

# "Investor Protection in a Digital Age," Remarks Before the 2022 NASAA Spring Meeting & Public Policy Symposium



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Thank you, Melanie. My thanks to the state securities regulators in the audience and to the North American Securities Administrators Association (NASAA) for your vital work to protect investors.

As is customary, I'd like to note that my views are my own, and I'm not speaking on behalf of the Commission or SEC staff.

Today, you've asked me to talk about investor protection in a digital age.

The topic gets me thinking about grocery stores.

When you visit a grocery store, do you notice that you travel around the outer aisles to find the fruits and vegetables, but the candy, gum, and chips are waiting for you near the cash register?

By design, grocery stores tap into our behavioral psychology, activating our impulses to purchase things we may not need. Research has shown that impulsive purchases account for 62% of supermarket sales.<sup>[1]</sup> A bit of evidence: all those bags of gummy bears I've purchased in my day.

These stores serve the public, and they also have a profit incentive. Thus, they may tempt us with products that serve their interests rather than ours, and use the latest technology and research to do so.<sup>[2]</sup> Many consumers recognize this.

When instead we seek advice from an investment professional, that expectation changes. If you are a broker-dealer or an investment adviser—including if you provide your services digitally through an investment platform—when you provide advice, you have to act in the best interests of us, your clients, and not place your own interests ahead of our interests.<sup>[3]</sup>

As my mom, Jane Gensler, might have said it, you have to put your client's interests first. You can't dangle gummy bears over an investor's shopping cart, so to speak—even if the latest technologies might make it all the more easy, subtle, and profitable to do so.

My mom would have been right, because there's something distinctive about finance. Investment professionals are dealing with other people's money. That's why brokers and advisers have to comply with specific duties—standards on care, loyalty, best interest, and best execution.

The challenge is to make sure that brokers and advisers live up to their obligations and the trust that's been placed in them.

This challenge is not new, nor is the digital age.

The technological advances of the 1990s, namely the internet, allowed anyone to execute a transaction online. Among other factors, that shift created further incentives for brokers to restyle themselves as advisers.<sup>[4]</sup>

By the naughts, investors found it difficult to see the difference between brokers and advisers, the services they offer, and the disparate standards required of those professionals.<sup>[5]</sup> After smartphones came around, investors might have started to believe that the difference between brokers and advisers might merely be tapping one part of their screen versus another.

In 2019, the SEC addressed this blurring and these disparities through rulemaking on Regulation Best Interest (Reg BI) for broker-dealers and through an interpretation of the fiduciary standard for investment advisers (IA fiduciary standard). <sup>[6]</sup> These set forth in clear terms the responsibilities that these investment professionals owe to investors when providing advice.

These responsibilities matter for tens of millions of investors. Think about them: the college graduate paying off her student loans; the parents-in-waiting saving for that new house with a crib; the grandparents living off their nest egg.

Our current digital age of the 2020s raises additional challenges for investors. It's dangling over their shopping carts. Through new technologies, investors—who at the time might not even be seeking advice—may be getting nudged toward those gummy bears.

### **Digital Engagement Practices**

I think what we're living through in the 2020s is as transformative as the 1990s was with the internet. What I'm referencing is the use of predictive data analytics, built upon artificial intelligence and machine learning, tapping into the veritable explosion of data on every one of us.

Coupled with differential marketing, differential pricing, and individually tailored behavioral prompts, these technologies—what we've called digital engagement practices (DEPs)—are increasingly shaping many parts of our economy.

#### *Conflicts of Interest*

Finance is no exception. Predictive data analytics and other DEPs are evolving the way that brokers and advisers engage with investors, including through robo-advisers, brokerage apps, and wealth management apps.<sup>[7]</sup>

As a thought experiment, imagine if the grocery store were a virtual experience. Imagine if the store rearranged its inventory, shelving, and pricing for each shopper who visited the store, each time they visited that store, down to the impulse items by the register. The precision with which the store could nudge you toward certain purchases—and the algorithms behind those nudges—could be powerful and profitable.

That thought experiment may not have fully come to finance yet. Through using DEPs, however, robo-advisers, brokerage apps, and wealth management apps increasingly can narrowly target each consumer with specific marketing, pricing, and nudges.

This raises a number of questions. In the case of online investment platforms, when they use certain DEPs, what are they optimizing for? Are they optimizing for the investor's benefits, including risk appetite and returns? Or are they prioritizing other factors, including the platform's revenue or performance?

When investment professionals offer advice or recommendations, including when they are using DEPs, our standards are clear—they must not place their own interests ahead of the investor's interests.<sup>[8]</sup>

This new digital world raises questions. Is a behavioral nudge—the gummy bears dangled above your cart, the flashing "options trading" button when you create a brokerage account—a recommendation?

Further, when do behavioral nudges take on attributes similar enough to advice or recommendations such that related investor protections are needed? The nature of certain steers raises questions between what is and isn't advice or a recommendation.

### *Bias*

A related issue is bias, and how people—regardless of race, color, religion, national origin, sex, age, disability, and other factors—receive fair access and prices in the financial markets.[\[9\]](#)

How can we help ensure that new developments in analytics don't instead reinforce societal inequities?

The underlying data used in these analytic models could be based upon data that reflects historical biases, along with underlying features that may be proxies for protected characteristics, like race and gender.

As investment platforms rely on increasingly sophisticated data analytics, I believe that it will be appropriate to safeguard against algorithmically fortifying such biases.

### *Systemic Risk—Concentration*

Further, today's new forms of predictive data analytics raise issues for financial stability through herding, interconnectedness, and possible greater concentration in our capital markets.

With respect to concentration, we have seen that sophisticated data analytics—and what's called network economics—have led to highly-concentrated platforms in a range of sectors. For example, last year, 92% of internet searches were logged on a single search platform.[\[10\]](#)

Today, though we still see significant competition on the front-end among brokerage apps, there is less so on the back-end.

More specifically, the provision of market making by wholesalers, paying for order flow, has already become relatively concentrated. For example, during GameStop events last year, 88% of internalized dollar volume in January 2021 was executed by three wholesalers.[\[11\]](#)

To protect investors in a digital age and best promote competition, what might we do if and as greater concentration emerges in finance? We've also seen growing concentration in the investment management field.

Generally speaking, the narrower and more concentrated a particular part of the market, the less robust the competition. Thus, I've asked staff to examine how to improve efficiency and competition throughout our markets.

### **Best Interest**

Under Reg BI and the IA fiduciary standard, when a broker or an adviser provides advice, digitally or otherwise, they must act in the best interests of their clients, and not place their own interests ahead of their clients' interests.[\[12\]](#)

These words matter to investors. They should have meaning for brokers and advisers as well. Thus, I've asked our Divisions of Investment Management, Trading and Markets, Examinations, and Enforcement to help ensure that investment professionals live up to these obligations.

The SEC staff published a bulletin in March regarding Reg BI and the IA fiduciary standard. The bulletin addressed account recommendations, including rollover recommendations, and focused on three core points.[\[13\]](#)

First, brokers and advisers need to prevent their own interests from inappropriately influencing their recommendations and advice. If they can't do that, they have decisions to make—eliminate the conflict, don't give the advice, or find some other way to ensure that they don't put their interests ahead of the retail investor's interests.

Second, in order to offer recommendations and advice in the best interest of the investor, brokers and advisers need to consider reasonably-available alternatives. This needs to be a meaningful evaluation.

Third, as part of that analysis, brokers and advisers need to consider costs and risks to investors. While it is true that they don't always have to recommend the lowest-cost option, they must have a reasonable basis to believe a higher-cost recommendation nonetheless is in the investor's best interests.

The staff is considering additional bulletins that would further provide their views on each of these three points.

Brokers and advisers have a critical role to play in all of this. Disclosure is important but not sufficient when it comes to acting in a retail investor's best interest. Firms need to take investor protection and compliance obligations seriously, reining in or curing any conflicts and really delivering the best interest advice that investors so need and deserve.

That's how we get the best out of best interest.

## **Crypto Markets**

Discussing investor protection in a digital age, I'd be remiss not saying a few words on the crypto markets. I'm reminded of Joseph Dolley, the Kansas Banking Commissioner who pioneered investor protection.<sup>[14]</sup>

Over the past year, several bank executives have shared their concerns with me about the sheer number of depositors who have moved money from their bank accounts into crypto-related exchanges and wallets.

When I first heard this, I remembered Mr. Dolley's story from a century ago. As banking commissioner, Mr. Dolley heard similar stories from local bank executives. People were withdrawing money from their bank accounts to purchase securities from hucksters and scammers across the state. Mr. Dolley knew something had to be done.

His calls for investor protection led to blue-sky laws across many states. This led to the founding of NASAA in 1919. All of this happened in an earlier era of rapidly-changing technology.

As I hear from bank executives about their customers shifting their savings to speculative crypto assets, I think of how Mr. Dolley responded to a clear need to protect investors as technology and finance changed.

I think there's a need to bring greater investor protection to these crypto markets. Central to that are crypto trading and lending platforms, where investors buy, sell, and lend around \$100 billion of crypto assets a day.<sup>[15]</sup>

As it relates to crypto tokens, if investors are putting money behind a group of entrepreneurs raising money from the public in anticipation of profits, that's the hallmark of an investment contract or a security under our jurisdiction.

The crypto-related events in recent weeks have highlighted yet again how important it is to protect investors in this highly speculative asset class.

## **Conclusion**

In conclusion, when new technologies comes along, the need for investor protection doesn't go away. It comes down to what my mom might have said. You can't simply dangle gummy bears...or crypto tokens...over an investor's shopping cart.

You have to put your client's interests first.

Thank you.

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[1] See Journal of Retailing and Consumer Services, "Impulsive Purchasing in Grocery Shopping: Do the Shopping Companions Matter?" (May 2021), *available at* <https://www.sciencedirect.com/science/article/abs/pii/S0969698921000618>.

[2] See Institute of Electrical and Electronics Engineers, "The Impacts of E-Payment System and Impulsive Buying to Purchase Intention in E-commerce" (Oct. 2, 2020), *available at* <https://ieeexplore.ieee.org/document/9211154>.

[3] See U.S. Securities and Exchange Commission, “Regulation Best Interest: The Broker-Dealer Standard of Conduct” (Sept. 10, 2019), *available at* <https://www.sec.gov/rules/final/2019/34-86031.pdf>. See U.S. Securities and Exchange Commission, “Commission Interpretation Regarding Standard of Conduct for Investment Advisers” (Jul. 12, 2019), *available at* <https://www.sec.gov/rules/interp/2019/ia-5248.pdf>. See U.S. Securities and Exchange Commission, “Regulation Best Interest, Form CRS and Related Interpretations” (March 30, 2022), *available at* <https://www.sec.gov/regulation-best-interest>. See U.S. Securities and Exchange Commission Staff, “Staff Bulletin: Standards of Conduct for Broker-Dealers and Investment Advisers Account Recommendations for Retail Investors” (March 30, 2022), *available at* <https://www.sec.gov/tm/iabd-staff-bulletin>.

[4] See U.S. Securities and Exchange Commission, “Study on Investment Advisers and Broker-Dealers” (Jan. 2011), *available at* <https://www.sec.gov/news/studies/2011/913studyfinal.pdf>. See The Rand Institute for Civil Justice, “Investor and Industry Perspectives on Investment Advisers and Broker-Dealers” (Jan. 2008), *available at* [https://www.sec.gov/news/press/2008/2008-1\\_randiabdreport.pdf](https://www.sec.gov/news/press/2008/2008-1_randiabdreport.pdf).

[5] See U.S. Securities and Exchange Commission, “Study on Investment Advisers and Broker-Dealers” (Jan. 2011), *available at* <https://www.sec.gov/news/studies/2011/913studyfinal.pdf>. See U.S. Securities and Exchange Commission, “Investor and Industry Perspectives on Investment Advisers and Broker-Dealers” (Jan. 2008), *available at* [https://www.sec.gov/news/press/2008/2008-1\\_randiabdreport.pdf](https://www.sec.gov/news/press/2008/2008-1_randiabdreport.pdf).

[6] See Footnote 3. See also U.S. Securities and Exchange Commission, “Regulation Best Interest, Form CRS and Related Interpretations” (March 30, 2022), *available at* <https://www.sec.gov/regulation-best-interest>.

[7] See Gary Gensler, “Prepared Remarks before the Investor Advisory Committee” (March 10, 2022), *available at* <https://www.sec.gov/news/statement/gensler-iac-2022-03-10>.

[8] See Footnote 3.

[9] See Gary Gensler, “Prepared Remarks before the Investor Advisory Committee” (March 10, 2022), *available at* <https://www.sec.gov/news/statement/gensler-iac-2022-03-10>. See Gary Gensler, “Prepared Remarks at SEC Speaks” (Oct. 12, 2021), *available at* <https://www.sec.gov/news/speech/gensler-sec-speaks-2021-10-12>.

[10] See StatCounter, *available at* <https://gs.statcounter.com/search-engine-market-share>.

[11] See U.S. Securities and Exchange Commission Staff, “Staff Report on Equity and Options Market Structure Conditions in Early 2021” (Oct. 14, 2021), *available at* <https://www.sec.gov/files/staff-report-equity-options-market-struction-conditions-early-2021.pdf>.

[12] See Footnote 3.

[13] See U.S. Securities and Exchange Commission Staff, “Staff Bulletin: Standards of Conduct for Broker-Dealers and Investment Advisers Account Recommendations for Retail Investors” (March 30, 2022), *available at* <https://www.sec.gov/tm/iabd-staff-bulletin>.

[14] See “Kansas Blue Sky Laws,” *available at* <https://www.kshs.org/kansapedia/kansas-blue-sky-laws/18618>.

[15] See Gary Gensler, “Prepared Remarks of Gary Gensler on Crypto Markets at the Penn Law Markets Association Annual Conference” (April 4, 2022), *available at* <https://www.sec.gov/news/speech/gensler-remarks-crypto-markets-040422>.