



February 16, 2021

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

**RE: Regulatory Notice 20-42**  
**Comment on Lessons from the COVID-19 Pandemic**

Dear Ms. Mitchell:

The University of Miami School of Law Investor Rights Clinic (“IRC”) appreciates the opportunity to respond to the Financial Industry Regulatory Authority’s (“FINRA”) Regulatory Notice 20-42, which invites input on changes during the COVID-19 pandemic and potential rule changes that FINRA may consider moving forward. The IRC supports FINRA’s efforts to update its regulatory framework and administrative processes as the COVID-19 pandemic has brought about unprecedented change, not only in broker-dealer operations and business models but also in the extensive use of remote offices and work-from-home arrangements.

On behalf of our clients—largely unsophisticated investors—the IRC advocates for the strengthening of FINRA’s regulations and procedures by: (1) reviewing the practices of online brokerage firms and considering implementation of greater individual investor protections, and (2) providing a Zoom arbitration option for *all* investors.

**I. Business Practices of Online Broker-Dealers Merit Regulatory Review.**

In 2020 a surge of new retail investors entered the marketplace through online brokerage firms. The enormous tide of new investors does not appear to be ebbing, as the Robinhood trading application was downloaded at least 1 million times on January 29, 2021.<sup>1</sup> Along with the rise of zero-commission brokerage firms, “the pandemic-fueled market volatility [has]

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<sup>1</sup> Eliza Haverstock & Alex Konrad, *Robinhood Upping Emergency Funding To \$3 Billion As Downloads Hit Record 1 Million Per Day*, FORBES (Feb. 1, 2021), <https://www.forbes.com/sites/elizahaverstock/2021/02/01/exclusive-robinhood-secures-another-1-billion-in-funds-and-is-in-talks-for-more-as-downloads-hit-record-1-million-per-day/?sh=3d5e3a130055>.

brought new investors into the world of stocks, sometimes for the first time.”<sup>2</sup> Work-from-home arrangements and stimulus checks have only augmented the boom in day trading.<sup>3</sup> With playful interactive interfaces, online brokerage firms such as Robinhood and Webull have turned investing into an online game-like social activity and as a result have made it easy and “fun” to wager money on stocks through utilizing complex and risky trading strategies like options and margin.<sup>4</sup> For many, including clients of the IRC, the outcome has been anything but fun.

The IRC currently represents a young, inexperienced investor who was lured into high-risk trading strategies by the representatives of one of the most prominent online trading platforms. This 30-year-old investor had an annual income of about \$15,000, a liquid net worth of around \$30,000, and very little prior investment experience. The firm approved him for options and margin trading after receiving answers to a few questions on an application that required less than five minutes to complete. Rather than offering meaningful disclosure of the risks associated with these complex trading schemes, firm representatives “coached” the inexperienced investor on how to utilize these advanced strategies, even referencing specific stocks to purchase for use in certain strategies. Unfortunately, this uninformed investor was unable to avoid the inevitable risks of options trading and margin and, as a consequence, lost approximately \$30,000 in funds, representing his life savings. To this inexperienced investor who expected financial institutions to have his best interests in mind, the easy approval process and later discussions with firm representatives conveyed a sense that options and margin were appropriate trading strategies for his life savings.

Unfortunately, this client of the IRC is not alone; several callers to the IRC have reported similar experiences with online brokerage firms. Online brokerage firms promoting “zero-commission” trading have generated enormous revenue from the massive influx of investors who have opened actively traded accounts in recent years. In addition to sales pitches touting no account minimums and zero-commission trading, at least part of these online broker-dealers’ success is founded upon clever forms of advertising, marketing, investment presentation, and even push notifications. These “behavioral nudges,” for instance, congratulate new investors on Robinhood with confetti animations for conducting their first trade, encouraging novice investors to trade at high frequencies with investment strategies that they do not understand.<sup>5</sup> While brokerages may see such platform qualities as a way to improve an investor’s access to potential investment opportunities, these features undoubtedly have heightened risks for customers because they have not been developed with the retail investor’s best interest in mind. Rather, these features have been fashioned to attract platform users toward risky trading practices as a method to promote more account activity, e.g., one-click trading. Assuredly unbeknownst to many customers and potential customers is the fact that platforms have a great financial incentive

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<sup>2</sup> Maggie Fitzgerald, *The GameStop Mania Might be Over, but Retail Investors Look Here to Stay*, CNBC (Feb. 13, 2020), <https://www.cnbc.com/2021/02/13/why-retail-investors-are-here-to-stay.html>.

<sup>3</sup> *See id.*

<sup>4</sup> Annie Massa & Edward Robinson, *Robinhood’s Role in the ‘Gamification’ of Investing*, WASH. POST (Dec. 21, 2020), [https://www.washingtonpost.com/business/robinhoods-role-in-the-gamification-of-investing/2020/12/19/83b310ca-41bf-11eb-b58b-1623f6267960\\_story.html](https://www.washingtonpost.com/business/robinhoods-role-in-the-gamification-of-investing/2020/12/19/83b310ca-41bf-11eb-b58b-1623f6267960_story.html).

<sup>5</sup> *Id.*

to encourage more and more trading.<sup>6</sup> Online brokerage firms should appropriately tailor their practices in accordance with a suitable compliance framework to match the level of risk of the trading strategies that they promote in order to generate more revenue from their customers.

As part of its retrospective review process, FINRA should review the operations of major online broker-dealers relating to the marketing of their services, the adequacy of their risk disclosures and approval processes for high-risk trading, and the representations their representatives make to customers by telephone. FINRA should determine whether new regulation, or greater enforcement of existing regulation, is necessary in order for the conduct of online-broker dealers to comply with the spirit of FINRA Rule 2210's requirement that "all communications be based on principles of fair dealing and good faith."

## **II. FINRA Should Require Online Brokerage Firms to Implement a More Rigorous Supervisory System to Better Protect Inexperienced Investors.**

As discussed in the previous section, the recent surge of online investors has provided an opportunity for online brokerage firms to prey on customers lacking investment experience. As discussed below, feasible solutions to this problem are easily within reach.

### **A. Online Communications and a "Red Flag" System**

First, FINRA should more closely scrutinize online brokerage firms' disclosure requirements and approval procedures—specifically those accounts approved for high-risk strategies like options trading. This would provide insight into deficiencies in the firm's current disclosure practices.

Second, all online broker-dealers should implement a supervisory communication review system to confirm that firm representatives are accurately explaining the precise benefits *and* risks of investment strategies. This system should include increased supervisory review of telephone conversations with firm representatives, including review of randomly selected calls scaled to the size of each firm and review of calls with customers who trade and speak with firm representatives frequently. Without such a mechanism, customers will continue to be misinformed as to the true risks of active trading and other risky strategies.

Third, FINRA should require online brokerage firms to implement a "red flag" system to monitor persistent detrimental or risky behavior by their customers. These systems could then notify investors of high-risk exposure positions or trading, while also providing investors an educational supplement regarding their investment strategy or product. Investors would be more adequately protected if they better understood if, when, and why their trading strategies are especially risky.

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<sup>6</sup> Nathaniel Popper, *Robinhood Has Lured Young Trades, Sometimes With Devastating Results*, N.Y. TIMES (Jul. 8, 2020), <https://www.nytimes.com/2020/07/08/technology/robinhood-risky-trading.html>.

## B. Online Educational Content Provided by Brokerage Firms

FINRA should scrutinize all online brokerage firms' educational training modules for sufficient disclosure as to the risks associated with a specific investment or investment strategy. These educational tools undoubtedly encourage investor participation in high-risk trading strategies as they may promote a false sense of confidence in the investor's ability to grasp complex and risky investment strategies. While these educational tools can promote financial literacy amongst their clients, FINRA should monitor these educational tools for misleading statements and to determine whether their content balances explanations of strategies and potential for profits with corresponding disclosure of risks and potential for loss.

### III. The IRC Urges FINRA to Adopt a Zoom Arbitration Alternative for Investors.

In the years leading up to the pandemic, the prevalent use of video-calling and video conferencing indicated that the potential implementation of virtual arbitration was as tenable as it was conceivable. During the pandemic, the necessity for virtual, remote meetings soared, and thus the Zoom boom was born. To keep fundamental legal processes in motion, while protecting parties and the general public, courts and attorneys around the country began using Zoom for meetings, hearings, mediations, arbitrations, and in some cases, trials. Many attorneys and judges have advocated for the continued proliferation of Zoom conferencing for dispute resolution, even after the pandemic subsides and normal life returns. Not surprisingly, evidence of legal practitioners' effective use of Zoom conferencing is not hard to come by. For example, "[t]he State Bar of Texas polled all of their attorneys and asked for impressions of Zoom. According to Judge Miskel, 76% of the attorneys had used Zoom for legal work; 94% had no issues with their client using it; 93% found it to be positive or neutral for their hearings; 85% would recommend using it; and 73% felt it was effective in relation to the courts."<sup>7</sup>

In response to the COVID-19 pandemic, FINRA has administratively postponed all in-person arbitration hearings and mediations until April 30, 2021.<sup>8</sup> Until then, FINRA has provided the ability for proceedings to take place via Zoom, if both parties so stipulate.<sup>9</sup> However, investors are often denied a virtual hearing. Through December 2020, FINRA has received 222 customer motions for virtual hearings.<sup>10</sup> Of those 222 requests, fifty-eight of those motions were denied—amounting to more than 31 percent of all customer virtual hearing requests.<sup>11</sup> The IRC submits that FINRA should continue providing investors the option to conduct arbitration proceedings on Zoom but should make this option available at the investor's choice without the need for agreement by the parties or a contested motion.

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<sup>7</sup> Joseph Raczynski, *The Current Status of the (Virtual) Courts*, THOMSON REUTERS (July 22, 2020) <https://www.legalexecutiveinstitute.com/virtual-courts/>.

<sup>8</sup> *Coronavirus Impact on Arbitration Hearings*, FINRA, <https://www.finra.org/rules-guidance/key-topics/covid-19/arb-hearings>.

<sup>9</sup> *Id.*

<sup>10</sup> *Dispute Resolution Statistics*, FINRA, <https://www.finra.org/arbitration-mediation/dispute-resolution-statistics#resultscustomerclaimant>

<sup>11</sup> *Id.*

However, that is not to say that a Zoom proceeding is a panacea for wronged investors. For arbitration hearings conducted via Zoom in 2020, investors reportedly prevailed in only 28.8 percent of the published awards.<sup>12</sup> On the other hand, from 2015 to 2019, investors prevailed approximately 43.7 percent of the time when in-person hearings were conducted. In addition, when investors win in Zoom arbitrations, they tend to recover less than successful claimants in in-person arbitrations.<sup>13</sup> From 2015 to 2019, the average that claimants recovered was between 54.1 to 73.1 percent of what they requested. For Zoom arbitration hearings from May to December of 2020, claimants recovered an average of only 33.3 percent of the amount they requested.<sup>14</sup>

For all matters that are heard via Zoom, FINRA should seek out comments from the parties regarding their online arbitration experience. This undertaking would ensure that resolution on Zoom is effective, efficient, and fair and may ultimately correlate any issues experienced in the virtual arbitration room with the reduced percentage of prevailing investors. To the extent that FINRA identifies deficiencies related to the fairness of Zoom proceedings, it should implement corresponding training and education programs for all FINRA arbitrators.

It is also important to note that in 2020 awards in favor of investors were statistically less likely for telephonically conducted “Special Proceeding” customer cases (20 percent of customers received any award) than for regular in-person cases (34 percent of customers received any award).<sup>15</sup> This discrepancy in award rates raises questions of whether telephonic hearings are inherently less fair and if they, in fact, provide sufficient due process to the customers. Given the prevalence and low cost of video conferencing, the IRC urges that FINRA consider a rule amendment offering Special Proceeding claimants the option to request a hearing via Zoom.

While FINRA is not subject to the Federal Rules of Procedure, similar notions of fairness should apply in FINRA arbitration. Civil and criminal courts require in-person, live testimony to ensure a fair and just trial. Denying customers access to in-person arbitrations already inhibits their chances of adequate recovery. Unfortunately, as noted, the COVID-19 pandemic has made in-person arbitrations and mediation proceedings impossible due to health and safety concerns. Nonetheless, FINRA can mitigate this problem with Zoom proceedings when requested by the customer by ensuring that current processes and arbitrator training provide fair hearings and outcomes to claimants in Zoom proceedings.

#### **IV. Conclusion**

The IRC’s core mission is to protect vulnerable investors. We strongly support implementing further measures to ensure investors are better educated and protected for today’s

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<sup>12</sup> Craig McCann and Chuan Qin, *The Impact of ZOOM on FINRA Arbitration Hearings*, SLCG <https://www.slcg.com/pdf/sampleresults/Impact%20of%20Zoom%20on%20FINRA%20Claimants%20Final.pdf>

<sup>13</sup> *Id.*

<sup>14</sup> *Id.*

<sup>15</sup> *Dispute Resolution Statistics*, FINRA, <https://www.finra.org/arbitration-mediation/dispute-resolution-statistics#resultscustomerclaimant>.

society. FINRA should carefully review the activities, marketing, communications, educational tools, approval processes, and disclosure practices of online brokerage firms. In addition, notwithstanding Zoom's noted imperfections, investors should at a minimum never be denied the opportunity for an online proceeding when requested; however, FINRA should also undertake a robust review of the parties' experiences to determine whether any measures can be implemented to improve a process that has resulted in disproportionately poor results for investors. Implementing the foregoing suggestions will not only protect investors but will also increase the FINRA arbitration forum's integrity. The IRC appreciates FINRA for providing a platform to voice concerns on this important topic.

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