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What is in Our Best Interest? Are Educational Digital Engagement Practices a Way to Avoid Pending Gamification Regulation?

I. INTRODUCTION

As the world came to a halt in the spring of 2020, a perfect storm was brewing for a retail trading boom.[1] In the first quarter of 2020, major brokerages like TD Ameritrade, E-Trade, and Schwab saw record-setting new investor accounts.[2] None gained more new accounts than the mold-breaking electronic broker, Robinhood. In May of 2020, Robinhood reported three million new accounts year-to-date.[3] A company that revolutionized trading by charging no commissions to retail investors, Robinhood made $180 million in the second quarter of 2020, thanks to its new 'clients.'[4] Of the $180 million, $111 million came from options trading.[5]

Trading volume is crucial for the ability of broker-dealers like Robinhood to offer fee-less trading. Through an increasingly common practice called payment for order flow, market makers pay Robinhood and other brokers for the right to execute customer trades.[6]

It sounds like a win-win-win scenario: market makers get their spread, Robinhood makes millions in payment for order flow, and retail investors get to trade freely at a better price, encouraging and increasing

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1. *See* John R. Fallon, *Equal Access to Investments: At Whose Expense?*, 21 WAKE FOREST J. BUS. & INTELL. PROP. L. 431, 432–33 (2021) (discussing factors that led to the increase of retail investors).

2. *See* Matt Phillips, *Trading Sportsbooks for Brokerages, Bored Bettors Wager on Stocks*, N.Y. TIMES (June 14, 2020), https://www.nytimes.com/2020/06/14/business/sports-gamblers-stocks-virus.html [https://perma.cc/2JHG-KDXU] (reporting the increase in retail investor participation starting in early 2020).

3. *Id.* (reporting the record-setting number of new Robinhood accounts).

4. *See* Kate Rooney & Maggie Fitzgerald, *Here's How Robinhood is Raking in Record Cash on Customer Trades–Despite Making it Free*, CNBC (updated Aug. 14, 2020, 10:17 AM), https://www.cnbc.com/2020/08/13/how-robinhood-makes-money-on-customer-trades-despite-making-it-free.html [https://perma.cc/L6QX-JNJH] (explaining the strategies Robinhood and other broker-dealers use to make money while keeping trading free for retail investors).

5. *See id.* (reporting second quarter numbers for Robinhood).

6. *See id.* (explaining payment for order flow process).

investor participation.[7] Unfortunately, it's not that simple; broker-dealers like Robinhood use digital engagement practices to engage users and, arguably, encourage more trading.[8] Digital engagement practices ("DEPs"), include behavioral prompts, differential marketing, game-like features, and other design elements to engage with retail investors on digital platforms.[9] DEPs also include analytical tools and methods.[10] As Robinhood's revenue is directly tied to how many trades their clients make, many are calling for increased regulation, citing predatory DEPs[11] and laissez-faire approval of options accounts as dangerous conduct.[12] This leads to the key question—is there a need for increased regulation for DEPs designed to keep investors hooked?[13]

This Note proceeds in five parts and seeks to answer this question. Part II establishes the background on payment for order flow and Regulation Best Interest ("Regulation BI"), which enhances broker-dealers' fiduciary relationship with investors.[14] Part III analyzes additional regulations if Regulation BI is not enough.[15] Part IV proposes the best solution for protecting investors while maintaining

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7. *See* Rick Fleming, Inv. Advoc., U.S. Sec. & Exch. Comm'n, Investor Protection in the Age of Gamification: Game Over for Regulation Best Interest?: Remarks at SEC Speaks (Oct. 13, 2021) (transcript available on SEC website), https://www.sec.gov/news/speech/fleming-sec-speaks-101321 [https://perma.cc/6UHT-TQRC] (explaining the dangers of gamification, emphasizing the positive impact of increased participation).

8. *See generally id.* (discussing that digital engagement practices potentially induce trading).

9. *See* Request for Information and Comments on Broker-Dealer and Investment Adviser Digital Engagement Practices, 86 Fed. Reg. 49067, 49068–69 (Sept. 1, 2021), https://www.govinfo.gov/content/pkg/FR-2021-09-01/pdf/2021-18901.pdf [https://perma.cc/2VZF-VNPZ] [hereinafter DEP Request] (listing the types of DEPs).

10. *See id.* (listing types of DEPs).

11. *See* Dennis M. Kelleher et al., *Securities – Democratizing Equity Markets With and Without Exploitation: Robinhood, GameStop, Hedge Funds, Gamification, High Frequency Trading, and More*, 44 W. NEW ENG. L. REV. 51, 56 (2022) (labeling some digital engagement practices "predatory").

12. *See generally* Administrative Complaint, Robinhood Fin., LLC, No. E-2020-0047, (Mass. Sec. Div. Dec. 16, 2020), 2020 WL 7711667, https://business.cch.com/srd/MSD-Robinhood-Financial-LLC-Complaint-E-2020-0047.pdf [https://perma.cc/EKU7-GEC2] [hereinafter Mass. Complaint] (discussing Robinhood's questionable approval of options accounts).

13. Justin Chretien & Carlton Fields, *What Will the SEC Do About the "Gamification" of Trading in 2022?*, JD SUPRA (Jan. 20, 2022), https://www.jdsupra.com/legalnews/what-will-the-sec-do-about-the-8585299/ [https://perma.cc/A8P3-QVKS] (discussing the public comment period and pending SEC regulation).

14. *See infra* Part II.

15. *See infra* Part III.

inclusive investing—requiring more educational DEPs via regulation to avoid further SEC intervention.[16] Part V concludes this Note.[17]

II. BACKGROUND

A. Payment for Order Flow

For market makers like Citadel,[18] execution rights are incredibly valuable.[19] This is because of the bid-ask spread.[20] The bid-ask spread is a range, the two sides being "the highest price buyers are willing to pay for a stock, the bid, and the lowest price sellers are willing to sell that stock, the ask."[21] By holding the execution rights from both buyers and sellers, market makers are able to match up the orders and pocket the difference.[22] They do this by selling a share to the buyer for a fraction less than the normal bid price, buying a share from sellers for a fraction more than the normal ask price, and retaining fractional profits.[23] Brokers like Robinhood collect a commission from the market maker for every trade they send its way.

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16. *See infra* Part IV.

17. *See infra* Part V.

18. *See* Katherine Doherty, *Citadel Securities Opens Up After Record $7 Billion Windfall*, BLOOMBERG (Mar. 15, 2022, 2:40 PM), https://www.bloomberg.com/news/articles/2022-03-15/citadel-securities-opens-up-after-record-7-billion-windfall [https://perma.cc/6JXW-LLPH] (discussing how Citadel handles over forty percent of all U.S. retail trading volume and one in every four U.S. equities trades); Andrew Bloomenthal, *Market Maker Definition: What it Means and How They Make Money*, INVESTOPEDIA (Aug. 31, 2021), https://www.investopedia.com/terms/m/marketmaker.asp [https://perma.cc/A8D3-EQUG] ("The term market maker refers to a firm or individual who actively quotes two-sided markets in a particular security by providing bids and offers (known as asks) along with the market size of each.").

19. *See* Paul J. Ingrassia, *How Robinhood has Revolutionized Online Trading and Dramatically Upended the Traditional Model for Payment for Order Flow (PFOF)*, 16 VA. L. & BUS. REV. 183, 184 (2021) (breaking down the payment for order flow process in simple terms).

20. *See* Vox Creative. *Payment for Order Flow, Explained*, VOX MEDIA (Mar. 22, 2022, 11:36 AM) [hereinafter *Payment for Order Flow*], https://www.vox.com/ad/22960319/pfof-payment-for-order-flow-trading-commission-public [https://perma.cc/B6SC-8PUU] (explaining the process of payment for order flow).

21. *Id.*

22. *Id.*; *see also Eat the Rich: The GameStop Saga: The Reckoning* (Netflix television broadcast Sept. 28, 2022) (illustrating bid-ask spread and payment for order flow).

23. *See Payment for Order Flow, supra* note 20 (explaining the process of payment for order flow); *see also Eat the Rich: The GameStop Saga: The Reckoning*, *supra* note 22 (illustrating bid-ask spread and payment for order flow).

B. Regulation Best Interest

Regulation BI was adopted by the Securities and Exchange Commission ("SEC") in 2019.[24] Through Regulation BI, the SEC sought "(i) to enhance the obligations that apply to broker-customer relationships when giving a recommendation and (ii) to reduce the potential harm to customers that may result from conflicts of interest" affecting recommendations.[25] Put simply, the primary goal of Regulation BI is to implement fiduciary duties of care and loyalty into the relationship between broker-dealers and their clients.[26]

Regulation BI generally requires that broker-dealers must act in the best interest of their client when recommending securities transactions or strategies involving securities.[27] Involving recommendations, one of the issues Regulation BI seeks to eliminate is "churning."[28] An example of churning is when broker-dealers encourage excessive trading so that they can rake in more transaction-based compensation.[29] An exorbitant amount of trading is almost always in the best interest of broker-dealers.[30] Tim Welsh, CEO of a wealth management consulting firm, says, "[I]t could be hazardous to your financial health the more you trade. Every study on planet Earth has shown day traders that are not sophisticated do not make money."[31] So, why can't the SEC, on a case-by-case basis, punish broker-dealers that do not act in the best interest of their clients when giving a recommendation?[32]

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24. *See* Fleming, *supra* note 7 (discussing Regulation Best Interest at SEC Speaks).

25. *See generally* Les Jacobowitz & Raida "Maggie" Lopez, *Does the SEC "Best Interest" Regulation Go Far Enough?*, THE NAT'L L. REV. (Aug. 1, 2022), https://www.natlawreview.com/article/does-sec-best-interest-regulation-go-far-enough [https://perma.cc/8KTG-2QFS] (exploring SEC Best Interest's goals and what it covers).

26. *See id.* ("Ultimately, Reg[ulation] BI seeks to supplement broker-dealer obligations by building on principles inherent in the existing fiduciary duties of care and loyalty owed by financial advisors but historically not required of broker-dealers.").

27. *See* Fleming, *supra* note 7 (discussing Regulation Best Interest at SEC Speaks).

28. *See Final Rule, Regulation Best Interest: The Broker-Dealer Standard of Conduct*, 84 Fed. Reg. 33318, 33331 (July 12, 2019) (codified at 17 C.F.R. pt. 240) (explaining churning).

29. *See id.* (explaining churning).

30. *See* Rooney & Fitzgerald, *supra* note 4 (explaining the perils of excessive trading).

31. *See id.* (quoting Tim Welsh, CEO of Nexus Strategy).

32. *See* Lydia Beyoud, *Trading 'Gamification' Is Huge Concern, SEC Enforcement Chief Says*, BLOOMBERG (July 19, 2022, 11:59 AM),

There are two main issues. One issue arises out of what the SEC considers a "recommendation."[33] In the past, the SEC has used four factors to determine if a recommendation is made: (1) the nature and relationship between the dealer and the customer; (2) reliance on the dealer; (3) nature of specific communications; and (4) initiation of the subject.[34] However, the SEC has recently said the determination of whether a broker-dealer has made a recommendation that triggers application of Regulation BI turns on the facts and circumstances of a particular situation.[35] For better or for worse, the SEC does not want to implement a bright line definition.[36] The lack of a clear definition has enabled brokerages to escape SEC scrutiny of their use of DEPs. Further, the Financial Industry Regulatory Authority, ("FINRA"), the self-regulatory organization that oversees brokerage firms, has announced that it plans to coordinate its response to the SEC's regulatory approach.[37] Given FINRA's deference, this Note will focus on the SEC's response.

The other issue is the SEC's explicit words that it would not apply Regulation BI to self-directed transactions.[38] Robinhood users

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https://www.bloomberg.com/news/articles/2022-07-19/trading-gamification-concern-for-sec-enforcement-chief-says [https://perma.cc/H8NW-GLAQ] (referencing the SEC enforcement chief on his concern for when gamification crosses over into recommendations).

33. *See* Chretien & Fields, *supra* note 13 (defining SEC recommendations).

34. *See* Michael Frederick Siegel, Rel. No. 58737 SEC. Admin Proc. File No. 3-12359, at 10 (Oct. 6, 2008) (discussing the factors considered in finding a recommendation).

35. *See Regulation Best Interest: A Small Entity Compliance Guide*, SEC. & EXCH. COMM'N (last updated Sept. 23, 2019), https://www.sec.gov/info/smallbus/secg/regulation-best-interest [https://perma.cc/UT47-EATY] (explaining what a recommendation is under Regulation BI).

36. *See id.* ("The determination of whether a broker-dealer has made a recommendation that triggers application of Regulation Best Interest turns on the facts and circumstances of a particular situation, and therefore, whether a recommendation has been made is not susceptible to a bright line definition. Factors considered in determining whether a recommendation has taken place include whether the communication 'reasonably could be viewed as a "call to action"' and 'reasonably would influence an investor to trade a particular security or group of securities.'").

37. *See* Regulatory Notice from Fin. Indus. Regul. Auth., No. 22-08: Complex Products and Options, 15 n.80 (March 8, 2022), https://www.finra.org/sites/default/files/2022-03/Regulatory-Notice-22-08.pdf [https://perma.cc/NW6E-VWQD] (explaining that FINRA will coordinate its response to the SEC's response).

38. *See Final Rule, Regulation Best Interest: The Broker-Dealer Standard of Conduct*, *supra* note 28, at 33334–35 (quoting the SEC's stance on self-directed transactions) ("We confirm that . . . Regulation Best Interest would not . . . apply to self-

have self-directed brokerage accounts.[39] In a self-directed account, a brokerage serves only as an executor of the account's trades and the customer has control over how their money is invested.[40] The customer agreement typically contains disclosures regarding the nature of the account.[41] According to the SEC, Regulation BI does not apply if the transaction is self-directed or unsolicited, whether or not the customer also receives a separate recommendation from the broker-dealer.[42] This means that, for self-directed eBroker accounts, separate recommendations from the eBroker are irrelevant.[43] This is where digital engagement practices muddy the waters.[44] Chair of the SEC, Gary Gensler, has consistently expressed concern with DEPs since being appointed.[45] The question is, to what extent are transactions self-

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directed or otherwise unsolicited transactions by a retail customer, whether or not she also receives separate recommendations from the broker-dealer.").

39. *See Investments You Can Make on Robinhood*, ROBINHOOD, https://robinhood.com/us/en/support/articles/investments-you-can-make-on-robinhood/ [https://perma.cc/Z7GC-RUL7] (last visited Jan. 3, 2023) (explaining the nature of Robinhood user accounts).

40. *See* Valelly v. Merrill Lynch, Pierce, Fenner & Smith Inc., 464 F. Supp. 3d 634, 638 (S.D.N.Y. 2020) (explaining self-directed accounts); *see also Robinhood Financial LLC & Robinhood Securities, LLC Customer Agreement*, ROBINHOOD (last updated Sept. 30, 2022), https://cdn.robinhood.com/assets/robinhood/legal/Robinhood-Customer-Agreement.pdf [https://perma.cc/82TL-P99B] (reading in the agreement clauses: "2.3. Your Account is self-directed and, except as provided in Section 2.4 below, you are solely responsible for any and all orders placed in your Account, for your investment decisions, and for determining the suitability of any particular transaction, security, or investment strategy. You agree that all orders entered by you (or placed on your behalf) are based on your own investment decisions. 2.4. You agree and understand that Robinhood or persons acting on Robinhood's behalf does not provide any investment advice or recommend any particular security, transaction, or order, or other matter connected with your Account, nor will they advise you about the merits of any action or investment decision relating to your Account or any security you hold, unless specifically agreed upon in writing and clearly identified by Robinhood as an individualized investment recommendation for you.").

41. *See Robinhood Financial LLC*, *supra* note 40, at 2 (explaining a self-directed account).

42. *See Final Rule*, *Regulation Best Interest: The Broker-Dealer Standard of Conduct*, *supra* note 28, at 33334–35 (discussing the limitations of Regulation Best Interest).

43. *Id.*

44. *See* Gary Gensler, Chair, Sec. & Exch. Comm., Prepared Remarks at SEC Speaks (Oct. 12, 2021) (transcript available on the SEC website), https://www.sec.gov/news/speech/gensler-sec-speaks-2021-10-12 [https://perma.cc/G8T6-BMKZ] (speaking about the conflicts of interest present in DEPs).

45. *See id.* (speaking about the conflicts of interest in DEPs); *see also* Gary Gensler, Chair, Sec. & Exch. Comm., Prepared Remarks before the Investor Advisory Committee (Mar. 10, 2022) (transcript available on the SEC website), https://www.sec.gov/news/statement/gensler-iac-2022-03-10 [https://perma.cc/6VFC-

directed or unsolicited when brokers use DEPs to encourage more trading?[46] For example, Robinhood sends lists of popular stocks, like the "Most Popular 100 List" and the "Top Movers List."[47] Sometimes these DEPs are sent and the notification reads something like, "Popular Stocks: Can't decide which stocks to buy? [thinking emoji] Check out the most popular stocks on Robinhood."[48] If a customer trades after receiving these notifications, are the transactions really unsolicited and self-directed?[49] Further, are these recommendations truly "separate" if eBrokers provide a list of stocks, from which the customer picks one?[50] Unfortunately, according to the SEC, it relies on a recommendation to trigger Regulation BI, which leaves self-directed transactions and accounts unprotected.[51] This means that, if the SEC decides that additional regulations are needed, they would almost certainly have to start with amending Regulation BI by applying it to self-directed accounts.[52]

XURB] (discussing DEPs, ethical issues and fiduciary responsibilities related to the use of technological advances like algorithms).

46. *See* Gensler, *supra* note 44 (speaking about the conflicts of interest present in DEPs).

47. *See* Mass. Complaint, *supra* note 12, at 11–12 (listing Popular Lists categories on Robinhood).

48. *Id.* at 14.

49. *See* Fallon, *supra* note 1, at 451 (arguing that these lists are DEPs that constitute recommendations under NASD standards, as they are subjective, and not merely informative).

50. *See Final Rule*, *Regulation Best Interest: The Broker-Dealer Standard of Conduct*, *supra* note 28, at 33334–35 (explaining that Regulation Best Interest does not apply to self-directed accounts, whether or not the customer receives a separate recommendation).

51. *See supra* note 42 and accompanying text; *see also* Statement, Jay Clayton et al., Joint Statement Regarding Complex Financial Products and Retail Investor (Oct. 18, 2020), https://www.sec.gov/news/public-statement/clayton-blass-hinman-redfearn-complex-financial-products-2020-10-28 [https://perma.cc/XHN6-L7M5] ("While these various developments have combined to provide retail investors with greater access to our financial markets and a variety of products, including complex products, at a lower cost, it should be recognized that self-directed retail investors are typically making investment decisions on their own accord via online trading platforms and without the assistance of a financial professional. In other words, these self-directed investors do not have the required protections that apply when they receive recommendations or advice from a broker or investment adviser, who must understand, and may explain if necessary, the characteristics and potential risks and rewards of the investment, and determine that it is in the best interest of the retail investor."); Fallon, *supra* note 1, at 463–4 (concluding that Regulation BI possibly does not apply to self-directed accounts).

52. *See Final Rule, Regulation Best Interest: The Broker-Dealer Standard of Conduct*, *supra* note 28, at 33334–35 (explaining that Regulation Best Interest does not apply to self-directed accounts).

III. ADDITIONAL REGULATIONS

Of the additional regulations proposed, three merit some consideration: (A) the SEC could seek to focus on limiting the use of DEPs;[53] (B) the SEC could focus on regulating and limiting payment for order flow and identify this as the underlying practice that most enables zero-commission brokerage and excessive trading,[54] or; (C) the SEC could make Regulation BI more meaningful by expanding its definition of a "recommendation" to consider the various behavioral prompts, algorithms, and other incentives that cause clients to trade.[55]

A. The Regulation of DEPs

Many people in the industry call for the regulation of DEPs because they have "gamified" the investor trading world.[56] What some call "behavioral churning,"[57] DEPs can be used to maximize revenue by driving unsophisticated retail investors to excessively trade.[58] While well-meaning brokers can use DEPs to require customers to engage with important educational content before making important decisions, or to imbed warnings to help investors avoid making foolish decisions, it is no secret that not all DEPs are used for good.[59] One Wall Street Journal columnist details his first few days on the Robinhood app, describing signing up as fun and easy, feeling like he was playing a scratch-off lottery ticket as he swiped his finger back and forth to reveal a free $5 stock.[60] The next day, he began receiving push notifications on his

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53. *See* John C. Coffee, Jr., *Gamification: Why Do We Care About Robinhood? What Could the SEC Realistically Do?*, N.Y. L.J. (2021) (listing proposed solutions for gamification regulation).

54. *Id.*

55. *Id.*

56. *See* Chretien & Fields, *supra* note 13 ("Comments from retail investors are the most numerous and appear to fall in to three groups. The first group rails against DEPs. (*e.g.*, 'I feel like all of those gimmicks are designed to lure in younger naïve investors who don't know any better')).").

57. Kyle Langvardt & James Fallows Tierney, *On "Confetti Regulation": The Wrong Way to Regulate Gamified Investing*, 131 YALE L.J.F. 717, 737 (2022).

58. *See Final Rule, Regulation Best Interest: The Broker-Dealer Standard of Conduct*, *supra* note 28, at 33331 (discussing churning generally).

59. *See* Fleming, *supra* note 7 (discussing the positive uses of DEPs).

60. Jason Zweig, *I Started Trading Hot Stocks on Robinhood. Then I Couldn't Stop.*, WALL ST. J. (Dec. 4, 2020, 1:03 PM), https://www.wsj.com/articles/robinhood-day-trade-i-started-trading-hot-stocks-then-i-couldnt-stop-11607095765 [https://perma.cc/G6PW-LGRD].

phone: "Your free share of SIRI is up 1.05% today. Check on your portfolio now."[61] Two hours later: "Start Trading Today." An email this time, "You're Ready To Begin Trading!"[62] Whenever a stock's price changed, Robinhood updated him by showing the classic uptick in green and a downtick in red, by implementing casino-like graphics, spinning digits up and down like a slot machine.[63] "This flux of direction and color quickly becomes hypnotic."[64]

Not surprisingly, brokerage firms that employ DEPs and trade associations that represent industry professionals have commented that DEP regulation may undermine its very purpose by limiting information and access to investment opportunities and educational tools for underrepresented, less financially educated, and/or less affluent retail investors.[65] Notably, the Securities Industry and Financial Markets Association (SIFMA), submitted a comment reflecting this view: "[T]he 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."[66] Investor-oriented trade associations like The North American Securities Administrators Association ("NASAA") share the opinion that existing regulations like Regulation BI already adequately address the use of DEPs.[67] Specifically, NASAA says, "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

61. *Id.*
62. *Id.*
63. *Id.*
64. *Id*.
65. *See* Chretien & Fields, *supra* note 13 (providing positive and negative reactions during the SEC public comment period).
66. Comment letter from Kevin M. Carroll, Managing Dir. & Assoc. Gen. Couns., Sec. Indus. & Fin. Mkts. Ass'n, to Vanessa A. Countryman, Sec'y, Sec. & Exch. Comm'n (Oct. 1, 2021), https://www.sifma.org/wp-content/uploads/2021/10/SIFMA-comment-re-DEPs-10.1.2021-FINAL.pdf [https://perma.cc/AK39-C66J]; *see also About*, SIFMA, https://www.sifma.org/about/ [https://perma.cc/QMT2-NVX7] (last visited Oct. 17, 2022) (describing themselves as "[T]he leading trade association for broker-dealers, investment banks and asset managers operating in the U.S. and global capital markets.").
67. *See* Chretien & Fields, *supra* note 13 (providing positive and negative reactions during the SEC public comment period).

other technology."[68] Some scholars have even gone so far to say that "confetti" regulation policing brokerage apps would be "subject to heightened First Amendment scrutiny."[69] So, although it may seem that going straight to the source of the problem and regulating DEPs would be the best way to impede the gamification of trading, many believe additional DEP regulation stretches too far.[70]

B. The Regulation of Payment for Order Flow

Instead of going "straight to the source," another solution is to regulate the primary underlying motivation of DEPs—payment for order flow.[71] In light of experiences such as that of the Wall Street Journal columnist's account of his experience, there is no wonder why some believe that the "behavioral churning" has gone too far.[72] However, regulating payment for order flow is tricky and will encounter strong resistance. The practice has been lauded for its ability to lower barriers to entry and allow for more inclusive investing—it has become the backbone of zero-commission trading.[73] The SEC wants more investor participation, and if payment for order flow is *regulated*,

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68. *See* Comment letter from Melanie Senter Lubin, NASAA President & Md. Sec. Comm'r, N. Am. Sec. Adm'r Assoc., to Vanessa A. Countryman, Sec'y, Sec. & Exch. Comm'n (Oct. 1, 2021), 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 [https://perma.cc/ZK5P-9B66] (arguing that regulations are already in place that cover the use of DEPs).

69. *See* Langvardt & Tierney, *supra* note 57, at 732 ("Confetti in an investing app might be read to endorse trading, or perhaps day trading, as a good thing—and a regulation banning confetti in trading apps but not in other apps might be said to single out the pro-trading 'message' for suppression . . . . If a court were to hold that confetti regulation is content or viewpoint discrimination, it would presumably apply strict scrutiny."). However, Robinhood has voluntarily regulated its confetti practice. *See* Caitlin McCabe, *Robinhood to Remove Controversial Digital Confetti From Trading App*, WALL ST. J. (Mar. 31, 2021, 7:11 PM), https://www.wsj.com/articles/robinhood-to-remove-controversial-digital-confetti-from-trading-app-11617195612 [https://perma.cc/N737-E832] (explaining that Robinhood removed confetti from their trading app to address concerns from critics before going public).

70. *See* Chretien & Fields, *supra* note 13 (providing positive and negative reactions during the SEC public comment period).

71. *See supra* Part II.A.

72. *See* Langvardt & Tierney, *supra* note 57, at 737 (discussing the impact of behavioral churning).

73. For example, Robinhood made $180 million off trades in the second quarter of 2020—roughly double from the prior quarter. *See* Rooney & Fitzgerald, *supra* note 4 (discussing the significant rise in payment for order flow practice); *see also* Coffee, Jr., *supra* note 53 (discussing the positive impact of payment for order flow).

brokerages will almost certainly be *relegated* to charge transaction fees directly to their clients.[74] This is by far the most extreme proposal and, "uses the elephant gun to hunt rats."[75]

C. *Redefining Recommendation*

As discussed before, the SEC has held Regulation BI's recommendation requirement open to interpretation and refuses to promulgate a bright line definition of "recommendation."[76] However, the SEC has stated that factors considered in determining whether a recommendation has been made include whether the communication "reasonably could be viewed as a 'call to action'" and "reasonably would influence an investor to trade a particular security or group of securities."[77] Another factor the SEC considers is the extent to which the communication is "individually tailored . . . to a specific customer or a targeted group of customers" which increases the likelihood "that the communication may be viewed as a 'recommendation.'"[78] The exact contours of what constitutes a recommendation are still ambiguous, however, because broker-dealers can carefully phrase prompts to avoid regulation. Brokers use phrasing like, "attached is a list of the most popular stocks in the portfolios of our other clients" or "our other clients who most match your demographics."[79] Again, however, defining a recommendation too broadly can lead to less communication between broker-dealers and their clients, possibly limiting access to information and investment opportunities for unsophisticated investors.[80]

74. *See* Rooney & Fitzgerald, *supra* note 4 (explaining the strategies Robinhood and other broker-dealers use to make money while keeping trading free for retail investors).

75. Coffee, Jr., *supra* note 53.

76. *See* Regulatory Notice from Fin. Indus. Regul. Auth., No. 11-02: Know Your Customer and Suitability (Jan. 2011), https://www.finra.org/sites/default/files/NoticeDocument/p122778.pdf [https://perma.cc/757X-M3CP] (discussing how recommendations are to be examined on a case-by-case basis and how defining the term would raise complex issues).

77. *Final Rule, Regulation Best Interest: The Broker-Dealer Standard of Conduct*, *supra* note 28, at 33335 (July 12, 2019) (codified at 17 C.F.R. pt. 240).

78. *Id.*

79. Coffee, Jr., *supra* note 53.

80. *See* Chretien & Fields, *supra* note 13 (providing positive and negative reactions during the SEC public comment period).

IV. THE BEST SOLUTION IS TO REQUIRE MORE EDUCATIONAL DIGITAL ENGAGEMENT PRACTICES

There are valid concerns to all three additional regulation options, which necessitates a new proposal.[81] This new proposed solution must avoid (A) overregulating DEP communications, (B) disrupting the payment for order flow market, and (C) redefining recommendation.[82] Unfortunately, because the SEC has signaled that it sees DEPs as a problem by soliciting comments, there must be some sort of proposed regulatory solution.[83]

In weighing the interests of the above factors—(A) not inducing an overbearing micromanagement of DEP communications, (B) keeping payment for order flow, and (C) encouraging investor participation while still protecting naïve investors—the best solution is for the SEC to require more financial education through tools like DEPs.[84] In short, more DEPs, or at least better DEPs, is the solution.[85] The SEC has already discussed educational communication, and indicated that it does not view certain types of communications as recommendations of any securities transaction or investment strategy involving securities.[86] The SEC views communications like basic investment concepts and assessments of customers' investment profiles to be educational.[87]

To explain why this is the best solution, let us return to the original factors the SEC considers in determining what constitutes a recommendation: (a) the nature and relationship between the dealer and the customer (the stronger the relationship, the more likely the communication is a recommendation); (b) reliance on the dealer; (c) nature of specific communications; and (d) initiation of the subject.[88]

81. *See supra* Part III (discussing proposed additional regulations and their corresponding concerns).

82. *See supra* Part III (listing the main concerns with each additional regulation).

83. *See* DEP Request, *supra* note 9 (requesting comments from the public regarding DEPs).

84. *See* Fleming, *supra* note 7 (discussing the positive uses of DEPs).

85. *Infra* Part IV.

86. *See Final Rule, Regulation Best Interest: The Broker-Dealer Standard of Conduct*, *supra* note 28, at 33338 (July 12, 2019) (codified at 17 C.F.R. pt. 240) (explaining that educational communications are generally not going to be considered recommendations).

87. *See id.* at 33337 (listing communications that are considered educational and therefore are not recommendations).

88. *See* Siegel, *supra* note 34, at 10 (listing the factors considered in finding a recommendation).

By using these already-established factors, there is no need to redefine recommendation.[89] These factors give ample guidance on what is a recommendation as well as what is not. If the solution avoids classification of educational DEPs as recommendations, it will meet the goals of the SEC, and thus decrease harm to investors and eliminate the need for stronger SEC enforcement.[90]

A. *Educational DEPs will Fulfill SEC's Goal of Creating a Fiduciary Relationship*

Considering Regulation BI has the goal of creating a stronger fiduciary relationship between the broker-dealer and the client, then (a) the nature of the relationship is a factor weighing in favor of finding a recommendation.[91] With a special emphasis on protecting naïve investors who may only get investor information from the brokerage app, most DEP communications could be a recommendation.[92] With the use of more educational DEPs, the nature and relationship between the dealer and the customer becomes one closer to an actual fiduciary relationship—one of the SEC's primary goals.[93] However, brokers might balk at the idea because it subjects them to a higher standard of care. Ultimately, however, the close relationship is mitigated by the fact that the communications are educational, which the SEC indicates are not recommendations.[94] An educational DEP would look like, "Leveraged product: This product is designed to multiply your potential risk and returns. Leveraged products may not be for all investors. [Learn more button] [Dismiss button]."[95]

89. *See supra* note 80 and accompanying text; Fallon, *supra* note 1, at 446 (discussing factors that led to the increase of retail investors).

90. *See supra* Part II (discussing what the SEC considers a recommendation, and the goals of Regulation Best Interest).

91. *See* Jacobowitz & Lopez, *supra* note 25 ("Ultimately, Reg BI seeks to supplement broker-dealer obligations by building on principles inherent in the existing fiduciary duties of care and loyalty owed by financial advisors but historically not required of broker-dealers.").

92. *See* Fleming, *supra* note 7 (discussing investor protection at SEC Speaks).

93. *See supra* note 14 and accompanying text.

94. *See supra* text accompanying note 84.

95. *See* Comment Letter from David Dusseault, President, Robinhood Fin., LLC, to Vanessa A. Countryman, Sec'y, Sec. & Exch. Comm'n (Oct. 1, 2021), https://www.sec.gov/comments/s7-10-21/s71021-9316498-260092.pdf [https://perma.cc/L6RD-SJZT] (listing examples of educational DEPs in exhibit B).

B. Educational DEPs will Reduce the Customer's Reliance on Broker

Reducing customer reliance on brokers is good because it means that educational DEPs are less likely to be interpreted as recommendations by the SEC. Reliance on the dealer is closely tied to the nature and relationship between the dealer and customer.[96] The more the investor relies on the dealer, the more the relationship looks fiduciary in nature. Less sophisticated investors rely more on the dealer. More educational DEPs will create more sophisticated investors, who are less reliant on their brokers for trading suggestions.

Professor John C. Coffee, Jr. of Columbia University Law School presents a great example: "suppose that after the client has traded with the broker for a year and, the broker's algorithm knows that the client has traded some 100 times in total, and in eighty-four cases purchased a stock on a list just supplied by the broker to the client."[97] In this instance, the broker's algorithm should know that their communications are far closer to recommendations, as the client has demonstrated reliance far more often than not.[98] Unfortunately, this idea is likely unworkable. These algorithms may not be advanced enough, and many brokers may not wish to grant the SEC access to how their DEPs work or bear the burden of micromanaging all DEPs and communications.[99] By implementing educational DEPs, brokers will likely decrease customers' reliance on their communications. This is important because it means that educational DEPs will probably not be treated as "recommendations" by the SEC. As the investor becomes more sophisticated, this creates less of a need to regulate all other forms of DEPs.[100]

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96. *See* Siegel, *supra* note 34, at 10 (listing the factors considered in finding a recommendation).

97. Coffee, Jr., *supra* note 53.

98. *Id.*

99. *See generally* Langvardt & Tierney, *supra* note 57 (discussing the regulation of communication by SEC).

100. *See Final Rule, Regulation Best Interest: The Broker-Dealer Standard of Conduct*, *supra* note 28, at 33424 (July 12, 2019) (codified at 17 C.F.R. pt. 240) (explaining study results in which sound advice was given, but the overwhelming majority of unsophisticated investors did not take the advice, authors cite lack of sophistication, familiarity, and trust as reasons why advice was not followed).

C. Educational DEPs will Decrease the Need to Closely Monitor and Regulate Communications by Brokers

The nature of each specific communication is highly important to understanding whether a DEP communication is a recommendation. However, determining the nature of the communication implicates the same issue as it does in (b) reliance on the dealer. This is because the nature of the communication will vary from trader to trader, depending on their sophistication. Therefore, the SEC might need to require brokers to closely monitor and report their communications, which would be a difficult task for brokers. Requiring more educational DEPs helps because it will decrease the need to closely monitor other forms of communication, barring blatant Regulation BI violations.[101] The need to closely monitor other communications will decrease because, as customers get savvier, the likelihood that the communications induced the customer to trade will decrease. Further, the more time spent on the app or website, the more educational DEPs that customers receive, the savvier the customers become. When customers are savvier, it is less likely that a communication will induce trading, and the SEC's motivation for regulation is not triggered. In other words, the monitoring and regulation of communications could be focused largely on new customers, because new customers are inherently less savvy investors.

D. Educational DEPs will Decrease the Importance of which Party Initiates Communication

The broker is almost always the party who initiates the communication regarding trading suggestions through the use of DEPs. This means that this factor will almost exclusively weigh in favor of the SEC interpreting DEPs as recommendations. In this sense, which party initiated the communication is not as important to weigh in the proposed solution. However, practices like giving the client an option to re-engage or learn more than what is presented periodically will decrease

101. *See id.* at 33338 (explaining that educational communications are generally not going to be considered recommendations, as long as they do not include recommendation of a particular security or particular investment strategy involving securities).

the likelihood of finding a Regulation BI violation, because the interaction was initiated by the investor.[102]

E. Summary of Proposed Solution

With this in mind, requiring more educational DEPs is the best solution because: the nature and relationship between the dealer and the customer becomes more like an authentic fiduciary relationship.[103] Reliance on the broker will likely decrease as the investor becomes more sophisticated.[104] Lastly, by informing or warning customers before they make an excessively risky trade, the nature of these communications will sometimes even save the wallets of investors while still keeping payment for order flow intact.[105]

This solution is also a direct response to one of Robinhood's criticisms. Robinhood claims that broadening the definition of recommendation would subject them to massive liability and limit the educational resources that brokerages offer to their customers out of fear of enforcement.[106] To address Robinhood's concern even more, the SEC and eBrokers can work together to carve out an educational safe harbor, where eBrokers can avoid enforcement if their customer completes enough training in each type of investment strategy the customer uses.

V. CONCLUSION

Moving forward, perhaps gamification of trading could be flipped on its head.[107] As Rick Fleming said at SEC Speaks, not all DEPs are bad, and some of these communications can be used to

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102. *See* Siegel, *supra* note 34, at 10 (listing the factors considered in finding a recommendation).

103. *See supra* Part IV.A.

104. *See supra* Part IV.B.

105. *See* Fleming, *supra* note 7 (discussing the positive uses of DEPs).

106. *See* Robinhood Markets, Inc., *Form S-1 Registration Statement* 1 (July 1, 2021), https://www.sec.gov/Archives/edgar/data/1783879/000162828021013318/robinhoods-1.htm [https://perma.cc/JP58-HPCP]
(stating in its IPO its concern that "[p]roviding investment education tools could subject us to additional risks if such tools are construed to be investment advice or recommendations."); *see also* Fallon, *supra* note 1, at 446 (quoting Robinhood's registration statement and addressing Robinhood's criticism).

107. *See* Fleming, *supra* note 7 (discussing the positive uses of DEPs).

inform, warn, and educate investors.[108] The opportunity for more investor participation initially created a hotbed for abusive practices like dopamine-driven, incessant DEPs.[109] There may be initial pushback to educational DEPs, similar to what was seen in the public comment period,[110] especially from broker-dealers who fear their payment for order flow will decrease as a result.[111] However, if eBrokers like Robinhood want to make peace and avoid the possibility of over-regulation, it might be in *their best interest* to employ more "good" DEPs.[112] After all, many new investors may be feeling burned from their original experience.[113] Keeping all else equal and encouraging investor education, this may be the win-win-win scenario between market makers, broker-dealers, and retail investors.

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108. *See id.*

109. *See generally* Langvardt & Tierney, *supra* note 57 (discussing the regulation of communication by the SEC).

110. *See supra* Part III.A.

111. *See* Chretien & Fields, *supra* note 13 (providing positive and negative reactions during the SEC public comment period).

112. *See* Fleming, *supra* note 7 (discussing the positive uses of DEPs).

113. *See* Jesse Pound, *Robinhood Reports Shrinking Revenue, Fewer Active Users*, CNBC (Apr. 29, 2022, 4:26 PM) https://www.cnbc.com/2022/04/28/robinhood-hood-q1-2022-earnings.html [https://perma.cc/7TLG-UKSR] (reporting a decrease in active users).

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