



Ms. Vanessa A. Countryman,
Secretary,
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

September 20, 2021

Re: Release Nos. 34-92766; IA-5833; File No. S7-10-21 (the "Request")

Dear Ms. Countryman:

On May 4, 1999, SEC Chairman Arthur Levitt stepped to the dais of the National Press Club to deliver a somber address.¹ He spoke about a controversial new practice that had attracted the interest of commissioners and staff, members of Congress and the financial news media. The public eagerly awaited the Chairman's remarks.

His topic was not fraud or market manipulation or nefarious trading behavior. Rather, it was *on-line investing*. Five years before his speech nobody traded online. At the time of his speech, about seven million Americans traded online, comprising 25 percent of all trades made by individual investors. The new technology worried Chairman Levitt and just about everybody else.

Chairman Levitt inveighed against "day trading," which he likened to gambling. He recognized the benefits of trading online but said:

¹ <https://www.sec.gov/news/speech/speecharchive/1999/spch274.htm>

I'm concerned about the great influx of new and relatively inexperienced investors who may be so seduced by the ease and speed of Internet trading that they may be trading in a way that does not match their specific goals and risk tolerance.

He criticized the advertising practices of low-cost, Internet broker-dealers:

Quite frankly, some advertisements more closely resemble commercials for the lottery than anything else. When firms, again and again, tell investors that on-line investing can make them rich, it creates unrealistic expectations.

He complained about chat rooms, "which increasingly have become a source of information and mis-information for many investors."

Today these worries seem quaint. In 1999 about seven million Americans traded online. By January 2021 the number of accounts at the six largest e-brokerage firms had grown to over 100 million.²

Nevertheless, Chairman Levitt's speech established the principles by which the Commission would regulate digital platforms, that the Commission would take care not to undermine well-established law, and that it would rely on the industry to address investor protection concerns subject to Commission oversight. The Commission and FINRA have abided by these principles for over two decades and the Commission should follow them as it considers any possible investor protection concern associated with the "digital engagement practices" of online brokerages and other digital platforms.

In Part 1 we will explain that DEPs do not appear to be radically transformative and the Commission's response should be proportionate to their incremental nature. In Part 2 we discuss the regulatory principles established by Chairman Levitt in 1999 and observed by the Commission

² <https://www.usnews.com/news/top-news/articles/2021-01-29/factbox-the-us-retail-trading-frenzy-in-numbers>

and FINRA ever since. The Commission should continue to adhere to these principles as it addresses DEPs.

1. *The Request is Appropriate; Agency Action Should be Proportionate*

The Request is an appropriate and useful exercise to elicit as much information as possible about DEPs. The responses will help the Commission evaluate DEPs. The Commission has launched a thoughtful inquiry into the potential investor protection concerns associated with DEPs, even as it recognizes some of the benefits that these new technologies can provide to retail investors. The thoroughness of its questions will enable the Commission to address any investor protection concern.

Nevertheless, DEPs appear to constitute little more than “design elements or features.”³ We grant that information in response to the Request might prove otherwise. At this point, however, DEPs only seem to be different iterations of older practices.

For example, the Request explains that firms might use artificial learning/machine learning models to “tailor the features with which different retail investor segments interact on the firms’ digital platforms, or target advertisements to specific investors based on their known behavioral profiles.”⁴ Since the birth of online financial services, firms have endeavored to enhance the way different investors interact on their platforms. Even before the advent of the Internet, firms have “target[ed] advertisements to specific investors based on their known behavioral profiles.” AI/ML probably comprise the most advanced techniques mentioned in the Request, but even AI/ML represent only an improvement upon existing forms of customer interaction and advertising.⁵

The development of online trading in 1999 was far more dramatic than the development of DEPs. Retail customers at that time were unfamiliar with online trading and the Internet was still in its infancy. Today many retail

³ Request at 1.

⁴ Request at 4.

⁵ See generally <https://www.finra.org/sites/default/files/2020-06/ai-report-061020.pdf>.

investors are comfortable with digital platforms for many different uses, including consumer purchases, social media, and most relevant, online trading.

If Chairman's Levitt's anxieties over online trading seem quaint to us today, one can imagine how our frets over "gamification" will seem in 2040.

The Commission's regulatory actions should be proportionate to the incremental nature of DEP development. No radical alteration of existing regulation, no precipitous abandonment of existing precepts, are necessary. Instead, the Commission should simply adhere to the principles by which it has regulated digital platforms since 1999.

2. *The Commission Should Continue Its Approach to Digital Platforms*

Without stating so explicitly, Chairman Levitt implicitly established two principles for regulating online trading. The Commission has adhered to these principles, with few exceptions, since 1999. Adherence to these principles has better ensured that the Commission can address investor protection concerns swiftly and completely, while allowing digital platforms to flourish. Retail investors now have easier access to investment platforms, at lower cost, with greater investor protection, than ever before.

A. Principle One: Don't Muck Up Existing Law

The Request will elicit information about the investor protection concerns DEPs might present. At this point, DEPs arguably present two issues related to broker-dealer regulation. Both are addressable under existing law.

I. Potential Issue: "Recommendation"

First, some DEPs might entice trading so much that they could, or should, be said to constitute a "recommendation" for purposes of Regulation Best Interest. The Request asks for comment on this question⁶ and some

⁶ See, e.g., Request at 7.

activists argue that the Commission should ensure that these DEPs do, in fact, constitute a recommendation as a matter of law.⁷

The term “recommendation” has a well-accepted meaning under FINRA’s suitability rule, under Regulation Best Interest,⁸ and under the investment adviser’s fiduciary duty.⁹ It essentially represents a “call to action.”¹⁰ Because of the long history of interpreting the application of the suitability rule and the investment adviser’s fiduciary standard, broker-dealers and investment advisers typically understand whether a particular communication constitutes a “recommendation.”

This understanding of a recommendation as a “call to action” is capacious enough to accommodate new design techniques or features on digital platforms. There is simply no justification for the Commission to veer from this common understanding in order to impose unique constraints on digital platforms.

In fact, a radical restatement of “recommendation” could not be confined to digital platforms. It would be impossible to insulate such a definition from all of the other communications and interactive techniques used by broker-dealers and investment advisers.

For example, if the Commission were to announce that a digital alert that a customer’s stock has moved 5% constitutes a recommendation, then every full-service financial adviser would presume that calling a customer to discuss the price movement of her security might also comprise a “recommendation” under Regulation Best Interest or the investment adviser’s fiduciary duty. Even if the Commission stated that its broader definition applied only to DEPs, it would be imprudent for a firm to ignore the possibility that a wayward examiner or an arbitration panel might apply the definition to other practices. Communications that would educate

⁷ See, e.g., <https://www.advisorhub.com/sec-chair-investor-advocates-sharpen-criticism-of-gamification-in-online-trading/> (reporting comments of Stephen Hall of Better Markets).

⁸ <https://www.sec.gov/tm/faq-regulation-best-interest#recommendation>

⁹ <https://www.sec.gov/rules/interp/2019/ia-5248.pdf>

¹⁰ See, e.g., NASD Notice to Members 01-23 (“Online Suitability”) at 2 (April 2001).

customers and could protect them from adverse price movements would be stifled.

Those who argue for the application of a “best interest standard” to DEPs could be attempting to manipulate the Commission into a wholesale revision of Regulation Best Interest. If the Commission determines that Regulation Best Interest is deficient, then it should amend its application to all broker-dealers and investment advisers, not only digital platforms.

II. Potential Issue: Misleading Communications

A second possible concern with brokerage DEPs might be their noncompliance with Commission or FINRA marketing rules. The Request asked for information on how digital platforms comply with these rules.¹¹ These rules are, for the most part, principles-based, requiring that communications be fair, balanced and not misleading. They rules cover every conceivable form of retail communication. FINRA’s Rule 2210, for example, applies to social media communications,¹² websites, newspapers, magazines and other periodicals, radio, television, telephone and audio recordings, video displays, signs and billboards, motion pictures, telephone directories, correspondence, and public appearances.¹³ The rules easily cover DEPs.

DEPs that constitute a retail communication should be judged by these well-established standards. If the Commission alters existing standards as they apply to DEPs, or demands that FINRA do so, then the Commission might inhibit the many forms of legitimate communication between firms and their customers, including educational communications. The Commission also would sow confusion among firms that try to apply those standards elsewhere. As with a change to the meaning of “recommendation,” any limited benefit of revising longstanding advertising rules to fit DEPs would not be worth the cost.

¹¹ Request at 42

¹² See, e.g., <https://www.finra.org/rules-guidance/key-topics/social-media>.

¹³ See generally FINRA Rule 2210.

III. The Commission Should Apply Existing Law

The Commission should address any investor protection issue through existing law. Chairman Levitt wisely invoked the federal securities laws, hearkening to the New Deal, whose concepts, in his words, “are as indelible as the Constitution.”

He did not propose to adjust Commission rules or interpretations for the sake of online trading. Rather, he invoked the rules already in effect, warning that online broker-dealers “still have the same obligations to their customers” as other established firms.

I am not convinced it’s necessary for the SEC to pronounce a totally new and radical scheme of regulation specifically tailored to on-line investing. Yet, I don’t rule out the possibility that there may come a time when the SEC sees a need for new approaches to better meet the imperatives of the Internet.

The Commission today should not embark upon an ambitious regulatory excursion that will inhibit educational and other communications with customers and sow confusion in the industry about how its rules apply elsewhere. Rather, it should apply existing law to digital platforms, as it has since 1999.

B. Principle Two: Make the Industry Do It

If the Request exposes any concerns with DEPs, then the Commission can impose behavioral changes through industry self-regulation, subject of course to Commission oversight.

Chairman Levitt urged firms to review their trade routing practices and directed the Commission’s examiners to focus on those practices in an examination sweep. He addressed his concerns about online advertising by asking the NASD to augment “the work they’re already doing to improve fairness in advertising.” He requested that firms communicate more clearly to customers about the risks or required action in the event of trading outages or service interruption. Chairman Levitt formed a private sector

advisory committee on technology and expanded the Commission's investor education program. He requested on-line firms to create links from their web sites to the Commission's investor education site.

By demanding that the industry clean up the concerns that online trading created, the Commission accomplished several salutary objectives. First, it ensured that those concerns would be addressed more expeditiously than could be accomplished through the agency's rulemaking or interpretive processes. Second, it better ensured that the solutions would reflect the various aspects of online trading in 1999 and in the future. Industry self-regulation allowed for more subtlety than wooden governmental rulemaking. Finally, the Commission ensured that it controlled the outcome and that any failure by the industry to address these concerns would be overcome by direct Commission action.

The Commission today should similarly demand that the broker-dealer and investment adviser industries and the self-regulatory organizations address any concerns that the Request might expose. The application of the "recommendation" definition and the advertising rules to DEPs, for example, require consideration of how different techniques square with existing law. Such subtle distinctions are not easily applied by a government agency, but they can be imposed through industry self-regulation.

By requiring that the industries and self-regulatory organizations address any concerns created by DEPs, the Commission will better ensure that the concerns are resolved expeditiously and that their solutions reflect the various circumstances that might arise in the future. These improvements would take place, as always, under the Commission's aegis.

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Thank you for the opportunity to comment on this Request.

Respectfully Submitted,

/s/ Thomas M. Selman