected cyber-breach. Generally, when these issues arise, it is very difficult for the investor to speak to someone at the firm to receive guidance, instructions, or explanations.

Investors dealing with online Broker-Dealers are particularly vulnerable. Historically, investors would communicate with the Broker-Dealer through a financial advisor. In this way, investors obtain a significant amount of investor education through their relationship with and communications with their financial advisor. Financial advisors are explaining their advice to their customers, and customers have had the ability to ask their financial advisors to explain or clarify terms and strategies. There are a number of issues with respect to how younger investors obtain information when dealing primarily with an online Broker-Dealer. First, many platforms do not provide a person to whom an investor can ask follow-up questions if they do not understand something. Further, because the investor is not interacting with a financial advisor, they may not even realize that they do not understand the firm's written materials. This is more likely to become evident if they are conversing with a financial advisor. This makes the written communications so much more important, because investors must be able to understand the materials and accomplish their goals wholly on their own.

Additionally, online Broker-Dealers exercise a great degree of control over investor actions, as they nudge users towards higher frequency trading and risky trading through the use of various DEPs, machine learning and predictive analytics.<sup>23</sup> However, online Broker-Dealers may have the perception that they are not subject to the same regulations that traditional brokerage firms are because they do not believe that the behavioral nudges constitute recommendations.<sup>24</sup>

To a large extent, the existing rules and guidance in place do encompass these practices. The concerns raised today about online trading and DEPs echo concerns raised by then-SEC Chairman Arthur Levitt in 1999.<sup>25</sup> Chairman Levitt recognized that a firm's obligations do not change even though their platforms have changed:

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<sup>23</sup> Adameczyk, *supra* note 4.

<sup>24</sup> See *e.g.*, Complaint for Injunctive and Declaratory Relief, Robinhood Financial v. Galvin, Civil Action No. 2184 CV 00884 BLS (Apr. 15, 2021) (brokerdealers' only duty in regard to self-directed accounts is to execute customers' orders), <https://cdn.robinhood.com/assets/robinhood/legal/complaint-for-injunctive-and-declaratory-relief.pdf>.

<sup>25</sup> See Arthur Levitt, Chair, Sec. Exch. Comm'n, Remarks to the National Press Club, Plain Talk About On-Line Investing (May 4, 1999), [http://3197d6d14b5f19f2f440-5e13d29c4c016cf96cbbfd197c579b45.r81.cf1.rackcdn.com/collection/papers/1990/1999\\_0429\\_LevittDraftT.pdf](http://3197d6d14b5f19f2f440-5e13d29c4c016cf96cbbfd197c579b45.r81.cf1.rackcdn.com/collection/papers/1990/1999_0429_LevittDraftT.pdf).

The laws regulating our markets are a product of the New Deal era. To me, their concepts are as immutable as the Constitution. They have weathered challenge after challenge, decade after decade, and are every bit as relevant and effective today as they were the day they were written. Companies offering their shares -- whether off a website or through a prospectus -- still have to disclose what they are selling and why. Brokers -- whether traditional or on-line -- still have the same obligations to their customers. And fraud -- whether perpetrated over the Internet, on the phone, or in-person -- is still fraud.<sup>26</sup>

Chairman Levitt raised concerns about the influx of new and inexperienced investors trading inconsistently with their goals and risk tolerances.<sup>27</sup> He recognized that as firms grow, their ability to provide effective customer service must keep pace.<sup>28</sup> He emphasized that firms have an obligation of best execution, regardless of how the trade has been placed.<sup>29</sup> He also raised concerns about the clarity of communications, and the accuracy of advertising.<sup>30</sup> These same concerns are echoed today by the Commission, FINRA, and the state regulators.

The existing rules must be enforced, and guidance must be updated to ensure firms understand their behavior is subject to the existing regulations. Further, the guidance should be updated to explicitly capture the technological advancements that may be exploited by online Broker-Dealers. For example, FINRA and the Commission have provided guidance as to what constitutes a “recommendation” for purposes of determining when the FINRA Suitability Rule and Regulation Best Interest apply to a communication.<sup>31</sup> In Notice to Members 01-23, FINRA explained how to determine whether a communication was a “recommendation:”

[T]he “facts and circumstances” determination of whether a communication is a “recommendation” requires an analysis of the content, context, and presentation of the particular communication or set of communications. The determination of whether a “recommendation” has been made, moreover, is an objective rather than a subjective inquiry. An important factor in this regard is whether—given its content, context, and manner of presentation— a particular communication from a broker/dealer to a customer reasonably would be viewed as a “call to action,” or suggestion that the customer engage in a securities transaction. Members should bear in mind that an analysis of the content, context, and manner of presentation of a communication requires examination of the underlying substantive

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<sup>26</sup> *Id.*

<sup>27</sup> *See id.*

<sup>28</sup> *See id.*

<sup>29</sup> *See id.*

<sup>30</sup> *See id.*

<sup>31</sup> *See* Regulation Best Interest: The Broker-Dealer Standard of Conduct, 84 Fed. Reg. 33,318, 33,335 (July 12, 2019); FINRA, NOTICE TO MEMBERS 01-23, ONLINE SUITABILITY (Apr. 2001), <https://www.finra.org/rules-guidance/notices/01-23>.

information transmitted to the customer and consideration of any other facts and circumstances, such as any accompanying explanatory message from the broker/dealer. Another principle that members should keep in mind is that, in general, the more individually tailored the communication to a specific customer or a targeted group of customers about a security or group of securities, the greater likelihood that the communication may be viewed as a “recommendation.”<sup>32</sup>

FINRA went on to describe certain communications which were likely to be deemed recommendations:

- An email or pop-up to a targeted customer or targeted group of customers encouraging the purchase of a security;
- A list of stocks accompanied by a request that the customer purchase one or more stocks on the list;
- A portfolio analysis tool that provides a list of specific securities the customer could buy or sell to meet the investment goals the customer has inputted; and
- Sending or pushing specific investment suggestions following the firm’s use of data mining technology to analyze a customer’s financial or online activity.<sup>33</sup>

Pursuant to the “facts and circumstances” test set forth by FINRA and adopted by the Commission, many of the DEPs should be deemed to be recommendations. If they were, investors would receive the protections of either the FINRA Suitability Rule or Regulation Best Interest. It may be helpful for the Commission to reissue FINRA’s prior guidance, with an update that makes it clear what DEPs may be deemed recommendations, similar to the examples FINRA previously provided.

FINRA has also made it clear that the communications rules apply regardless of the platform utilized by the firm and has provided some guidance with respect to communicating via social media.<sup>34</sup> However, some of the online Broker-Dealers utilize layered communications which may create challenges in complying with the communication standards. The entirety of the firm’s message may not fit the character parameters of a standard tweet, but the firm may strategically include just enough information to draw interest and then use hyperlinks to direct the user to additional information. To the extent layered communications will be utilized, the Commission could offer further guidance as to what sorts of layering are effective and permissible. It is not sufficient to have provided the important information in a link if there is little likelihood that the link will be clicked.

The Commission may also consider what information it makes available about online Broker-Dealers. Through BrokerCheck, FINRA makes limited information available about firms. For example, FINRA makes available certain information filed on

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<sup>32</sup> FINRA, NOTICE TO MEMBERS 01-23, *supra* note 31.

<sup>33</sup> *Id.*

<sup>34</sup> See FINRA, REGUL. NOTICE 19-31, ADVERTISING REGULATION (Sept. 19, 2019), <https://www.finra.org/rules-guidance/notices/19-31>.

the Form BD and BDW, as well as certain information about arbitration awards.<sup>35</sup> The Commission has also requires other information be disseminated through the Form CRS.<sup>36</sup> However, this may not be the information most relevant to an investor when assessing whether to do business with an online Broker-Dealer. The Commission may consider a separate disclosure, similar to the Form CRS, but which includes information relevant to those engaging the services of an online Broker-Dealer, such as (i) the primary method of interacting with customer service, including whether the firm offers live assistance and how to engage with live assistance; (ii) the services that the firm makes available to investors and whether there are restrictions or limitations on the services; (iii) whether there have been investor complaints associated with online specific issues, such as trading outages or cybersecurity issues; (iv) whether the firm has an early dispute resolution program; and (v) what benefits the firm receives from investor trading.

The Commission may also consider requiring online Broker-Dealers to include a prominent link to the Commission's, FINRA's, and NASAA's investor education sites and social media handles. FINRA already requires that firms include a link to BrokerCheck on "(i) the initial webpage that the member intends to be viewed by retail investors; and (ii) any other webpage that includes a professional profile of one or more registered persons who conduct business with retail investors."<sup>37</sup> The Commission may require that firms include the investor education links in the same manner, and may require that firms that are active on twitter or other social media platforms disseminate the links via the social media platforms no less frequently than once a month or quarter.

The Commission may ultimately promulgate new rules to address unique features of DEPs or amend existing rules to address new technology and communication practices. However, as noted by Chairman Levitt, brokerage firms offering self-directed trading services through digital platforms are still subject to existing rules and standards applicable all Broker-Dealers. Accordingly, investors may receive immediate protections if the Commission makes it clear that these existing obligations apply, even in the context of self-directed trading and regardless of whether the firms utilize DEPs.

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<sup>35</sup> FINRA Rule 8312.

<sup>36</sup> Sec. Exch. Comm'n, SEC Adopts Rules and Interpretations to Enhance Protections and Preserve Choice for Retail Investors in Their Relationships With Financial Professionals (June 5, 2019) (Firms will summarize information about services, fees and costs, conflicts of interest, legal standard of conduct, and whether or not the firm and its financial professionals have disciplinary history.), <https://www.sec.gov/news/press-release/2019-89>.

<sup>37</sup> FINRA Rule 2210(d)(8).

The Clinic thanks the Commission for the opportunity to comment on these important issues. To the extent any further information is helpful, please feel free to contact us.

Respectfully submitted,

/s/

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/s/

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