



May 9, 2022

Ms. Jennifer Piorko Mitchell
Office of the Corporate Secretary
Financial Industry Regulatory Authority
1735 K Street, NW
Washington, DC 20006-1506

Re: FINRA Regulatory Notice 22-08

Dear Ms. Mitchell:

AARP, on behalf of our 38 million members and all older Americans nationwide, appreciates the opportunity to submit comments in response to the Financial Industry Regulatory Authority's (FINRA) request for comment regarding Effective Practices and Rule Enhancements. As the largest nonprofit, nonpartisan membership organization representing people age 50 and older, AARP is pleased to offer its views regarding complex investment products. This letter discusses the problems that can arise when older Americans, and investors generally, are enabled or encouraged to purchase or trade complex products without proper information and understanding of their unique characteristics and risks.

1. The Regulatory Framework for Complex Investment Products Should be Enhanced to Account for Major Changes to the Securities Marketplace Resulting from Rapid Technological Innovation and Increased Direct Retail Investor Participation.

AARP applauds FINRA for its reexamination of the regulatory framework applicable to complex products.¹ While complex investment products and investment risk have always, to a certain extent, gone hand-in-hand, the number of retail accounts trading complex products has increased sharply in recent years. Moreover, the advent and proliferation of mobile application (app) based broker-dealers has made "self-directed" investing more accessible to investors of all experiences, backgrounds, and demographics. At the same time, as the number of investors purchasing securities through "self-directed" broker-dealers have risen, so has the exposure of retail investors to options and other complex investment products.

¹ There is currently no standard or "static" definition of a "complex product." However, FINRA guidance has established that complex products should be understood to encompass securities or investment strategy with novel, complicated or intricate derivative-like features, such as structured notes, inverse or leveraged exchange-traded funds, hedge funds and securitized products, such as asset-backed securities. Such features may make it difficult for a retail investor to understand the essential characteristics of the product and its risks. Under FINRA rules, such complex products are subject to heightened supervisory and compliance procedures. (See FINRA Regulatory Notice 12-03. Complex Products, Heightened Supervision of Complex Products. Jan. 2012).

In much the same way that advances in technology have made more complex products available in the marketplace, advances in technology have also enabled broker-dealers to employ new tools to encourage investors to purchase complex products. Trades involving complex investment products, which until recently required customers to consult with their broker or investment professional, can now be routinely undertaken by retail customers on a whim and in a matter of seconds on a smartphone, without any human interaction.

A third, critical factor, also arising from technological innovation, is the phenomenon of so-called “gamification.” Gamification refers generally to the use of technological tools to make trading securities easier and more appealing.² Increasingly, broker-dealers utilize a variety of digital engagement practices (DEP), to connect with a broader array of retail investors. Often, the types of DEPs adopted by broker-dealers are modeled on design features that were initially developed to augment other unrelated innovations – such as social media and virtual gaming. While demonstrably effective at gaining and keeping the attention of their users, as presently used, gamified features rarely serve to promote investor awareness of risk, understanding of complex products, or sound investing decisions. On the other hand, as the Securities and Exchange Commission (Commission) Investor Advocate recently noted, DEPs have the potential to promote more frequent or higher-risk trading than an investor would choose for herself in the absence of such features.³

Finally, for all of its benefits, the rise of zero commission trading has changed the way that many broker-dealers make money.⁴ In the past, broker-dealers typically charged investors a commission or a fee for every trade they executed on a customers’ behalf. Such commissions provided a measure of transparency and a tangible disincentive for investors to trade excessively or capriciously. Today, rather than making money by charging commissions to investors, many self-directed brokerages earn a significant portion of their revenue by routing their orders to market makers and big trading firms. This fact is relevant to the question of complex investment products because the amount of revenue brokerages can earn for routing trades involving complex products can dwarf the amount of revenue they are able to earn from routing trades involving more traditional equities.⁵ In short, today, many brokers have a powerful incentive to encourage their customers to transact in such products.

² Remarks by SEC Investor Advocate Rick Fleming. “Investor Protection in the Age of Gamification: Game Over for Regulation Best Interest?” Washington D.C. Oct. 13, 2021. <https://www.sec.gov/news/speech/fleming-sec-speaks-101321>

³ *Ibid*, Rick Fleming.

⁴The rise of zero commission trading is often cited as a primary basis for increased retail investor participation in the capital markets, particular among historically underrepresented segments of the population. Moreover, by some estimations, it has been argued that retail investors have “reached a watershed moment in which access to real-time information and increasingly sophisticated investment tools have made them more empowered than ever before.” (<https://www2.deloitte.com/content/dam/Deloitte/us/Documents/financial-services/us-the-rise-of-newly-empowered-retail-investors-2021.pdf>)

⁵ For example, in 2021 alone, the largest U.S. self-direct retail broker, Robinhood, earned 46% of its revenue from the buying and selling of options. The second most profitable instrument traded on Robinhood’s platform that year was cryptocurrency. Only a small fraction of its revenue derived from trading of traditional equities. (https://s28.q4cdn.com/948876185/files/doc_financials/2021/q2/fed1afc9-fc82-4a7a-8735-caed2497fbd3.pdf)

2. Modernization of the Regulatory Framework for Complex Products is Necessary to Maintain Investor Protection and Ensure Technological Innovation is Not Permitted to Dilute or Thwart the Duty of Care Owed by Broker-Dealers to Investors.

SEC Regulation Best Interest (“Reg BI”) generally requires that, when a broker-dealer makes a recommendation with respect to a securities transaction or strategies involving securities to retail customers, the broker-dealer acts in the customer’s best interest and does not place its own interests ahead of the customer’s. However, the investor protections embodied in Reg BI are not triggered purely by virtue of an interaction between the broker-dealer and a customer -- there must be a recommendation.⁶ The question of whether a recommendation has been made is interpreted consistent with precedent under the federal securities laws and how the term has been applied under FINRA rules. The present lack of clarity surrounding the question of when or whether DEPs rise to the level of a recommendation is problematic. This ambiguity is at the crux of many of the issues FINRA is grappling with in the context of its reexamination of the regulatory framework applicable to complex products.⁷ The Commission should clarify that broker-dealers utilizing DEPs to “nudge” or materially influence investor decisions with respect to a complex investment product, or to encourage trading of such products, are presumed to have made a recommendation.

The duties of care imposed by Reg BI, and similarly the fiduciary standard to which AARP believes all advisers should be held, are not a mere legal exercise; they exist because the Commission has determined that such rules are necessary to protect investors. In all instances, AARP believes firms and regulators should construe these consumer protection requirements broadly.

AARP is concerned that bad actors will attempt to systematically and intentionally engage in communication practices to influence investor behavior in a manner designed to circumvent the currently applicable regulatory definition of a recommendation – and hence the protections afforded by Reg BI. AARP strongly supports amendments to FINRA rules that aim to discourage or curtail attempts by broker-dealers to exploit present loopholes or shortcomings in Reg BI.

Moreover, we note that an individual’s ability to act as broker of securities, or make recommendations incidental to the sale of securities, in exchange for compensation, is a privilege, and not a right. As such, we urge that FINRA more strictly examine broker-dealers whose business models strive to operate in “grey areas” of the present regulatory framework, including by using DEPs to circumvent the intent of securities laws, including Reg BI, while ostensibly not violating the letter of those laws.

⁶ In fact, Reg. BI’s adopting release specifies that it is not intended to “apply to self-directed or otherwise unsolicited transactions by a retail customer.” (*See* Regulation Best Interest Adopting Release, 84 Fed Reg. at 33335.)

⁷ Importantly, FINRA rules governing options, security futures, and warrants, impose, among others, account opening requirements irrespective of whether a recommendation has been made; specific suitability requirements when recommending these products, including a reasonable belief that the customer has the knowledge and experience to evaluate the risks involved and the financial ability to bear these risks.

A. As the Self Regulatory Organization (“SRO”) of the broker-dealer industry, FINRA has an important role to play, and potent tools at its disposal.

- i. FINRA should adopt additional requirements with respect to complex products when such products are sold through a self-directed platform.*

FINRA should impose clear obligations that broker-dealers must satisfy prior to a retail customer’s account being approved to transact in complex products. For example, a requirement that broker-dealers “provide [a] retail customer with general, plain language, educational materials about the common characteristics and risks of complex products” is consistent with investor protection and common sense. Indeed, in the face of rapidly evolving technologies – and in light of the proliferating marketplace for complex products marketed to retail investors – the rationale for modernizing and strengthening such requirements is beyond question.

Similarly, AARP agrees that FINRA should amend its rules to require “customers to demonstrate their understanding [of] common characteristics and risks of complex products by completing a knowledge check,” particularly where such investors are not accredited investors, or where there is a reasonable basis to question the ability of such investor to understand the risks associated with complex products or sustain the investment losses that may reasonably result from such products.⁸

AARP does not believe that such rules would “unduly ... restrict investor access to complex products.” To the extent that FINRA modernizes rules in a manner that promotes greater awareness of the potential benefits and risks of complex products, on the part of both the broker-dealer selling such products and the investor considering the purchase of such products, such reforms stand to enhance the ability of retail investors to purchase complex products consistent with their investment goals and needs.

- ii. FINRA should adopt specific and appropriate restrictions related to DEPs and other targeted communications, including “push” notifications to retail customers regarding complex products.*

AARP supports appropriate guardrails for communications across self-directed platforms that could reasonably be expected to influence a retail investor’s decision-making with respect to an investment, but purport to “not rise to the level of a ‘recommendation’ under Reg BI.” Indeed, for reasons previously discussed, broker-dealers that, on the one hand, employ a business model that relies on such communications to influence investor decision making, and, on the other hand, seek to do so in a manner that “does not rise to the level” of a “recommendation,” should be closely scrutinized. FINRA’s communications rules could be an effective means to plug some

⁸ FINRA rules govern the approval process with which broker-dealers must comply when opening a customer’s brokerage account for options, as well as the requirement of ongoing specific supervisory reviews for options accounts.

of the more glaring gaps in the investor protection framework and modernize aspects of that framework to better keep pace with technology-driven innovation.

- iii. *FINRA should amend Rule 2210 to require broker-dealers to file certain communications that promote or recommend complex products with the Advertising Regulation Department of FINRA for review before their first use.*

There can be little question that the present rules related to communications with investors, particularly as they relate to “self-directed” accounts, are struggling to keep pace with the rate of change and innovation. Regulators, policymakers, firms, and investors each stand to benefit from an enhanced understanding of the rules-of-the-road as they relate to non-traditional forms of communication surrounding complex investment products.

To that end, AARP supports a requirement that broker-dealers file communications that promote complex investment products prior to their first use. While recognizing the value that stands to be realized due to innovations in securities trading, we also take note of the recent acceleration in the sale of complex products to retail investors, and the changing nature in the way that broker-dealers engage with customers surrounding these products. It is important that regulation keep pace with innovation, and such a filing requirement is consistent with this goal.

We appreciate FINRA’s commitment to ensuring that investors continue to benefit from reasonable and necessary protections relating to complex and risky investment products. We welcome the opportunity to discuss these issues further. If you have any questions, please feel free to contact Sarah Mysiewicz of our Government Affairs office at SMysiewicz@aarp.org or 202-893-4462.

Sincerely,



David Certner
Legislative Counsel and Legislative Policy Director
Government Affairs