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May 9, 2022

**VIA EMAIL**

Jennifer Piorko Mitchell
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506
pubcom@finra.org

**Re: Regulatory Notice 22-08, Complex Products and Options**

Dear Ms. Mitchell:

The Fairbridge Investor Rights Clinic at the Elisabeth Haub School of Law at Pace University,[1] operating through John Jay Legal Services, Inc.,[2] welcomes the opportunity to respond to FINRA's request for comment on effective practices and rule enhancements regarding complex products and options. Our mission is to represent investors of modest means who have been harmed by the misconduct of their brokers, as well as to advocate for the protection and education of small investors. Over the past year, the clinic has seen a rise in inquiries from investors regarding self-directed accounts. One concern with this increase is the lack of

[1] The Pace Investor Rights Clinic, which opened in 1997, was the nation's first law school clinic in which law students, for academic credit and under close faculty supervision, provide pro bono representation to individual investors of modest means in arbitrable securities disputes. *See* Barbara Black, *Establishing A Securities Arbitration Clinic: The Experience at Pace*, 50 J. LEGAL EDUC. 35 (2000); *see also* Press Release 97-101, Securities Exchange Commission, *SEC Announces Pilot Securities Arbitration Clinic To Help Small Investors – Levitt Response To Concerns Voiced At Town Meetings* (Nov. 12 1997), *available at* http://www.sec.gov/news/press/pressarchive/1997/97-101.txt.

[2] John Jay Legal Services, Inc. is a not-for-profit legal services firm that houses and runs the clinic and externship programs at the Elisabeth Haub School of Law at Pace University. In our clinics, students provide direct legal representation and access to justice for clients on a pro bono basis while being supervised by clinical faculty. In our externships, students work with and learn from practicing lawyers in a variety of placements tailored to their interests. These experiential learning programs offer students the opportunity to gain real-world practical legal experience during their time at Haub Law.

safeguards in place to protect self-directed, often unsophisticated, investors from investing in complex products and options, which they often do not understand. Therefore, our comments in this letter will focus on self-directed accounts.

We appreciate the allure to investors of potential high rewards associated with complex products and options. At the same time, we are concerned with the high risk associated with complex products and options, particularly to novice self-directed investors, who may not understand the nuances of the products and their related risks. We share FINRA's concern, highlighted in the Regulatory Notice, regarding customers accessing these products through self-directed platforms and without the assistance of a financial professional, who may act as a safeguard by explaining the key features and risks of a product to retail investors. Therefore, we believe it is important to implement additional safeguards to protect investors in self-directed accounts trading in complex products and options, including in the following areas: options account approval process, complex products approval process, conversations with self-directed customers, and targeted communications regarding complex products.

**Member Firms Should be Required to Follow a Mandatory Industry Standard for Options Trading**

In Question 1 regarding Options, FINRA asked: "What practices have proved effective with respect to compliance with the options requirements, including supervision, disclosure and account approval requirements?"

Rule 2360(16) governs the process for approving an account for options trading. The intention of the rule appears to be (and we agree should be) to impose mandatory requirements on firms when approving options trading. The mandatory nature of these requirements is addressed in FINRA Regulatory Notice 21-15 (reminding members about options account approval and supervision). However, Rule 2360(16) uses the word "shall" rather than the word "must" throughout, creating potential ambiguity. Therefore, we believe "shall" should be changed to "must" to promote a mandatory and consistent industry standard for options trading approval.

Specifically, Rule 2360(B) regarding Due Diligence in Opening Accounts states that "[i]n approving a customer's account for options trading, a member or any person associated with a member shall exercise due diligence to ascertain the essential facts relative to the customer, his financial situation and investment objectives." The rule goes on to detail the essential facts that the firm "shall seek to obtain…at a minimum," including investment objectives, employment status, estimated annual income from all sources, estimated net worth, estimated liquid net worth, marital status and number of dependents, age, and investment experience and knowledge. Rule 2360(B) also states that a "branch office manager, a Registered Options Principal or a Limited Principal … shall specifically approve or disapprove in writing the customer's account for options trading …" The use of the more permissive "shall" rather than the mandatory "must" may allow some member firms to interpret the rule as permissive rather than mandatory, contributing to a lack of due diligence and a uniform standard in the options approval process.[3]

[3] *See* https://www.plainlanguage.gov/guidelines/conversational/shall-and-must/ "'Shall' is ambiguous, and rarely occurs in everyday conversation. The legal community is moving to a strong preference for 'must' as the clearest

Further, Rule 2360(16)(B) also requires written approval by certain individuals specified in the rule. However, these individuals are listed in the recordkeeping subsection (Rule 2360(B(ii)(f)) on an "if applicable" basis. Written approval of options trading, as well the associated recordkeeping, should be mandatory to ensure that firms are conducting proper due diligence in the options approval process and maintaining complete associated account records.

Additionally, our experience and research have shown that there appear to be two types of approval processes for options trading in self-directed accounts. The first process uses an algorithm to instantaneously review and approve applications for options trading in self-directed accounts. The second process involves a questionnaire provided by the firm, which the customer fills out, submits back to the firm, and then waits approximately one to five days for a decision. We believe that the second process should be the mandatory industry standard, as it allows for a more thorough review, deters rash decisionmaking, deters investing based on fear of missing out (FOMO), and incorporates an essential waiting period.

Our first concern with the algorithmic approval process is that it may encourage customers to change their responses in order to get approved, if they are initially declined. The firm asks a few questions and then immediately approves or rejects the request for options trading. If customers are rejected, they can apply again and change their responses in order to be approved. Our second concern with this type of approval process is the lack of a waiting period. As a clinic, we have spoken to unsophisticated investors who were instantly approved for options, and then lost money because they did not understand how options worked. We believe a waiting period is crucial because it can act a safeguard to deter rash investments and filter out unsophisticated investors who do not (yet) understand how options trading works or its associated risks. We view the waiting period as a mindfulness checkpoint to allow investors to reflect on why they want to engage in options trading.

The second process should be standard for all firms because it requires them to perform actual due diligence and does not allow instant approval of options trading. While the instant algorithmic options approval process may attract some investors to these firms, we believe the waiting period is crucial to allow for true due diligence, deter rash decisionmaking, and limit investing based on FOMO.

**Complex Products Should be Available after a Similar Account Approval Process**

In Question 7/7b regarding Complex Products, FINRA asked: "Should different or additional requirements be applied with respect to complex products? For example, regardless of whether a recommendation has been made, should FINRA require members to implement an account approval process before the retail customer's account may transact in any product that the firm has reasonably assessed to be complex? If so, should that process be modeled on FINRA's options rule account approval process or a different process? Please explain."

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way to express a requirement or obligation."). *See also* https://thelawdictionary.org/shall/ ("'Shall'" is generally imperative or mandatory; but it may be construed as merely permissive or directory, (as equivalent to 'may') to carry out the legislative intention and [i]n cases where no right or benefit to any one depends on its being taken in the imperative sense, and where no public or private right is impaired by its interpretation in the other sense.").

We believe there should be additional requirements for complex products and that using a process like the options account approval process, incorporating the recommended changes suggested above, may make sense for complex products as well. We want to ensure that customers have a heightened level of sophistication and understanding when investing in complex products and options. We believe that FINRA should require firms to employ a disclosure and due diligence process to ensure that customers understand the products and associated risks with sufficient time to decide if the product meets their investment profile and needs. Disclosures must be easily accessible, use plain language, and be written in a legible font, as well as in ways that meet the needs of the vision impaired. In addition, we recommend considering the use of a grading system that assesses the riskiness of a complex product, which member firms can use as a safeguard to limit investors' ability to trade in complex products unless approved.

**Members Should be Required to Have a Conversation with Each Customer**

In Question 2b regarding Options, FINRA asked: "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?"

We believe FINRA should require member firms to have a conversation with each customer before approval for trading in options and complex products. This type of safeguard is currently missing in self-directed accounts. As noted above and by FINRA, customers accessing complex products and options through a self-directed platform miss out on the assistance of a financial professional, who may act as a safeguard by explaining the key features and risks of a product to them. Requiring a conversation before approval for trading in options and complex products adds an additional safeguard and mindfulness checkpoint to the due diligence recommended above for approval of complex product and options, where heightened customer sophistication and understanding is important to avoid harm to investors, particularly novice investors.

**Targeted Communications Should be Subject to Restrictions**

In Question 8 regarding Complex Products, FINRA asked: "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?"

Targeted communications, such as push notifications to self-directed retail customers, regarding complex products should be subject to specific restrictions. The default setting for customers with self-directed accounts should be to not receive targeted communications regarding complex products. If customers want to trade in complex products, they should be required to apply to do so, as discussed above. Once the customer is approved, the default still

should require the customer to opt in to targeted communications about these products, rather than having the receipt of such communications be a default setting.

As a clinic, we have seen the dangers of active targeted communications, whether related to complex products or other types of investments. For example, constant push notifications about a price change or a top movers list can lead investors to act on emotion in making trades. This can cause investors to make decisions not in line with their goals and profiles. The customer may view these types of notifications as a recommendation or call to action, when that action is not in their best interest. Therefore, we believe restrictions to targeted communications in general, as well as those regarding complex products, are particularly important for customers with self-directed accounts.

We are grateful for the opportunity to be able to share feedback on this important investor protection issue and support FINRA's efforts to protect investors with regards to complex products and options.

Respectfully submitted,

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