Consumers' Research
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RE: Consumers' Research Comment Letter to the Financial Industry Regulatory Authority (FINRA) on Regulatory Notice 22-08, "FINRA Reminds Members of Their Sales Practice Obligations for Complex Products and Options and Solicits Comment on Effective Practices and Rule Enhancements"

Consumers' Research[1] is a 501(c)(3) educational non-profit organization that advocates for the general interests of consumers. This comment letter intends to present a consumer-focused discussion of the issues relating to the proposal (Notice)[2] by FINRA in its reminder to "Reminds Members of Their Sales Practice Obligations for Complex Products and Options and Solicits Comment on Effective Practices and Rule Enhancements."

Consumers' Research has a significant and longstanding interest in protecting consumers' savings, financial literacy, financial access and inclusion, and securing financial independence from the designs of those who may not have the best interests of consumers at heart.

Consumers have greatly benefited from the recent growth of self-directed trading platforms. These platforms allow individual retail investors to take actions formerly limited to them through investment professionals. Thanks to these platforms, consumers now have substantially more control over their financial well-being. Consumers using these platforms can achieve higher returns. The platforms also have the benefit of creating competition with financial professionals, spurring further innovation in the investment market.

FINRA's Notice puts these newfound consumer benefits in jeopardy.

Based on the Notice, FINRA seems to believe that increased investor access to complex products should only be allowed under highly controlled conditions because such an increase in access puts the investor at the risk of overwhelming harm. FINRA makes no mention of the benefits of increased investor access. Congress mandated that the SEC and, by extension, FINRA and the SEC must consider efficiency and competition when regulating investor access.

[1] Founded in 1929, Consumers' Research is the nation's oldest consumer affairs organization. Consumers' Research aims to increase the knowledge and understanding of issues, policies, products, and services of concern to consumers and to promote the freedom to act on that knowledge and understanding.

[2] Regulatory Notice 22-08 | FINRA.org - https://www.finra.org/rules-guidance/notices/22-08

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As written, the Notice is not just irrational; it is unlawful.

FINRA is actively discouraging commenters from submitting comments supporting expanded investor access by telegraphing that it views investor access as a risk threat. Yet, it is these very comments that FINRA needs most. Without them, prejudgment will taint any finalized rule.

FINRA is composed of investment professionals that would benefit from the Notice. It is not a neutral third-party regulator. The Notice is basic professional investor protectionism prohibited explicitly in the Exchange Act. Its approach raises anticompetitive concerns disguised as investor paternalism. The goal of the Exchange Act is to allow investors to manage their investments, and FINRA should allow investors to do so.

The Notice fails to define the key term on which its entire approach hinges, nor does it address the costs of the confusion it creates. That is unreasonable and raises vagueness concerns under the Constitution's Due Process Clause. Should the Notice be made final, it would be arbitrary and capricious under the Administrative Procedure Act.

Furthermore, the Notice fails to establish empirically a problem that needs addressing. Instead, it starts at a conclusion and works backward to the question: Are retail investors confused about the products they trade?

Lastly, even if the Notice identifies a problem, it has not shown unilateral federal action is the solution. The States have a longstanding record of successful financial literacy and education programs. FINRA would be wise to recognize that the States are better positioned to remedy problems with expanded investment access while keeping its inarguable benefits.

In the Notice, FINRA Ignores the Benefits of Investor Access and Confuses Its Role.

The expansion of self-directed platforms that allow retail investors access to the full range of investment products that, to this point, were reserved for financial professionals offers the potential for expansive benefits for investors.

These platforms do not simply offer expanded investment access; they also eliminate the large fees charged by investment managers and advisors. By eliminating these fees, investors can achieve higher returns. The Notice would strip investors from full agency in their financial futures, making them beholden to investment professionals once again. Investors that want to manage their investments should be free to do so.

Planning one's financial future helps investors attain complete financial independence. Investment professionals may have a fiduciary duty to their clients, but they may not always be fully aware of their clients' long-term goals and personal values. A self-governing republic of citizens independent from the coercive influence of others - often achieved through financial independence - was a cornerstone of the

vision of America's Founders.[3]

In recent years, investment managers and advisory firms are increasingly steering client funds into ESG investing, pursuing preferred political outcomes rather than positive financial outcomes. The expansion in investor access allows investors to avoid political and financial conflicts of interest with investment professionals who stand to benefit more (financially or politically) from some investment decisions than others.

At bottom, expanded investor access forces investment professionals to innovate and create value for investors. The Notice would return investors to the days when professionals were allowed to profit simply by the FINRA-granted access to financial products unavailable to most investors who do not employ professional investment advisors.

These benefits are the most critical because it is these benefits that Congress aimed to foster in passing the Exchange Act. The Notice, however, completely ignores these benefits. The Notice, and by extension FINRA, considers expanded investment access as only a risk to investors.

Beyond a single cursory callout early in the Notice, there is no mention of the benefits to retail investors through self-directed platforms.[4] Meanwhile, the Notice spends several pages expanding on the myriad potential harms of investor access.[5] Contrasting the silence on investor benefits with the vociferous concern for investor risk clarifies that FINRA is acting irrationally.

It is irrational to look at only one side of the ledger.[6] Under the APA, any regulation addressing investor access to the full range of investment options through self-directed platforms must consider all harms *and* benefits.[7] Any final rule that omits the benefits of self-directed platforms while only focusing on the costs will be arbitrary and capricious under the APA. The SEC must follow the goals of the Securities and Exchange Acts. Congress requires the SEC to pursue efficiency, competition, and capital formation in these Acts.[8] FINRA must also pursue these goals in its rules because Congress directed the SEC to

[3] *See, e.g.*, Gordon S. Wood, *The Radicalism of the American Revolution* 106 (Alfred A. Knopf Inc., 1991).

[4] Notice 1.

[5] Notice 1-6.

[6] *See, e.g.*, *Michigan v. EPA*, 576 U.S. 743 (2015).

[7] *E.g.*, *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983).

[8] Exchange Act § 3(f).

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consider them "in the review of a rule of a self-regulatory organization."[9]

In the Notice, FINRA ignored the many benefits of investor access through self-directed platforms. As the Notice forms no views, FINRA is not in a position to form views as to whether diminishing investor access to products would promote or decrease efficiency, competition, and capital formation. It is implausible that barring trading platforms from offering access to products once limited to investment professionals promotes competition or efficiency.

For FINRA's rule to pass SEC muster and meet Congress's requirement to consider efficiency, competition, and capital formation, FINRA must be able to assess the benefits investor access. The Notice is unable to do so. However, FINRA's treatment of investor access as a threat without any measurable benefit is tainted with prejudgment that essentially ensures it would be impossible for FINRA to solicit the comments needed to finalize a reasonable rule.

The Notice Makes It Clear That FINRA Solely Views Expanded Investor Access as a Threat to Investors.

The Notice asks thirty-four questions and sub-questions seeking information about ways to address the harm FINRA believes investor access to complex products causes. However, there is not a single question in the Notice that seeks comment about the benefits provided by investor access or how to expand those benefits.[10] Instead, FINRA ultimately chose to completely ignore the issue, indicating that FINRA has already prejudged that there are no benefits, only harm. When an agency approaches a rule with an "unalterably closed mind"[11] on the core question, "What are the benefits and the costs of a what the agency looks to the regulate?" courts have ruled such rulemaking unlawful.

It stands to reason that the Notice's lack of benefit analysis is FINRA's way of sending a message to the public. FINRA does not see any benefits to expanded investor access, so any submissions with information about the benefits of investor access or ideas for preserving that access would be a waste of time.[12] By weighing the scales against the benefits of expanded investor access, it is unlikely that FINRA will receive the information it needs to have balanced considerations of the harms and benefits of expanded investor access.

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[9] *Id.*

[10] There is only one word in the Notice's questions suggesting it is possible to regulate investor access too stringently. *See* Notice 14 ("Would the aforementioned obligations unduly or appropriately restrict investor access to complex products?").

[11] *C & W Fish Co., Inc. v. Fox*, 931 F.2d 1556, 1565 (D.C. Cir. 1991).

[12] *See, e.g.*, *Nat'l Tour Brokers Ass'n v. United States*, 591 F.2d 896, 902 (D.C. Cir. 1978) (public is unlikely to comment when it believes a rulemaking's outcome is a "*fait accompli*").

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Should FINRA honestly wish to have a complete set of available information to best meet investors' needs, FINRA must withdraw the Notice. Not doing so would ensure that any final rule would be issued tainted with prejudgment. Should FINRA choose to proceed with this rulemaking, it must replace it with one that makes it clear:

1. FINRA acknowledges and appreciates the many benefits of the expanded investor access that self-directed platforms provide.

2. FINRA seeks to expand internal knowledge about the benefits of expanded investor access.

3. FINRA seeks ways to promote expanded investor access.

4. The alarmist nature of the current Notice's appraisal of harms was unrealistic, and FINRA will consider a more measured harm analysis.

Additionally, FINRA should seek outside input on the following questions:

- What drives retail investors to invest in complex products?
- How do these products help retail investors?
- What is the average level of expertise of retail investors who frequently use complex products?
- What complex products do retail investors use?
- How many products do retail investors use?
- Do retail investors understand the risk and returns of the complex products they use?
- What is the average amount a retail investor invests in complex products?
- Have retail investors suffered financially after unwisely using complex products? If so, how often and to what extent? How do these losses compare to those suffered from following misguided professional investment recommendations?
- Why do some retail investors interact directly with complex products instead of working with investment professionals?
- If FINRA prohibits retail investors from using complex products, would they turn to investment professionals or forgo investments altogether?

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In the Notice, FINRA Engages in Protectionism for Investment Professionals and Paternalism for Investors.

In the Exchange Act, Congress had little to say about the substantive requirements for securities. Congress did not prescribe investor returns or investor risks. However, Congress did have a goal that investors have agency over their investments. That is why the Act included a disclosure regime. Congress wanted to ensure that investors could have agency over their own decisions.[13] However, such disclosures are useless in the face of an inability of investors to act on those disclosures. In the Notice, FINRA proposes to do precisely that.

The SEC authorized FINRA to further the objectives of the Exchange Act.[14] As such, FINRA, by statute, is required to pursue the Act's goals of investment professional responsibility and investor agency promotion.

Another justification for the Exchange Act was a belief that brokers and dealers had been able to engage in sharp practice to the detriment of investors.[15] Congress intended to make investment professionals accountable to their clients, thus protecting clients from unscrupulous professionals.[16] In the Exchange Act, Congress aimed to make investment professionals the faithful stewards of the investors they served.

Based on the Notice, FINRA intentionally misconstrues Congress's intent. Instead of empowering and protecting investors, the Notice's policy would benefit investment professionals at the expense of the investors they mean to serve by limiting investor access. Should the Notice become finalized, investors would only have access to complex products through investment professionals, essentially banning retail investors from the benefits of expanded access to complex products.[17]

The Notice would decrease competition with investment professionals by only permitting retail investors

[13] *Basic Inc. v. Levinson*, 485 U.S. 224, 230 (1988).

[14] *See, e.g.*, *Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Order Approving Proposed Rule Change to Amend the By-Laws of NASD to Implement Governance and Related Changes to Accommodate the Consolidation of the Member Firm Regulatory Functions of NASD and NYSE Regulation, Inc.*, 72 Fed. Reg. 42169, 42182 (July 26, 2007).

[15] *See, e.g.*, *Stock Exchange Practices: Report of the Committee on Banking and Currency* (June 16, 1934).

[16] *See, e.g.*, Exchange Act § 15(c)(6).

[17] Notice 14 (inquiring whether FINRA should "[r]equire members to make a reasonable assessment of whether a product is 'complex' before allowing a retail customer to transact in the product."

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to transact in complex products after receiving the go-ahead from investment professionals.[18] The Notice may deny investors access to investment products simply because they are not "high-net-worth" or do not fall within "other categories of customers."[19]

The Notice goes further, soliciting investment professionals for ideas on how to further restrict investment access from retail investors.[20] The Notice also suggests other ways to restrict access for retail investors.[21]

A policy limiting investor options would allow investment professionals to charge higher fees that reflect both the value of their advice and the value of access to restricted financial products. Professionals restricting public access to products to benefit themselves in any other arena would be subject to public ire and potential criminal liability.

The Exchange Act's sanction of securities self-regulatory organizations provides some protection against federal antitrust laws. However, nothing in the Exchange forecloses antitrust liability on a self-regulatory organization that adopts horizontal restraints of trade to drive up prices for investors while limiting their options without regard to the goals of the Exchange Act.

This Notice claims it protects investors from themselves but promotes a Congressionally rejected paternalistic vision of investor protection. The Notice invokes the specter of systemic risk to justify removing investor access to complex products but cites no evidence that allowing retail investors to purchase complex products could cause significant damage to the U.S. financial system.[22] Is FINRA saying that retail investors are both too ignorant to understand financial products and so reckless that retail investors cannot help themselves but invest in those products? Paternalism has no place under the Exchange Act. While the Act trusts investors to make their own decisions, the Notice requires professionals to limit investors' ability to make decisions.[23]

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[18] Notice 13 (inquiring about "[e]nhanced account approval processes before an account may trade in complex products"); *id.* at 15 (inquiring whether FINRA should require that approval of investors for access to complex products turn on "objective criteria" rather than just the investors' own self-assessments).

[19] Notice 13.

[20] Notice 13.

[21] Notice 13-15.

[22] Notice 5.

[23] In the past, FINRA may have departed from this principle in the context of options trading. However, past actions do not justify another more troubling, departure. The Notice's approach applies to a vaguely-defined superclass that may include hundreds of types of products, not just to a single, definite class of products. The expansiveness of FINRA's proposal is more aggressive and much more impactful than existing options regulations. Should our arguments be in tension with options regulations, it would be better for investors for FINRA to change those misguided regulations than to expand those

If Incorporated in a Final Rule, the Notice's Approach will be Arbitrary and Capricious under the APA.

FINRA, As the Notice admits, has never clearly delineated complex from simple products. Instead, FINRA lists examples of complex products and states that its list is non-exhaustive. The Notice takes the same approach.[24] Unfortunately, this leaves both investment professionals and investors to their reconnaissance to determine what products would fall under the umbrella of the restrictions FINRA ultimately adopts.

FINRA's approach could eventually leave retail investors unable to legally access products they built their financial strategies around without investment professionals' permission. Without clarity, the line between complexity and simplicity pressures self-driven platforms to restrict retail investors' access to trade instruments that FINRA could eventually decide are not actually complex.

While FINRA declares "a complex product [is] a product with features that may make it difficult for a retail investor to understand the essential characteristics of the product and its risks," such opaque guidance is practically useless. [25]

Retail investors are not uniform, although FINRA seems to think they are. Retail investors vary in experience, preferences, education, and knowledge. How do investment professionals evaluate an investor to determine if that investor is sophisticated enough to invest in a complex product?

FINRA does not define the "essential characteristics of the product" in the Notice. Still, it is clear that a product's "essential characteristics" go far beyond its and underlying assets. The Notice, for example, suggests that "a wholly-owned offshore subsidiary"[26] involved in a product is enough to make it complex. The Notice also indicates that the involvement of certain asset classes, such as cryptocurrency, is *ipso facto* enough to make a product complex, despite millions of people worldwide transacting in the asset class.[27]

There is no explanation in the Notice why FINRA certain features establish the complexity of a product.

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misguided regulations to a more expansive class of investments. Our arguments centered on complex products more broadly. However, several of those arguments constitute good reasons against the Notice's suggested revisions to FINRA's rules on options trading.

[24] Notice 3.

[25] Notice 3.

[26] Notice 4.

[27] Notice 4.

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Essentially, the Notice would leave investors and professionals guessing what features would make FINRA determine an asset is complex. In FINRA's estimation, asking someone whether they understand the product is not enough.[28] FINRA endorses this nebulous definition "to avoid a static definition that may not address the evolution of financial products and technology."[29] However, regulatory certainty matters at least as much and maybe more than agency flexibility.

FINRA admits that new "products and technology" are rapidly "evol[ving]," which makes regulatory certainty much more crucial to investors and investment professionals.[30] Anything less than FINRA's acknowledgment of the costs of its choice to leave the central term in its regulatory approach as undefined would be arbitrary and capricious. The Notice does nothing to show that FINRA understands those costs or even carefully considers those costs. Instead, FINRA opts to preserve agency flexibility.

FINRA's justification for leaving its key term undefined is particularly perverse. FINRA chooses agency flexibility over regulatory certainty because it believes that retail investors cannot understand complex products. Retail investors will find it impossible to understand the products they will be permitted to access because FINRA prejudges that those investors cannot understand those complex products. That FINRA fails to see its circuitous logic is due primarily to FINRA's failure to abide by the goals of the Exchange Act.

The Notice denies retail investors the agency to craft personalized investment strategies because it fails to clarify the regulatory regime that retail investors must operate, potentially limiting their financial futures. The Notice's approach is "so vague that men of common intelligence must necessarily guess at its meaning."[31] Furthermore, the Notice demands that retail investors guess at the key term of the regulation. Subjecting the public to such guesswork is anathema to our Constitution.[32]

The Notice Fails to State a Problem.

While The Notice displays absolute certainty that expanded investor access to complex products is harmful, the Notice does not cite a single real-world example of harm from this access. The only real-world instances of harm cited by the Notice cites are cases of mistakes and misconduct by investment

[28] *See, e.g.*, Notice 15 (suggesting inadequacy of investor self-assessments).

[29] Notice 3.

[30] Notice 3.

[31] *FCC v. Fox Television Stations, Inc.*, 567 U.S. 239 (2012).

[32] *Id.*

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professionals.[33] However, instead of concluding that such errors and malfeasance demand options for expanded investor access to complex products, the Notice proposes to impose restrictions, further rendering investors dependent on professionals' skill and good faith.

FINRA infers that investor access to certain complex products could confuse retail investors that trade in the products instead of documenting real-world harms arising from investor access.[34] The lack of real-world examples of investor harm may indicate no investor harm. Perhaps all the retail investors that trade in complex products understand complex products. FINRA cites no evidence to the contrary. Investor access is only a problem if the retail investors looking to trade in complex products do not understand those products. A regulation curtailing a problem is "highly capricious if that problem does not exist,"[35] and FINRA has failed to show investor access is a problem.

The Notice Disregards the Critical Role of the States in Educating Their Residents about Financial Matters.

However, if FINRA's assertions that unsophisticated investors are suffering harm from transacting in complex products, education, not regulation, would be a better way to address that harm. Such education would minimize investor harm while preserving the benefits of investor access. Rather than top-down regulation, FINRA could enlist the States, drawing on their long tradition of financial education for their residents. Most States have implemented several initiatives to educate the public about financial matters. As of 2018, only five States had failed to build financial literacy standards into educational requirements.[36]

For example, through the Financial Literacy Commission, Tennessee established the Financial Empowerment Resource Library to provide resources to help adults become more financially conscious.[37] Utah established the Council on Financial and Economic Education "to ensure improved financial and economic education in Utah through collaboration with private and public entities that teach financial principles."[38]

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[33] Notice 5.

[34] Notice 12.

[35] *Alltel Corp. v. FCC*, 838 F.2d 551, 561 (D.C. Cir. 1988).

[36] *See* Kasman, Heuberger, & Hammond, *Are states providing adequate financial literacy education?*, Brookings (Oct. 3, 2018), https://www.brookings.edu/research/are-states-providing-adequate-financial-literacy-education/.

[37] Tennessee, *Education: Worth the Investment*, https://treasury.tn.gov/Financial-Education/Financial-Literacy-Commission/Education-Worth-the-Investment.

[38] Utah, *Financial Education*, https://treasurer.utah.gov/utahfe/.

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Also, there are many private financial literacy initiatives, such as the Jump$tart Coalition for Personal Financial Literacy, which "consists of more than 100 national organizations and a network of 51 … state coalitions that share a commitment to advancing youth financial literacy."[39]

As the SEC has discovered, the failure to consider whether the market needs federal regulation considering effective State efforts renders a regulation arbitrary and capricious under the APA.[40] The Notice fails to consider whether States (or private entities) are better situated to remedy the problem of expanded investor access through State and private educational efforts than FINRA could by limiting investor access.

Sincerely,

Will Hild

Will Hild – Executive Director

Beau Brunson – Director of Policy and Regulatory Affairs

[39] *About Us*, Jump$tart, https://www.jumpstart.org/who-we-are/about/.

[40] *Am. Equity Inv. Life Ins. Co. v. SEC*, 613 F.3d 166, 178-79 (D.C. Cir. 2010).

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