Securities Regulation Daily Wrap Up, TOP STORY—SEC requests information on digital engagement practices, (Aug. 27, 2021)

Securities Regulation Daily Wrap Up

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As brokers and advisers increasingly use behavioral prompts and predictive analytics when engaging with customers online, the Commission seeks a better grasp of these practices and how they might present conflicts of interest.

The SEC has requested information and public comments related to the use of digital engagement practices (DEPs) by broker-dealers and investment advisers. The Commission stated that it seeks to develop a better understanding of online market practices such as behavioral prompts and gamification and the related analytical and technological tools and methods. The agency also hopes to learn what conflicts of interest may arise from optimization practices and whether those practices involve making a recommendation or providing investment advice (*Request for Information and Comments on Broker-Dealer and Investment Adviser Digital Engagement Practices, Related Tools and Methods, and Regulatory Considerations and Potential Approaches; Information and Comments on Investment Adviser Use of Technology to Develop and Provide Investment Advice*, Release No. 34-92766, August 27, 2021).

The use of gamification by Robinhood Financial and other online broker-dealers has come under intense scrutiny following the volatility resulting from the retail short squeeze in shares of GameStop and other "meme stocks." Critics have argued that the securities industry's use of gamification and other "nudges" to exploit behavioral biases is not a responsible practice because it has the ability to create harm by creating financial fragility through wealth erosion.

DEPs. As discussed in the request, examples of DEPs may include social networking tools; games, streaks and other contests with prizes; points, badges, and leaderboards; notifications; celebrations for trading; visual cues; ideas presented at order placement and other curated lists or features; subscriptions and membership tiers; and chatbots. The request notes that various analytical and technological tools and methods can underpin these practices, such as predictive data analytics and artificial intelligence/machine learning models. Firms may use these tools to analyze the success of specific features and practices at influencing retail investor behavior, including opening new accounts or obtaining additional services, increasing engagement with the app, or increasing trading.

"While these new technologies can bring us greater access and product choice, they also raise questions as to whether we as investors are appropriately protected when we trade and get financial advice," said SEC Chairman Gary Gensler in a public statement. "In many cases, these features may encourage investors to trade more often, invest in different products, or change their investment strategy."

Gensler said that he is particularly interested in learning how the SEC might protect investors in light of the potential conflicts of interest that may exist when DEPs' optimization practices have a statistically significant impact on platform revenues, data collection, or investor behavior. And to the extent that optimization leads to significant changes in investor behavior, Gensler is interested in how optimization affects the determination of whether DEPs are making a recommendation or providing investment advice.

Goals and purpose. The SEC's fact sheet listed the following as the aims of the agency's request for information regarding DEPs:

- to assist the SEC in better understanding and assessing the market practices associated with the use of DEPs by firms, including: (1) the extent to which firms use DEPs; (2) the types of DEPs most frequently

used; (3) the tools and methods used to develop and implement DEPs; and (4) information pertaining to retail investor engagement with DEPs, including any data related to investor demographics, trading behaviors, and investment performance;

- to provide a forum for market participants and other interested parties to share their perspectives on the use of DEPs and the related tools and methods, including potential benefits for retail investors and potential investor protection concerns; and
- to facilitate an assessment by the SEC of existing regulations and consideration of whether regulatory action may be needed.

The SEC also seeks to gain a better understanding of the nature of analytical tools and other technology used by investment advisers to develop and provide investment advice to clients, including: (1) oversight of this technology; (2) how investment advisers and clients have been affected by technology; (3) potential risks to investment advisers, clients, and the markets more generally related to this technology; and (4) whether regulatory action may be needed to enhance investor protection while preserving the ability of investors to benefit from advisers' use of technology.

Request for comments. The public comment period will remain open for 30 days following publication of the request in the *Federal Register*.

The release is No. 34-92766.

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