CARLTON FIELDS

What Will the SEC Do About the "Gamification" of Trading in 2022?

January 11, 2022

The SEC recently solicited comments regarding broker-dealer and investment adviser "digital engagement practices" (DEPs), features commonly referred to as the "gamification" of trading. The request follows the GameStop trading event in January 2021, where the gamelike features on certain trading apps came under scrutiny following a surge in trading alleged to have ultimately prompted a trading halt.

According to the SEC's request, DEPs include "behavioral prompts, differential marketing, game-like features … and other design elements or features designed to engage with retail investors on digital platforms (e.g., websites, portals, and applications), as well as the analytical and technological tools and methods." The request cites the concerns of SEC Chair Gary Gensler:

> [T]hese features may encourage investors to trade more often, invest in different products, or change their investment strategy. Predictive analytics and other DEPs often are designed with an optimization function to increase revenues, data collection, or customer time spent on the platform. This may lead to conflicts between the platform and investors. I'm interested in the varied questions included in the Request for Comment, and I'm particularly focused on how we protect investors engaging with technologies that use DEPs.

The public comment period is now over, and the SEC received hundreds of comments. Comments from retail investors are the most numerous and appear to fall into three groups. The first group rails against DEPs (e.g., "I feel like all of those gimmicks are designed to lure in younger naive investors who don't know any better"). The second approves of their use (e.g., "[e]asily accessible settings/instructions … adds another way for users to feel more in control of their investing"). The third, and largest by number, focuses on other aspects of our markets (e.g., dark pools, hedge funds, payment for order flow, etc.).

Comments from the industry and associations regarding DEPs fall into two major groups. The largest group of comments is from brokerage firms that employ DEPs and from trade associations that represent the interests of industry professionals. These comments generally take the view that no additional rulemaking is necessary and that the existing regulatory regime adequately addresses firms' use of DEPs, preserving the benefits of DEPs while appropriately managing potential risks and conflicts. The Securities Industry and Financial Markets Association (SIFMA) submitted a comment reflecting this view:

> FINRA's communications (and related) rules and guidance cover [communications to retail investors], and the SEC's Regulation Best Interest ("Reg BI") covers [potential recommendations to retail investors]. Accordingly, new rules, guidance, or interpretations are not necessary or appropriate to address DEP use in our industry today. In fact, such additional regulation may well have the effect of undermining its very purpose by limiting information and access to investment opportunities and educational tools by underrepresented, less financially educated, and/or less affluent retail investors — the presumed beneficiaries of such prospective regulation.

The second, smaller group of comments is from investor-oriented trade associations that generally hold that the existing regulatory regime adequately addresses most issues arising from DEPs but that there may be a need for some gap filling to address particular issues. The North American Securities Administrators Association (NASAA) submitted a comment reflecting this view:

[E]xisting rules, regulations, and principles are broad enough to address most DEP tools and market practices. For example, the principles behind what constitutes a recommendation and the standards of conduct for broker-dealers and investment advisers are already developed. In our view, these principles apply regardless of whether a recommendation comes from a person, an algorithm, or some other technology. ... To the extent gaps are identified, the Commission should act to curtail practices that allow registrants to interact with investors without applying and observing appropriate standards of care.

To address such gaps, the NASAA advocates for:

- More investor education for firms that intend to use DEPs.
- Special considerations to ensure that customers are trading of their own accord, as opposed to responding to psychological or behavioral prompts.

- More guidance as to when DEP-based communications constitute recommendations subject to Reg BI.

Further, the NASAA sets forth specific concerns regarding:

- "[I]deas presented at order placement and other curated lists or features" that constitute advice or recommendations.
- Copy-trading practices that include suggestions to copy the trading activity of particular traders or "finfluencers."
- Features that encourage investors to make trades that may not be in their best interest (such as confetti, scratch-off style graphics, and award systems).

Finally, the NASAA advocates for the prohibition of "dark patterns" (i.e., user interface design choices knowingly designed to confuse users, make it difficult for users to express their actual preferences, or manipulate users into taking certain actions) and limitations on the use of "chatbots" to provide only simply factual information (prices, account values, etc.) and not to communicate or formulate advice or recommendations.

The American Securities Association (ASA), a trade association that represents the retail and institutional capital markets interests of regional financial services firms, adds a few nuanced concerns in its comment:

> [I]s it a trading recommendation when a firm uses an interactive artificial intelligence algorithm to target the behavioral characteristics of its customers to induce them to execute a trade on the app? Does the answer to that question change if the firm has a business model that depends on its customers executing orders on the app so it can receive payment for selling those orders to a third party?
>
> The use of predictive data analytics to increase the revenue of a digital application must be regulated when that application's profitability is solely dependent upon frequent trading by its customers.

In addition to the above, a handful of commenters — viewing DEPs as harmful to investors — urge broad reforms, more aggressive enforcement of Reg BI and FINRA's communication rule (Rule 2210), or more discussion.

Given the above — and Gensler's stated concerns — it appears that some rulemaking may be proposed in 2022. Stay tuned!

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