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Via E-Mail (NASAAComments@nasaa.org)

North American Securities Administrators Association
750 First Street NE, Suite 990
Washington, DC 20002

Re: Proposed Revisions to NASAA's model rule on Dishonest or Unethical Business Practices of Broker-Dealers and Agents

To the Broker-Dealer Committees:

The Fairbridge Investor Rights Clinic at the Elisabeth Haub School of Law at Pace University, (“the Clinic”)¹ welcomes the opportunity to comment on the North American Securities Administrators Association’s (“NASAA”) proposed revision to its model rule on *Dishonest or Unethical Business Practices of Broker-Dealers and Agents* (the “Business Practices Rule”). The Clinic applauds NASAA’s effort to align the Business Practice Rule with the standard of care set forth in the U.S. Securities and Exchange Commission’s (“SEC”) Regulation Best Interest (“Reg BI”), which requires broker-dealers to act in the best interest of their clients when recommending account types, investments, and investment strategies. The Clinic also endorses the proposed definition of the term “Recommendation,” set forth in Subpart 1d(5) of the proposed revisions to the Business Practices Rule. The Clinic believes that is appropriate to treat individualized digital communications as recommendations, which must serve the best interest of the customer. In addition, the Clinic believes that broker-dealers must act in the best of interest of their customers when making recommendations, regardless of the type of account held by the customer. The Clinic proposes minor modifications to the definition of recommendation to enhance its clarity and provide further protection to investors.

¹ The Fairbridge Investor Rights Clinic is the successor to the Pace Investors Rights Clinic, which was opened in 1997, and was the nation’s first law school clinic dedicated to providing pro bono representation to individual investors of modest means in securities disputes. See Barbara Black, *Establishing A Securities Arbitration Clinic: The Experience at Pace*, 50 J. LEGAL EDUC. 35 (2000); see also Press Release 97-101, Securities Exchange Commission, *SEC Announces Pilot Securities Arbitration Clinic To Help Small Investors – Levitt Response To Concerns Voiced At Town Meetings* (Nov. 12 1997), available at <http://www.sec.gov/news/press/pressarchive/1997/97-101.txt>. The Clinic is staffed by third year law students and operates through John Jay Legal Services, Inc., which is a not-for-profit legal services firm that runs the clinical and externship programs at the Elizabeth Haub School of Law at Pace University.

1. Background

The Clinic, which is staffed by third-year law students, represents underserved retail investors who have suffered losses due to the misconduct of their broker-dealers, but who likely would not be able to find representation. In addition, the Clinic's student interns advocate for regulatory changes to ensure the protection of retail investors. Over the last few years, the Clinic has received several inquiries from investors who have suffered losses after engaging in complex trading strategies (such as options trading, margin trading, and short selling), in "self-directed," on-line accounts. Frequently, these inquiries come from novice investors, who have difficulty explaining what happened and do not appear to have understood the risks associated with these complex investment strategies. These complaints naturally raise the question of why novice investors would choose to engage in complicated, high risk, investment strategies.

As law students in their mid to late twenties, we have grown up with social media and use on-line investing accounts and applications ourselves. Thus, we have experienced the extent to which certain on-line broker-dealers use digital engagement practices to communicate with on-line investors. These digital engagement practices range from providing general market information, which is merely educational or informative, to highly individualized "push notifications," which are clearly designed to encourage trading activity. As a result of our own investing experience and communications with our peers, we believe that some on-line trading platforms use artificial intelligence and algorithms to track users' investment and research activity to send targeted and highly individualized push notifications and other communications to encourage trading. We believe that retail investors, particularly novice investors using on-line accounts, likely view these notifications as "calls to action" or recommendations. Indeed, one study reported that push notifications increase the number of retail trades "by approximately 25% in the minutes following a notification."² Thus, in our view, these notifications are today's equivalent of a telephone call from a registered representative with a "tip," and should be treated as recommendations.

We agree with NASAA's assessment that the use of "sophisticated algorithmic digital engagement practices that feed on and cater to the personal attributes of individual retail investors" ("DEPs"), should be viewed as a "call to action." We therefore that DEPs should be treated as recommendations. We further agree that the use of DEPs should be deemed recommendations even when they are used to communicate with holders of "self-directed" accounts.

² Moss, Austin "How Do Brokerages' Digital Engagement Practices Affect Retail Investor Information Processing and Trading?" Henry B. Tippie College of Business, University of Iowa, (January 20, 2022)

II. Analysis of NASAA’s Proposed Definition of Recommendation

Pursuant to Reg BI, FINRA’s suitability rule, Rule 2111, and NASAA’s proposed revisions to the Business Conduct Rule, a “recommendation” is a gatekeeping event that triggers a broker-dealer’s duty to ensure that any securities transaction, investment strategy, or account type is in the customer’s best interest.³ Whether a communication can reasonably be viewed as a “call to action,” depends in large part, on how individualized the communication is to a specific customer.⁴ In the past, individualized communications were generally perceived to require interaction between the investor and an actual representative of a broker-dealer. However, as explained above, and in NASAA’s proposal, the increasing use of fintech, artificial intelligence, and DEPs allows broker-dealers to send highly individualized communications, which reflect the investor’s own trading practices, watch lists, and internet research, directly to the investor without any human interaction. We therefore welcome NASAA’s decision to provide greater regulatory clarity regarding the meaning of the term “recommendation.”

The Clinic applauds the language of Subpart 1(d)(5), which clearly states that “if a broker-dealer or agent utilized *any means, methods, or mechanism* to feature or promote an account type, specific security, or investment strategy to a retail customer,” then that transaction “will be deemed a recommendation.” (emphasis added). We understand NASAA’s desire to use broad language, such as “any means, methods, or mechanisms,” in the definition of recommendation, but we believe that the definition might be improved if NASAA actually referenced DEPs.

The Clinic also welcomes NASAA’s effort to ensure that broker-dealers act in customers’ best interests when making recommendations to customers who have “self-directed” accounts. As noted above, we have received an increasing number of complaints from novice investors who engaged in complex, high risk trading strategies in “self-directed” accounts. We do not believe that broker-dealers that employ highly individualized DEPs should be able to escape responsibility for recommendations by simply designating certain accounts as “self-directed.” Indeed, we question whether a novice investor who receives individualized push notifications and other digital communications is really engaged in “self-directed” trading. Thus, we recommend a slight revision to the language of Subpart 1(d)(5) to clarify that broker-dealers must act in the best interest of customers when making recommendations regardless of account type.

The Clinic therefore proposes the following modest revisions to proposed Subpart 1(d)(5), with additional language identified in italics and eliminated language identified by strike through:

The obligations set forth in this section do not apply to unsolicited transactions that a broker-dealer or agent execute for a customer in a self-directed or nondiscretionary account. *However*, if the

³ See Regulation Best Interest, 17 C.F.R. § 249.15I-1(a)(1); FINRA Rule 2111(a)

⁴ See “Regulation Best Interest: Frequently Asked Questions (FAQs),” U.S. Securities and Exchange Commission, <https://www.sec.gov/tm/faq-regulation-best-interest#recommendation>

broker-dealer or agent utilized any means, methods, or mechanism, *including but not limited to, any individualized digital engagement practice or communication*, to feature or promote an account type, specific security, or investment strategy to a retail customer, whether directly or through a third party, then that transaction ~~will not be deemed an unsolicited transaction, but rather~~ will be deemed a recommendation to which all of the ~~foregoing~~ obligations set forth in this subsection apply, *even if the transaction is executed in a self-directed or non-discretionary account.*

Although these changes are not substantive, the Clinic believes that these proposed changes make it clear that: (1) certain communications, including digital communications, constitute recommendations; and (2) broker-dealers who make recommendations must act in the best interest of their customers, regardless of whether the broker-dealer designates the account as “self-directed.”

We believe that NASAA’s proposal provides timely and needed clarity regarding the meaning of the term “recommendation,” and that it will encourage broker-dealers to use DEPs in a manner that is consistent with the best interests of their customers. In addition, the proposal will enhance the ability of investors to recover losses when they receive and act upon recommendations that are not in their best interest.

We appreciate the opportunity to provide comments to NASAA on this crucial investor protection concern and support NASAA’s effort to protect investors.

Respectfully submitted,

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