May 4, 2022

Jennifer Piorko Mitchell
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

Re: FINRA Request for Comments on Regulatory Notice 22-08

Dear Ms. Mitchell:

I currently serve as Co-CEO and CSO of Orion Trading Systems, (www.oriontradingsystems.com) a global supplier of multi-asset trading software. Prior to this role, I spent 15 years as a senior executive in Fidelity Investments' retail brokerage and active trader groups. In my final role at Fidelity, I was responsible for providing security-specific research to Fidelity customers on equities – stocks, exchange traded products (including ETFs, ETNs, and partnerships), and closed end funds as well as online education to our customers across a variety of topics – planning, products, platforms and investing strategies.

My comments below are based on my personal experience working directly with retail customers for nearly 20 years, and do not necessarily represent the views of my present or previous employers.

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As a requirement for my roles at Fidelity, I was licensed as a Registered Representative, as a General Securities Sales Supervisor, and as a Securities Trader with FINRA. One of the concerns raised by FINRA in this notice is as follows:

> "*These concerns may be heightened when a retail customer is accessing these products through a self-directed platform and without the assistance of a financial professional, who may be in a position to explain the key features and risks of the product to the retail investor*."

My licensing and continuing education required by FINRA provided little to no training and education on complex products. Outside of standardized product descriptions provided by brokerage firms, financial professionals today are ill-equipped to explain key features and risks of these products. **The first action FINRA should take is to require training and licensing for registered representatives selling complex products to individuals.**

I would like to focus my other comments in two general areas:

- **The sophistication and capabilities of the retail, self-directed customer**
- **Complex products and customer risk.**

FINRA has raised reasonable concerns about the proliferation of complex products in the market. The ETF wrapper has provided access to individuals to a variety of readily tradeable strategies. These strategies have enabled individual investors to craft low-cost investment portfolios previously only accessible to very high net worth individuals. This has been a huge step forward in democratizing finance. FINRA choosing to eliminate individual investors' access to these strategies would, in fact, be harmful to the investing public.

<u>The sophistication and capabilities of the retail, self-directed investor</u>

The financial industry often looks down on self-directed individual investors. In conversations over the years, I have heard investment professionals tell me that *investors shouldn't be buying individual bonds, portfolio management should be left to professionals,* etc. And while this may be true with respect to some individuals, I have personally met with many investors whose experience, knowledge, and capabilities are equal to if not better than that of many investment professionals.

Who is a *typical* self-directed investor? A typical self-directed investor is simply someone who chooses to take responsibility, in whole or in part, for managing their own investments. They made trade infrequently or actively. They may build their portfolio from index funds, select individual securities, or delegate security selection to investment managers.

What people saw throughout the GameStop saga represents a small but vocal minority of self-directed investors. If you look more closely at investing forums on Reddit, you'll see that even there, only a small percentage of individuals focus on highly leveraged all-or-nothing plays. Most investors are there to learn.

Learning is what separates better investors from the rest. For years, the most active booth at investor and active trader events was the bookseller. As a lead sponsor of several of these events, Fidelity had hundreds of individuals attending our educational presentations. Fidelity's online educational events regularly had thousands in attendance.

In one-on-one conversations with individual investors, I learned that many have very specific goals and well-thought-out strategies to achieve them. They range from covered call writing combined with technical analysis, sophisticated dividend growth strategies, momentum and trend following strategies, to numerous advanced options strategies to generate income or hedge risk. What do a large number of these strategies have in common? Many are the strategies that have been packaged by sponsors into easily tradeable, low cost, well-documented exchange traded products. Product sponsors are launching these new products to satisfy existing customer demands for a single tradeable asset to satisfy what would otherwise be difficult and/or expensive for an individual to replicate.

The challenge for FINRA is to identify a way to protect the minority while enabling the majority of investors to learn, grow, and protect and build their wealth.

<u>Complex products and customer risk</u>

Complex products can be categorized into a few general buckets:

- Risk enhancing – leveraged products
- Risk reducing – Defined outcome, call writing, rebalancing, hedging
- Alternative asset class access – commodities, crypto, bank loans, TIPs, currencies

<u>Risk Enhancing</u>

In this regulatory notice, FINRA states:

> "*While the number of geared ETPs and the market value they represent have remained fairly stable, some of these products are often among the most actively traded ETPs. It appears that retail investors continue to purchase these instruments.*"

For years, FINRA has focused attention on the risks inherent in leveraged ETPs. FINRA and broker-dealers have been explaining to customers the impact of daily rebalancing of these investments and the negative drag on outcomes over time. The emphasis across the industry has been that these are trading vehicles that are not suitable for long-term investing**. FINRA's statement above is in fact confirmation of the success of these communication campaigns.** Customers trade these ETPs very actively but have learned and understood the consequences of holding these products long term.

Risk Reducing / Alternative Asset Classes

These complex products can serve a valuable role in individuals' portfolios:

- A defined outcome fund could help keep an individual that fears a market decline invested when they would otherwise withdraw from equity markets.
- A currency-hedged investment can help make owning foreign stocks more attractive by reducing the impact of currency swings.
- Owning commodities which are non or less correlated assets can help improve individuals' portfolio outcomes.
- When individuals are concerned about inflation, owning TIPs or variable rate loan funds can be an attractive alternative fixed income investment.

The loss of access to these investment alternatives, imposing onerous qualifications for access, or drawing a line between acceptable and unacceptable products would do harm to self-direct individual investors.

The success of the efforts by FINRA, the Securities and Exchange Commission, and brokers around leveraged products clearly demonstrate that messages, communicated broadly and frequently, can positively impact investor behavior. FINRA should similarly focus communications and education to investors about other complex products.

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Responses to specific FINRA questions

Complex Products

2.a and 2.e - Enhanced account approval processes before an account may trade in complex products? Restrictions or limitations on retail customer access to complex products (*e.g.,* limiting access to high-net worth or other categories of customers)?

> These requirements would be both impractical to implement (a) and inherently discriminatory (e). Too much of today's financial wealth is off limits to many investors in the walled-off gardens of private investments. These proposals could lead to an increase the wealth disparities we see in society today.

7.c.ii and 7.d.i - Retail customers to demonstrate their understanding of those common characteristics and risks of complex products by completing a knowledge check and, if the customer fails to show the requisite knowledge, requiring the completion of a learning course and additional assessment? Before transacting in any particular complex product, or periodically while the customer holds the complex product, requiring retail customers to review disclosures regarding the characteristics and risks of the specific product and attest that they have read and understand them?

> This would be burdensome and expensive to administer, would discourage many brokerage firms from offering these securities to their customers, and would impose an unnecessary roadblock to self-directed customers. There is a false association here that complexity means risk. Customers routinely buy individual securities that expose them to far greater risk than many of these complex products and no testing, review or attestation is required for those investments.

10.a and 10.b - Should additional supervisory obligations apply with respect to complex products and retail customers, such as requiring members to implement: Heightened supervision for recommendations of complex products to retail customers? Policies and procedures to help ensure that retail customers possess the requisite understanding of the complex product and its risk prior to allowing such investment, including in self-directed accounts?

> 10.a and 10.b are completely separate. As stated earlier in this comment letter, FINRA should require all brokers recommending complex products to be licensed for them. Requiring self-directed investors to "qualify" to own complex products is both discriminatory and exclusionary.

Options

2. Should members be required to have a conversation with each customer, regardless of whether an account is self-directed or options are being recommended, prior to approval to trade options to ensure that it is appropriate to approve the customer to trade options? How would this best be implemented for a customer who has an online account?

> Customers have been trading options for decades. During this period, brokerage firms have had in place processes for reviewing what level of options trading, if any, a customer will be approved for. If FINRA believes that firms have recently not lived up to their obligations, then

FINRA should follow up with those firms. Interviewing each customer would be burdensome, expensive, and is unnecessary.

7. Should members be required to display total position risk for retail customers holding positions in options, or holding positions that have been entered into as the result of an options assignment? For example, where a customer holds positions in both an option and the underlying instrument, or in multiple options on the same security, such that the exercise of an option may act to limit overall risk, should members display the maximum potential loss and gain for each underlying asset based on their combined option and underlying exposure?

The time has long passed where customers depend solely on their (one) broker's platform to understand their options positioning. The use of options-specific tools and capabilities provided by third parties has rendered the brokers' displays for many customers an afterthought. Many of these tools are far more sophisticated and provide much more information than any broker supplied displays. In addition, active traders, who are the most frequent users of options, often have account relationships with multiple brokers. Since one broker does not have visibility to positions on another broker's platform, the information provided by one broker would be of limited use to a large segment of the potential population of users.

9. If in reviewing an account, a member identifies that a customer has entered into an options transaction (such as a spread traded above parity[82]) whereby it is impossible for the customer to profit from the transaction, should the member be required to pause or suspend the customer from further transacting in options or certain kinds of options?

This would be an egregious requirement by FINRA that would put customers at risk of significant losses. Stopping a customer from trading when they have open options positions could trap them in a situation where they lose money without remedy. [Allowing closing position trades only does not remedy the problem. Often, the best way to exit an options position is to buy a different options position (e.g. rolling a short-dated option position to a longer-dated position.)] Also, a customer could enter a multi-leg options order and be filled at a price disadvantageous to what they expected at the time of order entry. Multi-leg options orders are dependent on the willingness of a counterparty to fill the order – there is no natural market for multi-leg options, and no guarantees around execution price. Finally, as stated before, customers may have accounts at multiple brokers, so what may not make sense from one broker's point of view might make sense from the customer's point of view.

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I appreciate the opportunity to provide comments on complex products and options in the retail brokerage environment. I would be happy to answer any questions or provide additional detail as requested by FINRA.

Sincerely,

Franklin Gold