

# Ensuring Digital Engagement Practices Responsibly Expand Investment Opportunity

Remarks before the SEC Investor Advisory Committee

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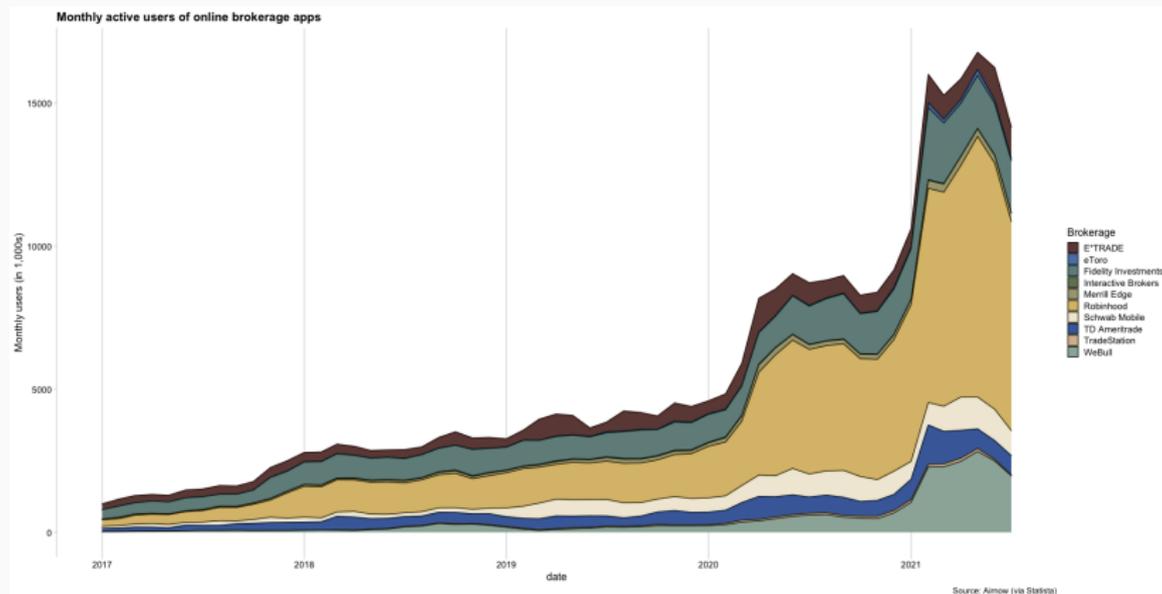
MARKETS

## Does Robinhood Make It Too Easy to Trade? From Free Stocks to Confetti

Some behavioral researchers say the app's simplicity encourages novice investors to take bigger risks



## Trends in retail investor trading



## Trends in retail investor trading



# Motivation — broad trends



**BREAKING NEWS**

**SEC CHAIR GENSLER ON GAMIFICATION OF MARKET**



# How do ordinary investors trade?

## Retail trader performance

- The more you trade, the worse off
- Professionals usually can't consistently outperform the "market" net of transaction costs
- Traditional normative finance: For most of us, better off investing in low cost index funds

# How do ordinary investors trade?

## Commission free trading

- Down from \$10/trade to \$0 ten years ago
- “Zero price effect” in behavioral economics: people significantly overvalue free stuff

## Then who is paying?

- If you're getting something for free, you're the product

## Who is a retail investor?

- Brokerage apps
- Active investment outside retirement plans (401ks, etc)
- Mainly of interest as unaccredited investors
  - Public companies you can buy vs. private companies you typically can't
  - Private markets limited to sophisticated/wealthy participants
  - May act like “retail investors” in private markets too but not our concern today

# How do ordinary investors trade?

## Who is a retail investor?

- Brokerage apps
- Active investment outside retirement plans (401ks, etc)
- Mainly of interest as unaccredited investors
- Orders are noisy or uninformed or uncorrelated



ALL RIGHT. FIRST ITEM,  
I LOST OUR LIFE SAVINGS  
IN THE STOCK MARKET.

# How do ordinary investors trade?

“Rational” retail trader behavior

- Risk preferences
- Sensation seeking
- Aspiration for riches
- Trading to learn?



Securities law:



### “Imperfectly rational” retail trader behavior

- Behavioral factors: overconfidence, etc.
- Salience: “attention induced noise trading”
- Being duped: “dark patterns” and the like

### Related to the underlying conflict of interest:

- Gamification appeals to imperfect rationality to encourage maladaptive trading

## Evidence for “attention induced noise trading”

- Barber et al (2021) model attention-induced noise trading and momentum herding
  - “Top mover” list induces attention-induced trading
  - But herding leads to negative returns
- Eaton et al (2021) model noise trading
  - “Zero commission traders have negative effects on stock market quality, consistent with behavioral noise trader and inventory risk models”
- Stein (2020)
  - Evidence of attention-induced trading in now deprecated “top 100” leaderboard
  - Some momentum strategies may be profitable

## Alternative visions of gamified investment apps

1. Techno populism
2. Techno skepticism
3. Techno optimism

Welfare analysis: is regulatory  
intervention appropriate?

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# Regulatory intervention?

## Benefits?

- It really does make it fun!
- Encourages “democratization” of finance
  - The people’s stock market and stakeholderism
  - Makes investing more approachable



Figure 1: It doesn't have to be this way

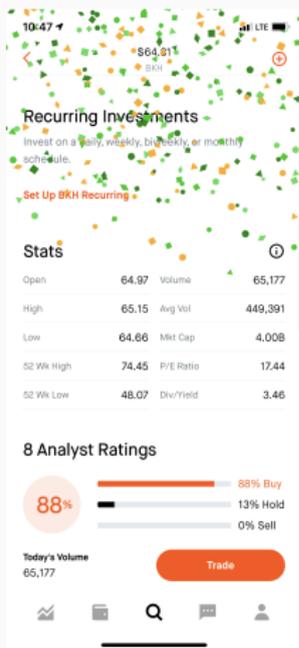
## Harms?

- Market quality
- Allocation of capital (crypto, meme stocks?)
- Active trading is “hazardous to your wealth”
- Pure distributional objection?
- Plus, “benefits” might be red herrings (see *techno-populists* and *techno-optimists*)



**WHAT IS  
TO BE  
DONE,  
THEN?**

# “Confetti regulation”



## Ban “confetti”?

### Problems

1. Defining objectionable gamification
2. First Amendment problem

See Langvardt & Tierney  
YALE LAW JOURNAL FORUM  
(Jan. 2022)

**Figure 2:** How much confetti is too much? “I know it when I see it”

### Possibly more desirable doctrinal interventions

- Fiduciary duty
- Brokerage sales practices regulation
- Antifraud manipulation?
- Compliance (books and records, written supervisory procedures)

## Sales practices regulation

- Quantitative suitability
- What to do with self-directed accounts?
- Concerns about
  1. Conflicts of interest
  2. Certain technologies
  3. Getting you to noisily trade in pursuit of conflicts of interest

## More ambitious structural reforms

- Reg NMS reform
- Ban PFOF
- Switch to periodic batch auctions

Spoiler alert: recently proposed equity market reforms would tinker with but not fully reform issues like PFOF and retail order flow

## Can gamification be used for good?

- Promoting the prescriptions of normative traditional finance
- Financial education

## Encouraging negative NPV entrepreneurship

- Trading  $\neq$  investing
- Noisy trading useful for generating arbitrage profit opportunities
- Role of retail noise trading in eliciting order flow means it's central to securities law's orientation toward retail traders

Comments? Questions?