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[redacted]

October 1, 2021

Via email: rule-comments@sec.gov
Ms. Vanessa A. Countryman
Secretary, Securities and Exchange Commission
100 F Street, Suite NE.,
Washington, DC, 20549-1090

Re: Release No. 34-92766; File No. S7-10-21
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

Dear Ms. Countryman:

The University of Miami School or Law Investor Rights Clinic ("IRC") appreciates the opportunity to comment on the U.S. Securities and Exchange Commission's ("SEC") review of digital engagement practices ("DEPs") and corresponding regulatory considerations. As the only *pro bono* organization in Florida assisting investors of modest means, the IRC has experienced a sharp increase in clients and prospective clients who suffered losses in their accounts with digital platforms that use DEPs. The IRC shares the SEC's interest in concerns raised by digital platforms and DEPs and urges the SEC to consider regulation to enhance supervisory review of customer account openings and to consider application of Regulation Best Interest to the use of online engagement practices that constitute recommendations.

Over the last two years, there has been a significant spike in new entrants into the stock market.[1] A recent study by Charles Schwab revealed that fifteen percent of all investors in the U.S. market entered in 2020, and the median age of the new entrants is more than a decade younger than those who began investing before then.[2] Brokerage firms' use of DEPs, particularly through mobile trading apps, are significantly changing the investing landscape. Barriers to entry for retail investing have fallen, as firms offer low- or zero-commission trading, no minimum

[1] Maggie Fitzgerald, *A Large Chunk of the Retail Investing Crowd Started During the Pandemic, Schwab Survey Shows*, CNBC (Apr. 8, 2021), https://www.cnbc.com/2021/04/08/a-large-chunk-of-the-retail-investing-crowd-got-their-start-during-the-pandemic-schwab-survey-shows html.
[2] *Id.*

balance accounts, and the opportunity to trade fractional shares.[3] It is estimated that at least thirteen million people started investing for the first time during 2020.[4] Thirty-eight percent of new accounts were opened by investors under the age of 45 who did not own other investment accounts before 2020.[5] These investors have lower incomes and come from more racially and ethnically diverse backgrounds.[6] They are also the class of investors that has been impacted the most by DEP investment strategies.

The IRC believes that the widespread availability of zero-commission trading, the rapid growth in customers using digital platforms, and the increasing sophistication of DEPs raise significant concerns for the protection of a new generation of investors and for scrutiny of the practices of digital platforms using DEPs, as further detailed in the IRC's comments to the below questions selected from the SEC's request for information and comments.

1.13: To what extent and how have DEPs enabled retail investors to access specific investments or investment strategies more quickly and/or with less investing experience than under traditional methods?

The majority of investors now access their accounts through mobile apps—apps which are designed to induce new users to impulse-buy.[7] The use of DEPs is more about optimizing certain styles of engagement rather than selling hallmark investments.[8] Through specific "gamification" features, DEPs are intended to influence investor behavior, specifically, by encouraging investors to trade more and to engage in riskier trading strategies.[9] Data collected by FINRA shows that new investors with accounts opened in 2020 trade more frequently than other investors. For example, while 56 percent of investors who access their accounts through a mobile app make one to three trades per month, 45 percent (a plurality) of investors who access their accounts from websites make no trades in a single month.[10] Another core feature of gamification is the promise of gifts, winnings, and general free earnings. For example, Robinhood gives users free stock for joining the app—an enticement to join and trade.[11]

Moreover, DEPs engage with investors by offering a customizable interface using research or analytics that can teach inexperienced investors how to trade using riskier strategies.

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[3] FINRA Investor Education Foundation and NORC Report, Investing 2020: New Accounts and the People Who Opened Them, at 1(Feb. 2021) (hereinafter, "FINRA/NORC Study"), https://www finrafoundation.org/sites/finrafoundation/files/investing-2020-new-accounts-and-the-people-who-opened-them_1_0.pdf.

[4] Polly Jean Harrison, *Forget Gamestop, Gamification Is the Real Investing Revolution*, THE FINTECH TIMES (Feb. 25, 2021), https://thefintechtimes.com/forget-gamestop-gamification-is-the-real-investing-revolution/.

[5] *See* FINRA/NORC Study, *supra* note 3, at 2.

[6] *See* FINRA/NORC Study, *supra* note 3, at 2.

[7] Mark Wilson, *How Robinhood turns stock trading into a game that it always wins*, FAST COMPANY (Feb. 09, 2021), https://www fastcompany.com/90602455/how-robinhood-turns-stock-trading-into-a-game-that-it-always-wins.

[8] *Id.*

[9] Robert W. Cook, President and Chief Executive Officer, FINRA, Statement Before the Financial Services Committee U.S. House of Representatives (May 6, 2021), https://www finra.org/media-center/speeches-testimony/statement-financial-services-committee-us-house-representatives.

[10] *See* FINRA/NORC Study, *supra* note 3, at 11.

[11] Wilson, *supra* note 7.

Among the offerings are short video clips; “Live News,” that includes finance headlines pulled from various sources; and “Trader TV,” a series of webcast videos that promotes options and margin trading strategies.[12] TD Ameritrade’s “thinkorswim” has 11 million client accounts with over $1 trillion in assets, which is aimed to help beginning traders learn how to use the platform before using real cash accounts.[13] But because the “thinkorswim” learning account interface mimics account user’s real money accounts, clients can and, in our experience, have confused the two.

Further, the ease and speed with which online brokerage firms open accounts is significantly greater than traditional methods, with less of a hands-on approach.[14] Generally, online accounts are opened and approved in less than one day and investors can begin trading that same day.[15] Specific securities and strategies, like options trading and margin accounts, are extended to investors–who do not understand the terminology–with just a few additional questions. As a result, investors are engaging in complex trading practices more quickly and doing so in reliance on the online firms’ approval of their accounts. Together with the surge in customers of online brokers, the Clinic has experienced a sharp increase in prospective clients who have little to no investment experience yet receive same-day approvals for margin and option trading in their digital platform accounts.

1.14: What trading or investment activities are retail investors engaging in through digital platforms that use DEPs? For retail investors who were investing prior to using digital platforms that use DEPs, how have their activities with respect to trading and investing changed since they started using such platforms and/or were first exposed to DEPs? How often do retail investors engage in trading or investing through such platforms? How do retail investors learn of these platforms (e.g., news coverage, social media, internet search, paid advertisements)?

Digital platforms that utilize DEPs, especially those that follow the integration techniques in social networking such as competition, badges, and other visual rewards, have yielded a trading surge.[16] Investing has become almost a hobby, with greater availability to younger and more ethnically/racially diverse individuals motivated to plan for retirement.[17] DEPs attract and encourage new investors with limited investment knowledge and experience who may be influenced to take risks they do not appreciate, such as purchasing a meme stock hyped by social media. Many in this new class of retail investors act under a short-term philosophy, quick to buy and perhaps quicker to sell, heavily swayed by the overwhelming amount of information surrounding each potential investment.[18]

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[12] Julia Glum, *Thinkorswim for Beginners: A Guide to Trading on the High-Tech TD Ameritrade Platform*, MONEY (June 22, 2021), https://money.com/how-to-use-thinkorswim-beginners/.

[13] *See Trading features in thinkorswim*, AMERITRADE, https://www.tdameritrade.com/futures/education-and-resources/placing-futures-trades/trading-futures-in-thinkorswim.html.

[14] *See FAQs: Opening*, AMERITRADE, https://www.tdameritrade.com/account-types/faqs-opening.html.

[15] *Id.*

[16] *The New Wave of Individual Investors*, MARCUS: BY GOLDMAN SACHS (Feb. 5, 2021), https://www.marcus.com/us/en/resources/heard-at-gs/stock-traders.

[17] *See* FINRA/NORC Study, *supra* note 3, at 2.

[18] *See* Wilson, *supra* note 7.

An entertainment ecosystem has risen parallel to online brokerages—particularly TikTok videos and Reddit message boards—to offer a market highlight reel that influences the decisions of new retail investors and keeps the public investing for longer with a casual disregard for losses.[19] Additionally, investors battle with the urgency conveyed by the platform's user interface that stirs up an "interface-invented stress."[20] The goal of these digital platforms is to sell investors more stocks more often, even when academic research has shown that "play time" has a negative correlation to performance.[21] The Robinhood app shows as green to soothe the user when the account is up, but when the investor's portfolio is down, the whole app shows red and incites a "fight-or-flight" response. Robinhood then feeds the user, in this time of "despair," opportunities to buy.[22] Investors who access their accounts primarily through mobile apps report more frequent trading, not because investing is more attractive to the mobile trader, but because these mobile apps create a marketplace that is addictive and tied to user emotions.[23] As one industry observer wrote, "[Robinhood] swaps poise, patience, and other hallmarks of careful investment for hyperbole, celebration, and immediate gratification."[24] The algorithms of digital platforms capitalize on the app's novice users to encourage market participation regardless of an individual's investment objectives or risk tolerance.[25]

1.17: Are there significant investor protection concerns that arise from the use of DEPs generally or particular DEPs?

Although mobile trading apps and DEPs have played a role in attracting new retail investors and encouraging them to invest for their futures, significant investor protection concerns remain. It should be acknowledged that the technological innovations on trading platforms provide easier access to investing in securities, present lower costs to investors, and offer educational information on a wide range of investment opportunities. These benefits of DEPs must be weighed against the significant investor protection concerns that these practices raise, especially for inexperienced investors. For example, unlike in a traditional brokerage setting where a financial professional may guide an inexperienced investor, DEPs are designed to encourage or facilitate trading without providing investment advice. Because of the ease of access of such DEPs, there is significant concern regarding whether such practices encourage investors to engage in higher risk trading strategies.

DEPs, such as those found in mobile games like badges, notifications, and celebrations, that create a sense of satisfaction and attention can incite frequent trading, a trading approach that is not necessarily consistent with a longer-term strategy. Moreover, DEPs may prompt inexperienced investors to trade in strategies or securities that expose them to higher risks than

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[19] Annie Massa & Tracy Alloway, *Robinhood's Role in the 'Gamification' of Investing*, BLOOMBERG WEALTH (Dec. 19, 2020), www.bloomberg.com/news/articles/2020-12-19/robinhood-s-role-in-the-gamification-of-investing-quicktake.
[20] *See* Wilson, *supra* note 7.
[21] Ben Soppit, *The Gamification of Investing Brings Opportunity—And Risks*, FORBES (Jan. 8, 2021), https://www.forbes.com/sites/forbesbusinesscouncil/2021/01/08/the-gamification-of-investing-brings-opportunity--and-risks/?sh=3079649cc08e.
[22] *See* Wilson, *supra* note 7.
[23] *See* FINRA/NORC Study, *supra* note 3, at 11.
[24] Wilson, *supra* note 7.
[25] *See* Cook, *supra* note 9.

appropriate for their profile. When DEPs like social networking ads oversimplify a complicated or risky investment or strategy, a new investor may be unable to understand the relative risk of that investment or strategy. We are also concerned that certain communications made through DEPs may encourage trading in a way that is similar to a recommendation, but would not be subject to the requirements of Regulation Best Interest.

DEPs can have an exceptionally strong impact on the investment decisions of new investors with little or no investment knowledge. A FINRA found that a significant minority of new investors self-assessed themselves to have very low/low investment knowledge.[26] Moreover, in an objective financial investment evaluation, new investors scored especially low.[27] Because of the lack of investment knowledge, investors are more likely to use outside knowledge when making investment decisions. Unfortunately, when making investment decisions, only 23 percent of new investors consulted financial professionals, while a majority of new investors received information from less reputable sources, including 27 percent from new media.[28]

1.18: Do retail investors believe that they would trade less frequently, invest in different products, or use different investment strategies if only more traditional methods were available?

Digital platforms actively markets their services as free and easy ways to invest in the market. However, payment for order flow—the practice of digital platforms selling customer orders to other brokers or exchanges—has recently come under scrutiny in several countries, including the United Kingdom and Australia.[29] Both countries have effectively banned payment for order flow.[30] However, without any domestic regulation in the U.S., payment for order flow remains the primary way for online brokers to provide customers commission-free trades. Firms relying on payment for order flow are driven by volume and may therefore encourage customers to trade at higher volumes or through complex trading strategies such as using margin and options. High-volume trading generates more profit for online brokers because the more trade volume they route to exchanges, the more return to the firms, even if their customers have no experience as active traders or knowledge of the practice of payment for order flow. If not for the availability and low costs offered by online brokers with an incentive to encourage more active and riskier types of investing, retail investors would trade less frequently and use more appropriate strategies.

As experienced by several clients of the Clinic, online brokers target unsophisticated investors with marketing campaigns designed to make trading on margin or trading options or futures seem easy and low risk. Unsophisticated investors with limited financial means often rely on the information they receive from online brokers to invest their savings or paychecks in high-risk, complicated strategies through apps in the palms of their hands. Client of the Clinic trust the

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[26] *See* FINRA/NORC Study, *supra* note 3, at 16.
[27] *See* FINRA/NORC Study, *supra* note 3, at 17.
[28] *See* FINRA/NORC Study, *supra* note 3, at 14.
[29] Sviatoslav Rosov, *Payment for Order Flow in the United Kingdom*, https://www.cfainstitute.org/en/advocacy/policy-positions/payment-for-order-flow-in-the-united-kingdom, June, 2016; *High Frequency Trading: The Australian Story*, https://asic.gov.au/about-asic/corporate-publications/newsletters/asic-market-supervision-update/asic-market-supervision-update-previous-issues/asic-market-supervision-update-issue-45/, April, 2014.
[30] *Id.*

financial institutions they use and express confusion as to the reason their trusted institution would promote high-risk strategies or approve them for levels of options or margin trading that are not appropriate for them. In many instances, these investors are using complex and risky strategies for the first time when they open a digital platform account, suggesting that the same investors would not engage in active trading strategies absent the facilitation of the digital platform.

1.19: Do retail investors believe they are receiving investment advice or recommendations from DEPs or certain types of DEPs? If so, please explain.

Investor confusion regarding advice or recommendations in connection with online trading dates back to the advent of public internet access and online trading.[31] As far back as 1999, the SEC received over 3,000 complaints against online brokers, an increase of nearly 200 percent from 1998 and a 1200 percent increase from 1997.[32] Even without today's sophisticated DEPs, the early, basic forms of online trading still allowed online brokers to influence the trading strategies of investors, many of whom were unsophisticated and seeking to take advantage of the perceived ease and accessibility of online trading.[33]

Now, as more easy-to-use websites and apps continue to make their way into homes and pockets,[34] digital platforms are using advanced DEPs to guide investors more than ever.[35] Firms are aware that investors want and expect investment advice from digital platforms.[36] In fact, a TD Ameritrade survey indicated that 90 percent of investors believe that tailored investing advice is the most important feature of these digital tools.[37] As DEPs and other digital tools continue to develop, firms and companies will likely look to cater to their customers to develop new engagement practices. Because investors desire tailored investing advice from the DEPs and other online tools they engage with, firms may compete for customers through use of DEPs that most resemble individualized advice. Under these conditions, it is likely that more targeted investment advice and recommendations in DEPs and other tools will continue to grow in popularity and use. An absence of appropriate rules governing what constitutes a recommendation in the context of digital platforms and DEPs will in turn likely lead to more investor losses and complaints as was seen with the introduction of online trading in the 1990s.[38]

1.20: For retail investors who have previously invested with the assistance of a financial professional, how do they believe their investing experience has changed as a result of interacting with a digital platform as opposed to a financial professional?

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[31] *See* Renée Barnett, *Online Trading and the National Association of Securities Dealers' Suitability Rule: Are Online Investors Adequately Protected?*, 49 Am. U. L. Rev. 1089, 1091–92 (2000).
[32] *Id.* at 1091.
[33] *See id.* at 1091–92.
[34] Steve Randall, *Investing Apps Have Seen Exponential Growth This Year*, Wealth Professional (Oct. 7, 2020), https://www.wealthprofessional.ca/news/industry-news/investing-apps-have-seen-exponential-growth-this-year/333978.
[35] *See* Ashley Viens, *Visualizing the Rise of Investment Tech*, Visual Capitalist (Oct. 16, 2019), https://www.visualcapitalist.com/visualizing-the-rise-of-investment-tech/.
[36] *Id.*
[37] TD Ameritrade, The Tech Effect: How the Digital Age is Changing Investing, at 24 (2018), https://s2.q4cdn.com/437609071/files/doc_news/research/2018/TDA_FinTech_ebook.pdf.
[38] *See* Barnett, *supra* note 31 at 1091–92.

The proliferation of online brokerage firms and digital investing can present a multitude of uncertainties on the part of retail investors who may expect the legal obligations of online brokerage firms to be similar to those of traditional brokers. For example, while traditional brokerage firms are governed by Regulation Best Interest, these same standards do not apply in most cases to online brokerage firms.[39] Further, online brokerage firms typically make retail customers sign contracts absolving them of fiduciary obligations.[40] The firms also insert in these contracts that they do not provide recommendations or advice like brokers do.[41] However, despite these and other provisions like it, the online firms operate much like traditional brokers, gathering information regarding the retail customer's investment profile, approving accounts for certain types of trading, and then tailoring the information displayed to them by showing some products more than others.[42] While standards to which brokers are held tighten, as in Regulation Best Interest promulgated by the SEC, online brokerage firms operate in an environment where they are not expressly required to offer appropriate investments, recommend products based on the customer's best interest, or disclose conflicts of interest.

Investors who have previously worked with financial professionals at best experience confusion because of the inconsistencies regarding the standards applied, and at worst invest with online brokers with the false impression that the legal obligations applied to them are the same as those applied to their financial professional. Investors also experience this confusion based on online brokers' advertising and marketing material. Even the act of an online broker's approval of certain types of trading or margin levels can assure an unsophisticated investor that the investments or trading strategies are appropriate for them. In these ways, investor expectations of the standards applicable to digital platforms far exceed the services those platforms provide.

Also, the relationship a customer has to a representative from an online broker may be different than the relationship to a financial professional. This creates investor confusion because communications with the online broker's representative will be similar in some ways to communications with a traditional broker. Clients of the Clinic have reported that digital platform representatives explain how to use specific investment strategies and even suggest specific stocks for use in those strategies. Thus, retail customers may encounter recommendations from the online firm's on-call broker representatives (or from DEPs), while facing limited or ambiguous legal solutions in the event a dispute arises.

1.21: How could firms adopt or modify DEPs to facilitate and increase opportunities for investor education and encourage longer-term investment activities, including, but not limited to, through increased contributions to or establishment of retirement accounts?

Part of the cause of the recent surge in customers of online brokerage firms is the gamification of investing through the use of DEPs, some of which may be harmful to investors.[43] For example, "paper trading competitions," based on customer accounts with pretend money, encourage new investors to treat investing like a short-term game—or worse, like gambling—

[39] *See* Alec Smith, *Advisers, Brokers, and Online Platforms: How A Uniform Fiduciary Duty Will Better Serve Investors,* 2017(3) Colum. Bus. L. Rev. 1201, 1209 (2017).
[40] *Id.* at 1210.
[41] *Id.* at 1213.
[42] *Id.* at 1207.
[43] *See* Massa & Alloway, *supra* note 19.

and are almost certainly a bad idea.[44] Firms can instead use DEPs to increase investor education and encourage smart investing. Many firms currently offer prizes (such as a free stock or access to a paid subscription) for investors who, for example, have assets of a certain amount or trade at a high volume. Why not offer similar rewards for investors who complete online educational investment trading? Likewise, firms could offer rewards and special access for members who open a retirement account like an IRA or based on contributions to such accounts. DEPs could also enhance investor awareness of model portfolio allocations for various objectives and risk levels, compared to their current portfolio. Rather than using DEPs to increase investor engagement that will maximize the firms' profits, firms could use DEPs to help investors, and the U.S. economy as a whole, by educating investors and rewarding those who make smart long-term decisions.

1.22: Do commenters believe that certain types of DEPs are more, less, or as appropriate in the investing context than in other contexts?

Many of the DEPs employed by digital platforms also occur outside the investing context.[45] Although some DEPs seem to be as appropriate in the investing industry as in other contexts, others are less appropriate and thus require additional safeguards. A feature of DEPs that may be especially problematic in the investing context is the use of "dark patterns." These design choices usually exploit cognitive bias and manipulate consumers into acting in a certain way, such as buying things they do not need.[46] Unlike consumers shopping for goods online, investors are putting their retirement savings and financial future at stake. The SEC should consider whether these design choices that influence investors into making specific choices should be deemed to be a recommendation for purposes of Regulation Best Interest and should establish clear standards for future practices on what constitutes a recommendation in the DEP environment.

Some online platforms also allow their users to follow other individual investors' trading.[47] Although other industries take advantage of social networking tools to promote products by having influencers use them,[48] this tactic is less appropriate in the investing context because individual investors could be more likely to assume that certain investments or investment strategies they follow are appropriate for their own personal investing needs, even though it is likely that many of these investors do not share the same objectives of the investors they are following via digital platforms.[49]

[44] *Id.*; Ben Broadwater, *What is Paper Trading?*, Investment U (May 25, 2021), https://investmentu.com/what-is-paper-trading.

[45] Anniek W. Eigenraam, Jiska Eelen, Arjen van Lin, Peeter W.J. Verlegh, *A Consumer-based Taxonomy of Digital Customer Engagement Practices*, 44 Journal of Interactive Marketing 102, 103 (2018).

[46] Jamie Luguri and Lior Jacob Strahilevitz, *Shining a Light on Dark Patterns*, 13 Journal of Legal Analysis 43, 44 (2021), https://academic.oup.com/jla/article/13/1/43/6180579

[47] Samantha Rosen, *What to Know Before You Start Investing With Public, One of Robinhood's Biggest Competitors*, NEXTADVISOR (Feb. 23, 2021), https://time.com/nextadvisor/investing/what-to-know-public-investing-app.

[48] John T. Gironda, Pradeep K. Korgaonkar, Understanding Consumers' Social Networking Site Usage, 30 Journal of Marketing Management, 571, 572 (2014).

[49] Jose Apesteguia, Jörg Oechssler, Simon Weidenholzere, *Copy Trading*, 66 Management Sciences 5608, 5619 (2020).

1.26: In particular, how effective are disclosures at informing retail investors of any associated conflicts of interest presented by the use of DEPs and how DEPs could influence them and their trading and investing behavior?

DEPs may encourage retail investors to trade more frequently and consider riskier behavior than they might have if they were working with a traditional brokerage firm. Through the practice of payment for order flow, digital platforms earn their profits not from commissions, but instead from the volume of trades they deliver to other brokers.[50] This incentivizes the online platform to encourage more trading. These business models present a conflict of interest between the retail investor's needs and the digital platform's incentive to make money. However, this conflict is not fully disclosed to the users who therefore cannot make decisions based on their knowledge of the compensation scheme. Knowledge of the compensation scheme is important to retail investors because it gives insight into the incentives of the firm to promote certain strategies or investments. With this knowledge, investors can make better informed judgments as to their own interests and the interests of the digital platform and as to the appropriate strategies for their objectives and risk tolerance.

Meaningful disclosures relating to profit incentives, gamification, and predictive analytics could give users more information about their broker's conflicts of interest and practices used to influence unsophisticated investors, especially younger investors.[51] For example, Robinhood received pushback from lawmakers when its app used digital confetti to celebrate the user's "trading firsts."[52] Robinhood currently has three dozen disclosure documents online that customers can review, but they are only useful if they are read.[53] Some disclosures might not be effective. As part of enhanced disclosure practices, digital platforms should implement enticing practices for retail investors to read and understand important disclosures. If online brokers can influence trading behavior through DEPs, why not require firms to incorporate disclosures and education into their DEPs in a manner that is just as effective? Robinhood's confetti might come in handy for congratulating a retail investor for reading disclosures and passing a quiz.

2.17: To what extent can the use of the tools and methods identified above (e.g., AI/ML models) in connection with the use of DEPs perpetuate social biases and disparities?

As the global pandemic has caused an overflow of new retail investors to join the market through self-directed, online brokerage accounts, AI/ML tools using DEPs have gained popularity and created easy access to the market with lower fees. On the other hand, firms are also using the data collected through these AI/ML tools to develop trading strategies and target marketing to customers. For instance, firms are now analyzing customer needs, curating investment products, and sending informative updates based on the information gathered,

[50] Rita Raagas De Ramos, *SEC Probing Digital Engagement Practices of B-Ds and RIA Firms*, Financial Advisor IQ (Aug. 30, 2021), https://www.financialadvisoriq.com/c/3303264/417504/probing_digital_engagement_practices_firms

[51] Andrew Ramonas, SEC 'Gamification' Study Ups Reporting Threat for Online Brokers, Bloomberg Law (Sept. 7, 2021), https://news.bloomberglaw.com/securities-law/sec-gamification-study-ups-reporting-threat-for-online-brokers

[52] *Id.*

[53] *Id.*

ultimately influencing the investor's behavior by promoting customized investment strategies and services to fit the individuals' profiles.[54]

However, differential marketing and personalized content based on an individual's profile may also perpetuate social bias by exposing investors to more risks despite their perks. Since every investor has different preferences and profiles, such custom DEPs might encourage skewed investment decisions that are ultimately harmful because they do not align with the investor's objectives or risk tolerance. This potential discrimination may happen through biased datasets or incomplete data collected by AI/ML tools.[55] Plus, the market volatility due to COVID-19 may also affect the reliability of the AI/ML predictions.[56]As a result, many new retail investors who are more diverse but have low financial literacy might sustain harm.[57] A study has shown that new investors relied heavily on DEPs while trading without fully understanding the risks.[58] Thus, a particular group influenced by DEPs may experience unfavorable results by simply relying on incorrect prompts on these trading apps that do not align with their investment profile, eventually suffering significant financial loss.[59]

Social bias and disparity already exist in society, and AI only addresses that as much as the people who created the data. Thus, firms need to monitor and use the information collected by the AI/ML tools so that it does not affect their ability to treat all customers fairly and offer unbiased financial recommendations catered to each investor's profile. The wealth of data could potentially be used to encourage new investors to become long-term traders if appropriately catered. Through the correct application, DEPs coupled with AI/ML tools might even ease the social disparities in the present system. [60]

3:13: What additions or modifications to existing regulations, including, but not limited to, those identified above, or new regulations or guidance might be warranted to address investor protection concerns identified in connection with the use by broker-dealers and investment advisers of DEPs, the related tools and methods, and the use of retail investor data gathered in connection with DEPs?

As detailed above, technology has provided retail investors increased access to the world of online trading. Such access has undoubtedly increased the need to enhance regulation to protect investors from the adverse effects of self-directed online trading accounts. We urge the Commission to consider regulation or additional guidance to broker-dealers to better protect investors:

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[54] FINRA, *Artificial Intelligence (AI) in the Securities Industry* (June 2020), https://www.finra.org/rules-guidance/key-topics/fintech/report/artificial-intelligence-in-the-securities-industry/ai-apps-in-the-industry#_ftn2
[55] Luke Scanlon, *AI in financial services: addressing the risk of bias* (July 08, 2020), https://www.pinsentmasons.com/out-law/analysis/ai-financial-services-risk-of-bias
[56] Aaron Nicodemus, *Report: AI tools carry many benefits, some risks for securities industry* (June 12, 2020), https://www.complianceweek.com/technology/report-ai-tools-carry-many-benefits-some-risks-for-securities-industry/29056.article
[57] *Id*.
[58] *Id*.
[59] *Id*.
[60] Aaron Klein, *Reducing bias in AI-based financial services* (July 10, 2020), https://www.brookings.edu/research/reducing-bias-in-ai-based-financial-services/

Enhanced supervisory review of onboarding clients. FINRA rules require all broker-dealers, including firms providing digital trading platforms and/or mobile trading apps, to exercise reasonable diligence in obtaining and maintaining the essential facts for every customer account.[61] For customers seeking to engage in certain higher risk trading strategies, such as options trading, the firm must also conduct due diligence and approve the customer for that strategy.[62] Firms have increasingly automated this process, using "bots" and algorithms for account opening and trading approval requirements. But as demonstrated by the recent FINRA enforcement action against Robinhood, serious programming failures in connection with the account approval "bots" – coupled with insufficient supervisory oversight by principals – led to approval of thousands of customer accounts that did not satisfy the firm's eligibility criteria or which contained red flags indicating that options trading may not have been appropriate for that customer.[63] This demonstrates that the increasing automation of these essential broker-dealer obligations exposes investors to serious gaps in regulatory protection intended by existing rules. The Commission should consider whether additional regulations, or enhanced FINRA rules governing account opening and approvals, are needed. At minimum, additional guidance to members using automated processes would be useful.

Regulation or guidance regarding broker-dealers' use of online interface mechanisms designed to increase trading, such as push notifications and chatbots. Features like push notifications engage investors and can "push" investors to trade without considering the investor's objectives or risk.[64] Without push notifications, an investor might not have considered making a specific trade. Similarly, digital platforms that use chatbots should be held accountable if a computer program offers information that investors rely on when trading securities. While such computer programs stimulate live human conversation, there is no guarantee that these digital platforms provide this information for their customer's best interest. Although both push notifications and chatbots may influence trading, broker-dealer firms operating these platforms stress in their customer agreements with investors that the firm "does not make investment recommendations." As a result, some DEPs may actually provide investment recommendations, yet the platforms and mobile apps have required investors to acknowledge that they did not receive any investment advice. We recommend that the Commission consider DEPs and whether they can or should come within the ambit of the SEC's Regulation Best Interest. At minimum, the Commission should set forth guidance that advises firms: (1) the types of DEPs that would be considered recommendations and, (2) that such boilerplate language in their customer agreements will not be determinative on the issue of whether the firm made a recommendation.

3:16: Should any such modifications or additional regulations be targeted specifically to increase protection for certain categories of investors (e.g., seniors or inexperienced investors)? If so, how?

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61 FINRA Rule 2090, *Know Your Customer*; FINRA Rule 4512(a), *Customer Account Information*.

62 FINRA Rule 2360, *Options.*

63 FINRA Dep't Enf. v. Robinhood Financial, LLC, Letter of Acceptance, Waiver, and Consent, No. 2020066971201, at 3-4 (June 30, 2021).

64 Game Stopped? Who Wins and Loses When Short Sellers, Social Media, and Retail Investors Collide, Part II: Hearing Before the H. Comm. on Fin. Servs., 113th Cong. (2021) (statement of Vicki L. Bogan, Associate Professor, Cornell University), [https://docs house.gov/meetings/BA/BA00/20210317/111355/HHRG-117- BA00-Wstate-BoganV-20210317.pdf](https://docs.house.gov/meetings/BA/BA00/20210317/111355/HHRG-117-BA00-Wstate-BoganV-20210317.pdf).

The surge in new and existing investors opening self-directed online accounts has led to a significant increase in calls to our Clinic from investors seeking assistance due to losses arising from their failure to appreciate or understand the platform itself or the risks of their trading. We have received calls from investors that: (1) have confused their "play trading" account with their actual account; (2) did not understand that expiring options could be assigned after trading hours; (3) did not understand that the firm could liquidate securities positions without notifying the account holder; and (4) did not understand the significant risks of margin and options trading. While many of these callers are young and inexperienced investors, we have also had calls from older investors who were trying to grow their retirement account.

In addition to some of the enhancements already suggested above concerning account opening and approvals, enhanced application of Regulation Best Interest, and additional guidance to firms, the Commission should consider requiring enhanced oversight of accounts opened by novice investors. Through automation, firms can flag trades that are inconsistent with stated customer information and profiles or that are not in line with previous trades. The firm can automatically send an interactive message to the investor to ensure that she is aware of the inconsistency and the risks of the trade.

Additionally, the SEC can strengthen the disclosure obligation found in Regulation Best Interest.[65] As mentioned above, the Clinic has seen clients who did not fully understand that expiring options could be assigned after trading hours and clients who did not understand that the firm could liquidate securities positions. Due to the influential nature of DEPs, the SEC should enhance the Regulation Best Interest disclosure obligation and conflict of interest obligation by requiring firms to flag investor trades and/or positions where there is a likelihood that the firm will act in a manner adverse to the investor's position and to notify investors of these potential actions.

Conclusion

The IRC is committed to advocating for investors of modest means who are increasingly joining the market through the use of digital platforms and DEPs. The increase in market entrants has a direct correlation to the increase in the number of harmed investors seeking assistance from the IRC. Digital platforms often encourage these investors to open accounts and approve them without sufficient review to engage in high-risk, high-volume trading practices. As the SEC continues its review of standards applicable to financial professional, it is critical to enhance investor protection in the fast-growing and increasingly harmful digital platform environment. While recognizing the benefits of access to low-cost investing, the IRC asks that the SEC pursue measures to enhance supervisory review of customer account openings and to consider application of Regulation Best Interest to the use of online engagement practices that constitute recommendations. Again, we thank the SEC for the opportunity to comment on its review of DEPs, related practices, and regulatory considerations.

[65] *See* 17 CFR 240 (Regulation Best Interest: The Broker-Dealer Standard of Conduct).

Respectfully submitted,

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