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May 9, 2022

By email to pubcom@finra.org
Jennifer Piorko Mitchell
Office of the Corporate Secretary
Financial Industry Regulatory Authority, Inc.
1735 K Street, NW
Washington, DC 20006

RE: Regulatory Notice 22-08: Complex Products and Options

Dear Ms. Mitchell:

I am writing on behalf of the North American Securities Administrators Association, Inc. ("NASAA")[1] in response to Financial Industry Regulatory Authority ("FINRA") *Regulatory Notice 22-08: Complex Products and Options – FINRA Reminds Members of Their Sales Practice Obligations for Complex Products and Options and Solicits Comments on Effective Practices and Rule Enhancements* (the "Notice").[2] We appreciate FINRA's efforts to understand the risks posed by these products and strategies, and we hope it will lead FINRA to enhance investor protections.

In general, NASAA believes that the safeguards surrounding the marketing and sale of complex products to retail investors are inadequate. Our recent Regulation Best Interest ("Reg BI") examination reports indicate that broker-dealers still have shortcomings in their due diligence, disclosure, and conflict management policies, procedures, and practices when recommending complex products to retail investors.[3] We have also observed that so-called self-directed online platforms and mobile applications push retail investors to trade options and complex products with little or no assurance that they are prepared to do so. Our comment letters to the Securities and Exchange Commission ("SEC" or the "Commission") and FINRA have consistently advocated for stronger requirements to ensure that developments in products, practices and technology do not leave investor protection considerations behind.[4] With respect to the Notice, NASAA believes

[1] Organized in 1919, NASAA is the oldest international organization devoted to investor protection. NASAA's membership consists of the securities administrators in the 50 states, the District of Columbia, Canada, Mexico, Puerto Rico, and the U.S. Virgin Islands. NASAA is the voice of securities agencies responsible for grass-roots investor protection and efficient capital formation.

[2] The Notice is available at https://www.finra.org/sites/default/files/2022-03/Regulatory-Notice-22-08.pdf.

[3] NASAA Regulation Best Interest Implementation Committee: National Examination Initiative Phase One (Sept. 2020) ("NASAA Phase I Report"), https://www.nasaa.org/wp-content/uploads/2020/09/Reg-BI-Phase-1-Report.pdf; NASAA Regulation Best Interest Implementation Committee: National Examination Initiative Phase II(A) (Oct. 2021) ("NASAA Phase IIA Report"), https://www.nasaa.org/wp-content/uploads/2021/11/NASAA-Reg-BI-Phase-II-A-Report-November-2021_FINAL.pdf.

[4] *See, e.g.* Letter from Melanie Lubin, NASAA President, to Vanessa Countryman, SEC, *Re: 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* (the "DEP

that FINRA could better protect retail investors by ensuring that its members and their representatives fully understand the products they are offering, requiring its members to limit a customer's access to complex products and strategies until they are confident that the customer has sufficient knowledge and experience to trade in them, requiring its members to provide educational materials and point-of-sale warnings for complex products and strategies, and prohibiting the indiscriminate marketing of complex products and strategies to retail investors. More detailed recommendations are set out below.

I. General Comments

A. FINRA Member Firms are Failing to Meet Their Regulation Best Interest Obligations by Offering Complex Products to Inappropriate Investors, Providing Inadequate Disclosures, and Failing to Eliminate or Mitigate Harmful Compensation Conflicts.

As part of its Reg BI implementation work over the past three years, NASAA has issued two reports that document numerous findings regarding industry policies, procedures, and practices involving complex products.[5] Those reports highlight – based in part on FINRA's own data[6] – how complex products continue to be a perennial source of investor complaints and regulatory actions. The data compiled in those reports establish that FINRA member firms, whether operating as standalone broker-dealers or dual registrants, are much more likely to recommend complex products than standalone investment advisers.[7] Within FINRA member firms, the data also establish that firms that recommend complex products are much more likely to engage in harmful compensation conflicts than firms that do not recommend these products.[8]

Comment Letter") (Oct. 1, 2020), https://www.nasaa.org/wp-content/uploads/2021/10/NASAA-Comment-Letter-for-File-No-S7-10-21-Digital-Engagement-Practices-and-Investment-Adviser-Technologies.pdf; Letter from Chris Gerold, NASAA President, to Vanessa Countryman, SEC, *Re: File No. S7-24-15: Use of Derivatives by Registered Investment Companies and Business Development Companies; Required Due Diligence by Broker-Dealers and Registered Investment Advisers Regarding Retail Customers' Transactions in Certain Leveraged/Inverse Investment Vehicles* (Mar. 27, 2020), https://www.nasaa.org/wp-content/uploads/2020/03/NASAA-Comment-Letter-re-SEC-Release-No.-34-87607-Use-of-DerivativesDue-Diligence-Requirement.pdf; Letter from Chris Gerold, NASAA President, to Jennifer Piorko Mitchell, FINRA Office of the Corporate Secretary, *Re: Regulatory Notice 19-27: Retrospective Rule Review* (Oct. 8, 2019), https://www.nasaa.org/wp-content/uploads/2019/10/NASAA-Comment-Letter-Re-Reg-Notice-19-27-10-8-19.pdf.

[5] NASAA Phase I and Phase IIA Reports, *supra* note 3.

[6] NASAA Phase IIA Report at 6 (drawing data from FINRA Dispute Resolution Statistics, Top 15 Security Types in Customer Arbitrations (2020), https://www.finra.org/arbitration-mediation/dispute-resolution-statistics/2020#top15securitycustomers). As noted in the report, the four complex products analyzed in the state initiative remained at the top of FINRA's list in 2021. *See* FINRA Dispute Resolution Statistics, Top 15 Security Types in Customer Arbitrations (2021), https://www.finra.org/arbitration-mediation/dispute-resolution-statistics#top15securitycustomers.

[7] *See, e.g.,* NASAA Phase I Report at 3-4; NASAA Phase IIA Report at 16.

[8] NASAA Phase IIA Report at 16.

To ensure that firms are acting in the best interest of retail investors, NASAA believes that firms' due diligence, disclosure, and conflict management policies, procedures, and practices must ensure that firms: properly match complex products with appropriate investors; provide full and fair disclosures regarding the costs, risks, and conflicts associated with these products at the time of recommendation; and eliminate or mitigate compensation conflicts that incentivize firms to steer investors into complex products when lower-cost and lower-risk products are reasonably available. NASAA members would be happy to meet with FINRA staff to make sure any regulatory policy updates involving complex products effectively address the findings and recommendations of our Reg BI reports.

B. Firms Owe Duties to Investors to Whom They Provide Trading Tools and Direct Market Access.

Regulatory guardrails for broker-dealers, including limitations on the types of products and account permissions made available to certain customers, should serve to control the access retail investors have to complex products. Allowing technological innovations to circumvent those guardrails will result in investor harm. Firms that attract retail investors to online platforms and mobile applications where they are provided with trading tools and market access have a responsibility to provide those investors with education on sound investing practices, and to perform the due diligence necessary to be confident that those investors are prepared to trade in the products and strategies made available to them. Self-directed brokerages especially should be required to implement product access and account gating procedures that are rigorous enough to ensure that investors understand the tools and products provided to them.

When it comes to complex products in particular, some form of intermediation is essential. For example, no reasonable industry participant would argue that a brand-new investor should be allowed to trade futures directly. Likewise, FINRA's own rules and guidance for validation and verification before a customer can trade options[9] speak to the necessity of gating and control over access to complex products as well; the concerns over allowing inexperienced investors to trade products or engage in strategies that they may not understand are the same.

C. Digital Engagement Practices that Encourage and Stimulate Trading are Recommendations.

NASAA has expressed concerns over digital engagement practices ("DEPs") from platforms and applications that use notifications, prompts, "nudges," and other tools to grab the attention of their customers.[10] These features are designed to increase interaction with an application or platform, the only ostensible purpose of which is to encourage and stimulate trading. As we have observed, self-directed platforms must get customers to trade frequently in order to

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[9] *See* FINRA Rule 2360(b)(16); FINRA Reg. Notice 21-15, *FINRA Reminds Members About Options Account Approval, Supervision and Margin Requirements* (Apr. 2, 2021), https://www.finra.org/rules-guidance/notices/21-15.

[10] DEP Comment Letter at 2-5.

make money.[11] The subtle and clever calls to action[12] that self-directed firms use to generate trading on their platforms and applications should be regarded as recommendations.

Unfortunately, DEPs can market complex products inappropriately, and can induce investors to make irrational trading decisions. It is hard to understand how ungated access to complex products, combined with unrelenting DEPs and marketing strategies, are in the best interest of investors. Indeed, just the opposite is clear; DEPs serve only the interests of the firms that push them. Further, encouraging trading in higher commission products serves firms, not investors. Accordingly, DEPs that push higher-commission options strategies and complex products are made either in ignorance of or with disregard for retail investors' best interests.

As we approach the third year following the adoption of Reg BI,[13] regulators and industry alike have an obligation to see that the new conduct standard is implemented robustly and that financial professionals conduct business in the best interest of investors. Adequate best interest standards require that investors are equipped to trade in the products and strategies to which they are given access despite being in self-directed accounts. SEC staff have already recognized that fiduciary principles applicable under Reg BI attach to account selection recommendations.[14] It follows that giving access to trading tools for options and complex products falls under the same principles. It is simply not acceptable that a self-directed firm could take the position that it holds no responsibility for investor choices when it facilitates and pushes investors toward those choices.

II. Responses to Certain Requests for Comment Regarding Complex Products

1. *How do members categorize products as "complex"? Have firms implemented categories or tiers of complex products and, if so, how have firms determined such tiers? What types of products have recently been introduced that should be viewed as complex? Does our description of characteristics that render a product "complex" continue to appropriately cover necessary products?*

NASAA agrees with FINRA's flexible description of "complex products" in this and previous regulatory notices. FINRA's focus on products with "features that may make it difficult for a retail investor to understand the essential characteristics of the product and its risks"[15] captures the essential concern. We recommend that FINRA convert its guidance into a definition flexible

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[11] *Id.* at 4 n.10 (discussing the use of payment for order flow arrangements by certain broker-dealers who offer zero commission brokerage services to retail investors).

[12] *See NASD Notice to Members 01-23* (Apr. 2001) (outlining recommendations as a call to action in a case-by-case inquiry), https://www.finra.org/rules-guidance/notices/01-23.

[13] *See* SEC Rel. No. 34-86031, *Regulation Best Interest: The Broker-Dealer Standard of Conduct*, (June 5, 2019) (setting June 30, 2020 as the compliance date for Regulation Best Interest implementation).

[14] *Staff Bulletin: Standards of Conduct for Broker-Dealers and Investment Advisers Account Recommendations for Retail Investors* (May 29, 2022), https://www.sec.gov/tm/iabd-staff-bulletin (the "Staff Bulletin") (noting that the standards applicable to IAs and BDs, while occasionally differing in some respects, "… generally yield substantially similar results in terms of the ultimate responsibilities owed to retail investors.").

[15] Notice at 3.

enough to keep pace with evolving product features but one that could also serve as a basis for future rulemaking.

We also believe that an illustrative and non-exhaustive list of products, subject to periodic updates, should be a component of that definition. We recommend that, in addition to the products already identified in FINRA regulatory notices, the list should include special purpose acquisition company offerings, leveraged and inverse exchange traded funds ("ETFs"), and derivatives-based ETFs, including those based on digital asset futures.

FINRA should also augment its concept of complex product risks by including products that are designed for rapid speculative trading, as well as volatile derivative products. In particular, leveraged and inverse ETFs, generally designed to be held for intra-day or single day trading, may be unsuitable for any retail investor because those investors most often use buy and hold strategies.[16] In general, products that require constant monitoring in order to avoid rapid losses are too risky and not appropriate for retail investors.

The purpose in defining complex products should be to require firms to identify and gate access to these products based on factors such as product features and evaluations of customer knowledge and trading experience.

2. *What practices have firms developed and implemented that have proved effective with respect to supervising sales and trading of complex products, including in self-directed accounts? For example, have members implemented and, if so found effective, any of the following measures with respect to complex products:*

    a. *Enhanced account approval processes before an account may trade in complex products?*

    b. *Requirements that a customer complete training or a learning course before approval to trade in certain complex products?*

    c. *Additional disclosures or educational materials on complex products?*

    d. *Required customer attestations regarding knowledge and experience?*

    e. *Restrictions or limitations on retail customer access to complex products (e.g., limiting access to high-net worth or other categories of customers)?*

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[16] *See* SEC, *Leveraged and Inverse ETFs: Specialized Products with Extra Risks for Buy-and-Hold Investors* (Aug. 1, 2009), https://www.sec.gov/investor/pubs/leveragedetfs-alert.htm, (explaining that "[m]ost leveraged and inverse ETFs 'reset' daily, meaning that they are designed to achieve their stated objectives on a daily basis" and that "[t]heir performance over longer periods of time … can differ significantly from the performance (or inverse of the performance) of their underlying index or benchmark during the same period of time").

Most of the example measures above would help protect retail investors, but they would not go far enough.[17] With respect to complex products, NASAA's Reg BI Phase IIA Report identifies a number of deficiencies in firms' supervisory procedures regarding the approval process. For example, many firms do not collect critical Know Your Customer information at account opening, such as customer education and debt, and do not restrict various complex products to retail investors based on common-sense customer criteria like age, retirement status, liquidity needs, and risk profiles. Enhancing account approval policies and tailoring retail customer access (as compliance-minded firms already do) based on appropriate criteria would go a long way toward remedying these deficiencies. Likewise, many firms continue to hide the ball from retail customers when it comes to the key costs, risks, and conflicts associated with complex products. Enhancing point-of-sale disclosures could address those deficiencies.

Further, none of the measures suggested in the Notice address the management of financial incentive conflicts that are frequently observed in recommendations involving complex products. In addition to the measures suggested, firms should implement (and supervise their representatives for compliance with) policies and procedures that eliminate or mitigate financial incentive conflicts.

With respect to self-directed accounts, NASAA members have unfortunately found that many firms have automated account opening and verification processes with little to no secondary or manual review. At a minimum, an investor's goals and objectives require a case-by-case review to determine appropriate account selection. Human review to open an account or engage in complex products and higher-risk strategies should be required. If application-based firms balk at such requirements, it is incumbent on them to define procedures that effectively make these determinations electronically. NASAA is skeptical that any such technology exists, and we do not believe it is acceptable for firms to shirk their obligations to their customers just because they believe it is difficult or does not fit within their business models.

Similarly, firms should be encouraged to develop and administer assessments designed to gauge an investor's knowledge of complex products. In order to maximize the efficacy of such programs, firms should have appropriately registered persons engage with investors to provide the information necessary to understand the product or strategy. The registered person would then conduct or review an assessment prior to approving an account for trading in complex products. While this may be an investment of time and capital, the increased confidence in investor knowledge and investor protection standards far outweigh any associated costs.

Additionally, firms should be required to create, maintain, and provide investors with educational materials that advise investors of the risks of complex products. Moreover, it is not enough to have such materials maintained in an online library separated from where the point of sale occurs. In order to best protect retail investors, firms should provide prompts and links to educational materials during the trading process so that investors understand, at the point of sale, that there may be things they should learn before committing to a trade.

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[17] NASAA questions the investor protection value of check-the-box customer attestations. In the digital age, many of us have built a habit of clicking "accept" on lengthy agreements and disclosures without reading them.

Finally, limiting access to complex products to high-net-worth individuals would shield many retail investors who are unable to bear the financial burden of extraordinary losses. NASAA has repeatedly pointed out that the natural person accredited investor income and net worth standards have eroded over time due to inflation.[18] While we maintain that these thresholds should be raised, the current thresholds could at least serve as an indicator, although not a sole indicator, that retail investors might be more able to withstand the sorts of losses that can be incurred through trades in complex and risky products.

5. *How do members assess financial professionals' understanding of specific products?*

It is incumbent upon firms and their representatives to understand the products they offer. As the most extreme example, no responsible firm or representative would offer a product if there were indications that the issuer was engaged in fraud. Likewise, no responsible firm or agent would argue that they have no duty to protect their customers from such products. The due diligence expected of firms and their representatives to ferret out frauds should be expected in the evaluation of the risks of legitimate products because the obligation is the same; namely, to protect customers from extraordinary risks. The first step that firms and their representatives must take in order to satisfy that obligation is to make sure that they thoroughly understand the products that they are offering to customers.

The failure to understand complex products being offered to retail investors is actionable misconduct. As just one salient example, UBS personnel sold reverse convertible notes to retail customers as savings vehicles, touting upside yields and downside protections without understanding of the volatility mechanism that determined the product's payout or potential for losses.[19] The SEC found that UBS failed to implement policies and procedures designed to educate its representatives in these complex products. While highlighting sales practice violations, this example should serve as a warning to firms that they have a responsibility to understand the products to which they are providing clients access.

6. *Should any of the current product-specific requirements (e.g., account opening requirements irrespective of whether a recommendation has been made; specific standard of care requirements when recommending these products; specific principal registration and supervision requirements; position limits; exercise limits; disclosure, confirmation and account statement requirements; or specific record-keeping requirements) apply more generally to complex products?*

Yes. Complex products have nonstandard terms, costs, restrictions, and payment and yield mechanisms. Investors should be provided with increased protections, especially in self-directed accounts, to balance out the unique risks posed by these products.

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[18] *See, e.g.* Letter from Christopher Gerold, NASAA President, to Vanessa Countryman, SEC, *Re: File No. S7-25-19: Amending the "Accredited Investor" Definition* (Mar. 16, 2020) at 4, https://www.nasaa.org/wp-content/uploads/2020/03/NASAA-Accredited-Investor-Comment-Letter.pdf.

[19] *See* In the Matter of UBS Financial Services, Inc., SEC Rel. No. 34-78958 (Sept. 28, 2016), https://www.sec.gov/litigation/admin/2016/34-78958.pdf; *see also* the cases cited in the Notice at nn.12-15.

7. Should different or additional requirements be applied with respect to complex products?

NASAA believes that firms should make reasonable assessments of whether any product is complex and risky before offering it to its customers. Firms should disclose that a product is a "complex product" before every transaction in such products and make significant educational materials available to investors at the point of sale. For example, transactions in leveraged or inverse ETFs should be accompanied by a clear warning and disclosure stating that those products are intended for short-term trading. Product warnings and disclosures need to be direct and short enough to capture the attention of retail investors in the midst of deciding to trade while tailored to the product at issue, highlighting the most pertinent risks or misunderstandings related to that particular product. Increasing investor education, providing adequate warnings to investors, and human-evaluated testing for investor knowledge should be considered by firms depending on the nature and complexity of the underlying investment.

Additionally, further customer engagement must take place after the initial approval to trade in complex products. This is essential for all investors, but especially for senior investors and those with diminishing capacities. For these groups, the potential need for liquidity coupled with potential difficulties with unravelling complex products positions requires heightened supervision and routine account reviews. Such reviews should also look for significant changes in circumstances that could or should remove an investor's permission to access complex products.

These positions should not be viewed as restricting investor access, but rather as tailoring access in a manner consistent with relevant conduct standards. Under Reg BI, firms may only recommend products and strategies that are in the best interest of their customers. It is virtually never in the best interests of senior or retired investors, who may need to tap into their investments quickly for healthcare expenses, to have their money tied up in illiquid complex products. Likewise, it is virtually never in the best interests of investors with limited risk tolerance to be placed into high-risk or speculative complex products. Firms and their representatives must faithfully adhere to the full import of duties under Reg BI when recommending complex products.

8. Should targeted communications, such as push notifications to self-directed retail customers regarding complex products, be subject to specific restrictions? For example, should they be restricted unless certain conditions have been satisfied, including that the account has been approved for complex products?

Yes. Most DEPs are recommendations. Firms should be prohibited from sending targeted communications related to options and complex products to customers who are not authorized to trade in those products. Investors seeking these opportunities are more likely to understand the inherent risks, while investors pushed into them by DEPs may lack the sophistication to understand these trades. Marketing should be tailored to tiered account levels and authorizations.

9. *In addition to applicable requirements in FINRA Rule 2210 (Communications with the Public), should members be required to file communications that promote or recommend complex products with the Advertising Regulation Department of FINRA for review before their first use?*

Yes. A common industry and regulatory adage for many complex products is that they are "sold, not bought." These products are "sold" today through a variety of communications that tend to promote the upside while glossing over downside risks. Those materials should be filed with and reviewed by FINRA.

10. *Should additional supervisory obligations apply with respect to complex products and retail customers, such as requiring members to implement:*

    a. *Heightened supervision for recommendations of complex products to retail customers?*

    b. *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?*

    c. *Testing relating to the implementation of those policies and procedures, including the testing of automated systems that are used as part of that implementation process?*

The suggested additional supervisory obligations listed above should be included in subsequent rulemaking. However, automated systems that approve investors for complex product trading should also have some form of human oversight and review. Accounts that have red flags or questionnaires with concerning responses should be put into a review queue for a determination as to whether the investor should be allowed to trade in complex products.

11. *Are there regulatory developments in other jurisdictions related to complex products that would strengthen protections regarding complex products, including in self-directed accounts? For example, to address the risk of customer overestimating their knowledge and experience, should members be required to implement:*

    a. *Procedures designed to limit a customer's possible circumvention of questionnaires such as a cooling-off period before a customer can respond more than once to a questionnaire designed to assess their level of knowledge?*

    b. *Tools to counterbalance self-assessments with objective criteria?*

    c. *In the case of online services, design features to ensure information and questionnaires are sufficiently clear?*

NASAA would likely support the measures described above. Online forms are susceptible to both confusion in how to respond to questions and possibly circumvention by eager investors, even though misrepresentations or omissions could lead to significant losses. Cooling-off periods would be helpful. Also, substantial changes in responses from earlier assessments should trigger account reviews and customer conversations. Such changes should also be accompanied by

objective criteria review that attests to the accuracy and validity of the information being provided. NASAA would also encourage FINRA to consider the advertising restrictions that European regulators are exploring with respect to investments deemed high-risk, an attribute commonly observed with many complex products.[20] For example, in the United Kingdom:

> [T]he FCA would ensure firms that approve and communicate financial marketing have relevant expertise and understanding of the investments being offered, improve risk warnings on ads and ban incentives to invest, for example new joiner or refer-a-friend bonuses. Those looking to make certain high-risk investments would also be asked more robust questions about their knowledge and investment experience, after research found many consumers were investing without being aware of the risks.[21]

12. *Given the uptick in transactions in options and other complex products through self-directed platforms, many of which are designed to provide retail customers with easy access to an array of financial products, are additional guardrails needed for these types of platforms, including for example, in cases where communications through the platform do not rise to the level of a "recommendation" under Reg BI?*

NASAA disagrees with the premise of this question because most DEPs are recommendations. Our securities laws are construed liberally in order to serve their remedial purposes.[22] We believe that the call-to-action standard[23] should likewise be applied liberally to DEPs for a similar reason; namely, most DEPs should be regarded as recommendations in order to limit the ability of registrants to disclaim responsibility for the harms that they allow, or even encourage, investors to inflict upon themselves. Any interpretation that allows firms to absolve themselves from responsibility to their customers is antithetical to our system of securities regulation.

NASAA does, however, agree that additional guardrails are needed for self-directed platforms because they often lack the supervisory controls that exist with traditional broker-dealer relationships. Having some account oversight and a point of contact with whom to discuss complex product investments and account distribution provides a net benefit for investors.

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[20] See, e.g., Financial Conduct Authority Consultation Paper, "Strengthening our financial promotion rules for high risk investments, including cryptoassets," (Jan. 2022), https://www.fca.org.uk/publication/consultation/cp22-2.pdf.

[21] FCA Press Releases, "FCA to strengthen financial promotions rules to protect consumers," (Jan. 19, 2022), https://www.fca.org.uk/news/press-releases/strengthen-financial-promotions-rules-protect-consumers.

[22] *See*, *e.g.*, *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128, 151 (1972) (interpreting Section 10 of the Securities Exchange Act of 1934, and stating that "Congress intended securities legislation enacted for the purpose of avoiding frauds to be construed 'not technically and restrictively, but flexibly to effectuate its remedial purposes'"); *SEC v. Capital Research Bureau, Inc.*, 375 U.S. 180, 195 (1963) (same with respect to the antifraud provisions of the Investment Advisers Act of 1940).

[23] *See NASD Notice to Members 01-23* (Apr. 2001).

III. Reponses to Certain Requests for Comment Regarding Options

1. *What practices have proved effective with respect to compliance with the options requirements, including supervision, disclosure and account approval requirements?*

NASAA believes that increased disclosure, and lower concentration and exercise limits should remain priorities for options. We note that FINRA has included important steps and considerations a member must perform in connection with approving an investor to trade options,[24] and we encourage this sort of guidance to be extended to self-directed platform providers.

2. *Are there additional requirements that should be added to the existing options requirements?*

    b. *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?*

More needs to be done to verify investor information and attestations for online accounts. In examinations, our members have observed disconnects between account suitability information and the option tiers investors were authorized to access. There do not appear to be sufficient efforts by firms to match suitability information with the approved options tier and access to the purchase and sale of specific options. While we encourage the rules surrounding authorizations to trade in options to include a conversation with the consumer, any automated or manual account approval system should, at a minimum, be structured to match the suitability information provided by the investor to the accessible option tier.

    c. *Should periodic reassessment of the retail customer's account be required to ensure that the initial account approval for options trading remains appropriate?*

Yes. An investor's profile, wealth, and capacity to understand options and derivatives trading can change substantially in a short amount of time. Reassessment should occur on a frequent basis, but at a minimum should be performed annually.

    d. *Should targeted communications, such as push notifications to self-directed retail customers, regarding options be subject to specific restrictions? For example, should they be restricted unless certain conditions have been satisfied, including, for example, that the account has been approved for options?*

Firms should be prohibited from sending targeted communications to trade options to customers who are not approved to trade them. The same should be true of complex products; firms should not send targeted communications to investors to trade products that they are not approved to trade. Push notifications that entice investors into higher-risk categories and attempt

[24] FINRA Reg. Notice 21-15.

to increase either interaction with the application or increased trading activities cannot, by definition, be in the best interest of the investor.

f.ii. SRO options rules (e.g., FINRA Rule 2360(b)(16)) require that a member give a customer the Options Disclosure Document prior to approval for options trading. Should a simple, perhaps single page, disclosure document that focuses on the key risks of trading options be required to be delivered, in addition to the ODD, to a customer prior to approval for options trading?

f.ii.A. What are the key risks that should be communicated other than those set forth in the ODD??

The Options Disclosure Document is very long, which is likely to discourage many retail investors from reading it. FINRA should craft a short document in plain English that includes clear warnings regarding the risks, potential losses, and downsides of options trading.

f.ii.B. Should members also receive an acknowledgement of understanding of the risks of trading options from customers before approving a customer to trade options? Should this requirement to acknowledge an understanding of the risks of trading options be required to be completed every year?

Yes. A documented understanding of the risks associated with options trading should be collected by firms at the time options trading is authorized and, at a minimum, annually thereafter.

g. 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?

Yes. Displaying the total amount at risk and potential exposures to one underlying asset or option reference would enhance investor protection and provide increased transparency into an investor's holdings. Clear and fulsome position risk information should be considered a necessity.[25] Significantly leveraged positions based on the same asset can quickly lead to financial hardships for unskilled investors venturing into options trading.

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[25] *See* Sergei Klebnikov and Antoine Gara, *20-Year-Old Robinhood Customer Dies by Suicide After Seeing a $730,000 Negative Balance* (June 17, 2020), https://www.forbes.com/sites/sergeiklebnikov/2020/06/17/20-year-old-robinhood-customer-dies-by-suicide-after-seeing-a-730000-negative-balance/?sh=283629591638.

k. Would any of the aforementioned obligations unduly or appropriately restrict investor access to options?

No. Safeguards are not access restrictions; they are prudent measures to ensure that investors understand and are in a position to assume certain risks. Options pose increased risks to investors and require a greater understanding of the financial markets. Increased scrutiny, more stringent reviews, and the ability to revoke access to options trading are appropriate safeguards that ultimately benefit investors.

IV. Conclusion

NASAA appreciates the opportunity to comment on the Notice. In summary, NASAA believes that FINRA could better protect retail investors by ensuring that its members and their representatives fully understand the products they are offering, requiring its members to limit a customer's access to complex products and strategies until they are confident that the customer has sufficient knowledge and experience to trade in them, requiring its members to provide educational materials and point-of-sale warnings for complex products and strategies, and prohibiting the indiscriminate marketing of complex products and strategies to retail investors.

Thank you for considering these views. NASAA looks forward to continuing to work with FINRA in the shared mission to protect investors. Should you have questions, please contact either the undersigned or NASAA's General Counsel, Vince Martinez, at (202) 737-0900.

Sincerely,

Melanie Senter Lubin
NASAA President
Maryland Securities Commissioner