January 20th, 2025

SIFMA and SIFMA AMG Comments on IOSCO DEPs Consultation

QUESTION 1: How would you define DEPs? What should the scope of this definition cover?

On behalf of the Securities Industry and Financial Markets Association ("SIFMA") and the Asset Management Group of SIFMA ("SIFMA AMG"), we appreciate the opportunity to provide input on the International Organization of Securities Commissions' ("IOSCO") November 2024 Consultation Report on Digital Engagement Practices ("Report").

Acknowledging the need for a common vocabulary, we believe that Digital Engagement Practices ("DEPs") can be most accurately described as methods of customer engagement, advertising, and education facilitated through digital means. This description accurately reflects our position that DEPs are nothing more than the natural evolution of customer engagement practices. For instance, push notifications about portfolio movements have replaced phone calls from brokers, digital lists of top-traded stocks have supplanted similar lists published in newspapers, and the publication of peer information is comparable to chatting with friends about the stock market.

Ultimately, we do not believe that a common regulatory definition is appropriate or necessary. DEPs will continue to evolve with investor demands and technology. This makes it difficult to establish a useful definition that will not quickly become outdated. That is why principle-based, technology-agnostic frameworks that do not rely on technical or specific definitions are better suited than DEP-specific regulations to address the concerns raised in the Report.

QUESTION 2: Do you agree with the findings of the Consultation Report and the proposed Guidance? Are there any significant issues, gaps, or emerging risks that should be further explored in the report?

We strongly agree with the Report's finding that DEPs can improve the aggregate welfare of investors by encouraging capital market participation, increasing financial literacy, and enabling positive investor outcomes We acknowledge that the use of DEPs can present certain risks. These risks, however, can be effectively mitigated by well-designed, principle-based, technology-agnostic regulatory frameworks. In jurisdictions where such frameworks are in place, DEP-specific regulatory requirements would be unnecessary and duplicative.

The Report describes certain mechanisms that may encourage retail investors "to trade more frequently to the benefit of the firm when it may not be in investors' best interest to do so, therefore creating a potential conflict of interest between the firm and the investor." The Report also discusses practices that could steer retail investors toward unsuitable products that are more profitable to the firm, or change investment strategies without full consideration of the risks involved. As an industry, we acknowledge the need to address these potential conflicts. DEPs should never mislead clients and should always present information in a manner that is fair and balanced.

Importantly, these potential conflicts of interest are not new to the industry. Rather, the conflicts described in the Report are the same types of conflicts that can arise in connection with any medium or form of communication or engagement with a client. In the United States, broker-dealers and investment advisers are subject to an extensive set of laws and regulations that are designed to protect investors across the range of client engagement practices, including DEPs. SEC Regulation Best Interest ("Reg BI") requires broker-dealers, when making recommendations to retail customers, to act in the best interest of the retail customer at the time the recommendation is made, without placing the financial or other interest of the broker-dealer ahead of the interests of the retail customer. Similarly, registered investment advisers owe a federal fiduciary duty of care and loyalty to clients, described by the SEC as an obligation to "act in the 'best interest' of its client at all times." There are also numerous SEC and FINRA rules, along with the anti-fraud provisions under the federal securities laws, designed to protect investors from deceptive or manipulative practices. Overall, we believe that this existing regulatory framework sufficiently addresses the potential risks associated with DEPs.

For this reason, we agree with some elements of the proposed Guidance, though other elements of the Guidance may not be necessary. We agree that market intermediaries should ensure that DEPs used to communicate investment advice or recommendations do not benefit of the market intermediary at the detriment of retail investors, and that DEPs should not be intentionally designed solely to increase transaction volume and resulting fees. We also strongly support the recommendation that market intermediaries should ensure that DEPs used to provide investment advice or recommendations are in line with the relevant jurisdictional regulatory frameworks. However, we do not agree that additional requirements beyond relevant jurisdictional frameworks such as DEP-specific policies and procedures, risk management systems, testing, and disclosures are necessary to achieve IOSCO's investor protection goals.

Regarding issues and topics that could be further explored in the Report, we recommend a more comprehensive and holistic analysis of the existing academic and regulatory literature on DEPs. In the following paragraphs, we highlight five examples where a more thorough summary of the cited research would be beneficial to the public and regulatory discourse on DEPs.

First, the Report claims that research has shown "retail investors' behavior in response to the use of DEP's may deviate from standard rational models of behavior." *Report* at 12-13. None of the cited materials, however, suggest that retail investors exist in a natural state of rationality and self-interest. Instead, they begin with the premise that retail investors are naturally irrational and can be influenced by a variety of social, cognitive, and emotional factors. *See*, Federal Research Division, *Behavioral Patterns and Pitfalls of US Investors* (2010) at 1 ("behavioral finance set[s] out to challenge the prevailing assumptions of rational expectations theory [and] emphasize[s] the social, cognitive, or emotional factors that lead investors to depart from the rational behavior that traditional economists presume"); see *also*, FCA, *Applying behavioral economics at the Financial Conduct Authority* (2013) at 4 ("People do not always make choices in a rational way. In fact, most human decision-making uses thought processes that are intuitive and automatic rather than deliberative and controlled."). We acknowledge that DEPs can hypothetically be designed to take advantage of human tendencies, but the Report should not imply that DEPs are the reason retail investors make economically irrational decisions.

Second, the Report states that research has found that "DEPs can effectively increase user engagement." *Report* at 14. We do not disagree; DEPs are intentionally designed to enhance the user experience. We are concerned, however, that the Report comes to this conclusion by citing literature reviews that are—at best—only tangentially related to the use of DEPs by financial intermediaries. For example, one review is devoted to "assess[ing] the amount and quality of empirical support for the advantages and effectiveness of gamification applied to health and well-being." Johnson et al., *Gamification for health and wellbeing: A literature meta analysis and integrative model* (2016) at 1. Another is dedicated to "examin[ing] the effect (if any) of gamification on student learning achievements." Bai et al., *Does gamification improve student learning outcome? Evidence from a meta-analysis and synthesis of qualitative data in educational contexts* (2020). The most relevant review plainly states that none of the studies it reviewed were "conducted in a marketing context" and that "no paper seemed to infer the relationship between gamification and purchase behavior." Hamari et al., *Does Gamification Work? – A Literature Revie w of Empirical Studies on Gamification* (2020), 3025, at 3028-9. Given the breadth of available literature, the Report should rely on more relevant sources.

Third, citing two pieces of research, the Report states that "several studies have examined the effect of DEPs on investor behavior and decisions." *Report* at 15. According to the Report, these studies show that push notifications induce investors to "trade more and to take on more risk." *Report* at 15. However, the Report does not disclose the limited scope of these studies. One paper only considered notifications about "large price changes for a stock on single day, streaks that highlight stock-price changes in the same direction over several days, and earnings-report dates." Arnold et al., *Attention triggers and investors' risk taking* (2021) at 8. The other paper was limited to a data set from one intermediary and only considered push notifications that alerted customers "when the intraday return of a stock in their portfolio reaches +/- 5%." Moss, *How do Brokerages' Digital Engagement Practices Affect Retail Investor Information Processing and*

Trading? (2022) at iv. The Report should discuss and consider the implications of these noteworthy limitations.

Fourth, without providing a citation, the Report asserts that regulatory research has found that default settings can be used to "influence the amount investors invested and the amount of leverage used, by using investors' tendency to follow the path of least resistance." *Report* at 17. While ostensibly true, this statement avoids acknowledging that regulatory research has recognized the important benefits of this type of DEP. For example, the Ontario Securities Commission acknowledged that "defaults are an inherent element of any platform and can benefit investors" and the US Federal Research Division found that "retirement plans featuring automatic enrollment have much higher participation rates than those in which enrollment is discretionary, because individuals tend to acquiesce in participating and to accept the plan's default options." OSC, *Digital Engagement Practices: Dark Patterns in Retail Investing* (2024) at 26; USFRD, *Behavioral Patterns And Pitfalls of US Investors* (2010) at 5.

Fifth, the Report claims that "direct evidence on how DEPs may be used for the benefit of investors is sparse." *Report* at 19. A cursory search of relevant scholarly sources disproves this statement. For example, there is academic research available on the benefits of push notifications, default settings, and design features. *See*, Karlan et al, *Getting to the Top of Mind: How Reminders Increase Saving* (2014); Firsanch et al., *Can a Mobile-App-Based Behavioral Intervention Teach Financial Skills to Youth?* (2023); Thaler and Benartzi, *Save more Tomorrow: Using Behavioral Economics to Increase Employee Saving* (2004); Looney et al., *Decision Support for Retirement Portfolio Management: Overcoming Myopic Loss Aversion via Technology Design* (2009). We strongly recommend that the Report contain a more thorough analysis of the existing research given the implications of the Report's findings and proposed Guidance.

QUESTION 3: Are there any other types of DEPs deployed by market intermediaries that are not covered in this report? Please elaborate providing examples and describing their impact on investor behaviour.

While the Consultation Report discusses various DEP use cases, we believe it downplays the existence of beneficial DEPs and exaggerates the prevalence of harmful ones. While it is impractical to provide an exhaustive list, we believe it is important to highlight examples of certain types of DEPs that benefit investors.

Retirement calculators and models are one example. These DEPs use relatively simple math, broadly accepted economic assumptions, and information provided by the user to show the potential value of a retirement savings account over a given timeframe. Providing this information helps investors visualize the importance of long-term investing while also facilitating an understanding of important but abstract financial concepts like the time value of money and compounding interest.

Portfolio monitoring tools are another example. One such tool can monitor an investor's accounts for excess cash that can be applied to a savings goal set by the investor. When excess cash is identified, the investor receives a notification. The notification alerts the investor about the idle cash and encourages the investor to consider putting it towards a savings goal. Another type portfolio monitoring DEP can help investors monitor their portfolio for concentration risk. When this tool identifies a concentrated position that is not aligned with an investor's risk tolerance, it sends the investor a notification. The notification alerts the investor of the concentrated position and provides general information about diversification. DEPs like these serve two purposes. First, they provide investors with important information from a reliable, trusted, and qualified source. Second, they help investors avoid the cognitive biases of inertia (the tendency to continue making the same decisions despite the presence of better options because it requires less effort) and familiarity (the tendency to favor familiar options over better, but unfamiliar, options).

It is also important to note that DEPs provide access to time-sensitive information. This is especially true for DEPs that inform investors about margin calls, upcoming maturity dates, and security issues. Overly broad and restrictive regulation could prevent intermediaries from using DEPs to deliver this type of information, which could ultimately harm investors.

QUESTION 4: How do you expect DEPs use cases to evolve in the future? What would be the regulatory implications?

The first generation of DEPs provided retail investors with access to new products and services, lower costs, and better customer service (e.g., robo-advisers, no-fee brokerages, and chatbots). By providing these services, financial intermediaries encouraged new retail investors to participate in capital markets. These new retail investors can leverage educational materials and lower-cost products enabled by DEPs to build wealth, increase their knowledge of the markets, and establish responsible saving and investing habits. DEPs can help these new investors understand how to select securities, trade positions, and manage risks on an informed basis. Restrictive regulation could cause intermediaries to decide that it is no longer prudent to use DEPs as a means of providing educational material, investment research, and market data, which could disincentivize new investors from accessing and learning about capital markets.

We expect that retail investor participation in capital markets will continue to grow, especially on self-directed trading platforms. We expect that DEPs will continue to adapt to the demands of these investors. Intermediaries are likely to continue pursuing innovative DEP practices as they compete to gain market share by providing differentiated services, products, and solutions. In this type of evolving environment, regulatory frameworks that are principle-based and technology-agnostic are the best equipped to address actual and potential risks.

QUESTION 5: What additional risks or benefits of DEPs should be considered? In your opinion, does the existing regulatory framework sufficiently address these risks, or are new measures needed?

As DEPs are a constantly evolving technology, it is difficult to identify and predict every benefit and risk associated with their use. In such dynamic situations, technology-specific regulations that are meant to mitigate risks tend to quickly become outdated. That is why principle-based, technology-agnostic regulatory frameworks are best equipped to address the concerns raised in the Report. In the following paragraphs, we use elements drawn from US statute, regulation, and self-regulatory organization rules to show how such frameworks can apply to the uses of DEPs.

FINRA's communications rules can address the risks referenced in the Report even though they do not contain an explicit reference to DEPs. For example, FINRA Rule 2210 applies to "any written (including electronic) communication" that broker-dealers distribute or make available to retail investors and establishes content standards for such communications. Among those content standards is a requirement that all communications be "clear and not misleading…[and] provide balanced treatment of risks and potential benefits." The technology-agnostic design of this rule allows it to address concerns related to how DEPs can "promote risky or complex products that may be cross-sold and presented to retail investors as simple and profitable." *Report* at 37. Since they are fundamentally electronic forms of written communications, most DEPs are likely within the scope of this rule and its content standards. Therefore, if a DEP promotes risky or complex products it would most likely need to include information about the associated risks.

The concern that DEPs could encourage retail investors to engage in more frequent or riskier trading strategies can also be addressed by principle-based, technology-agnostic frameworks. For example, in addition to the content standards previously discussed, Rule 2210 also requires that communications with retail investors "be based on the principles of fair dealing and good faith." "Fair dealing and good faith" are well-established legal standards that require full disclosure and the absence of an intent to defraud or seek unconscionable advantage. *Fair dealing,* Black's Law Dictionary, 10th Edition (2014); *Good faith*, Black's Law Dictionary, 10th Edition (2014). A DEP that is designed to manipulate investors into engaging in harmful trading activity would clearly violate these principles, and as such, would violate Rule 2210.

Regulation Best Interest ("Reg BI") also addresses this concern by requiring broker-dealers to act in the best interest of their retail customers when making recommendations about "any securities transaction or investment strategy involving securities." This obligation is intentionally designed to apply to all recommendations, regardless of transmission medium—including DEPs.

The Report expresses concern that certain DEPs can be used to "mislead/misguide retail investors about their expertise level, strategies, products traded, risk-adjusted returns, past returns, incentives and performance benchmarks/targets." *Report* at 37. If the intermediary is an investment adviser, this risk is already addressed by 15 U.S.C. § 80b-6. This statute prohibits investment advisers from using "any means or instrumentality of interstate commerce… to engage in any act, practice, or course of business which is fraudulent, deceptive, or manipulative." The technology agnostic and principle-based design elements of the statute allow it to effectively address any adviser's attempt to use a DEP (i.e., "an instrumentality of interstate commerce") to mislead or misguide retail investors (i.e., "engaging in a fraudulent, deceptive, or manipulative act").

Additionally, the Report expresses concerns about technology-related and privacy risks. These risks can also be addressed by principle-based, technology agnostic frameworks. For example, regulations like SEC Rule 206(4)-7 require intermediaries to adopt and implement written policies and procedures that are reasonably designed to prevent violations of the law—including those caused by the intermediary's use of technology. The rule also requires that covered intermediaries review the adequacy of their respective policies and procedures on an annual basis. This regulatory design intentionally places the onus of identifying necessary policies and procedures on the intermediary. This type of design can lead to earlier detection and mitigation of potential risks that may not be apparent to regulators in a dynamic technology environment. It also ensures that intermediaries take responsibility for understanding and managing the risks associated with their operations. It can also allow intermediaries to tailor their risk management strategies to their specific circumstances rather than adhering to a one-size-fits-all regulatory approach. Intermediaries operating within such a framework are more likely to identify and address novel technology- and privacy-related risks compared to intermediaries operating in a prescriptive regulatory environment.

Overall, we believe that principle-based, technology-agnostic regulatory frameworks are well-equipped to address potential risks associated with DEPs now and into the future, as illustrated by the above examples.

QUESTION 6: In your opinion, how should market intermediaries best avoid potential conflicts of interests when they are using DEPs? What should the best practices be in this respect? Please elaborate by highlighting the areas of conflicts of interests and how they can best be addressed/mitigated.

The Report raises the concern that "DEPs can create potential conflicts of interest when market intermediaries use them to aim to influence retail investor behaviour to drive revenue growth to the detriment of retail investors." *Report* at 7. While DEPs are a novel technology, this is not a novel risk. Commonly known as the principal-agent problem, this issue is the foundation of many regulatory frameworks. Primarily, these frameworks rely on disclosure and mitigation to address this enduring problem.

Under SEC and FINRA rules, broker-dealers are obligated to disclose both general and product-specific conflicts of interest and risks, the broker-dealer's commission or mark-up, and in the case of payment for order flow ("PFOF") or issuer payments, whether the broker-dealer is receiving such payments. Broker-dealers are also required to obtain pre-trade consent for certain principal trading activities and prescribe customer order handling practices where real-time conflicts with a broker-dealer's trading desk may arise. For investment advisers, the existing regulatory framework establishes a fiduciary duty of care and loyalty, which broadly covers conflicts of interest and is enforceable through the anti-fraud provisions of the federal securities laws. These long-established disclosure requirements provide the foundation for managing potential conflicts of interest that could arise with respect to DEPs.

DEP-related concerns regarding trading frequency and costs could be addressed through the disclosure of: (i) the fact that the broker-dealer or investment adviser is deploying DEPs; (ii) the possibility that DEPs might influence trading decisions; and (iii) the actual expected costs or risks of engaging in trading, including when such trading may be excessive or unsuitable for the particular investor's profile. If market intermediaries are found to be shirking such obligations and consistently inducing behavior to benefit their own businesses at the expense of investors, existing rules and regulations are sufficient to permit regulators to take action to address such conduct.

QUESTION 7: How can market intermediaries maximize the potential benefits of DEPs to improve investor outcomes and enhance financial literacy? How should regulators effectively leverage DEPs to advance regulatory goals, such as investor protection and education? In your opinion, how can potential benefits of DEPs be achieved for better investor outcomes and investor education purposes? How should regulators best leverage from the use of DEPs for regulatory objectives?

DEPs provide the latest technologies, tools, information, data, and education to facilitate and enhance their investment experience. DEPs can also offer retail investors a simplified, easily understandable path to effective financial planning and financial literacy at their digital fingertips – whether by mobile device or on their desktop computer. Firms' use of DEPs helps meet the demand of retail investors to engage and transact in the manner of their choosing. In meeting that demand, DEPs not only strengthen existing client relationships, but also have been appropriately credited with improving investor access and opportunity on the latest investment platforms, resulting in a significant, well-documented increase in retail investor participation in the capital markets.

DEPs have been credited with developing and providing new channels for delivering investor education tools and resources to retail investors. Perhaps the greatest benefit of DEPs is their potential to encourage positive, beneficial investor behavior. For example, DEPs may assist retail investors in growing their own retirement savings and engaging in other wealth-building activity, better educating themselves about the risks and features of prospective products and services, and ultimately, transacting in a manner that is consistent with their investment goals and risk tolerance. Relevant studies support the view that effective DEP communications can help retail investors make more responsible decisions and ultimately improve their financial outcomes.

Regulators should affirmatively encourage and facilitate the development of DEPs that encourage financial literacy and enable positive outcomes rather than subject such tools to further regulation. As discussed, retail investors derive significant benefits from tools that deliver education and information about financial services and products. For example, DEPs that help investors learn how to trade without putting their money at risk should be encouraged. Overall, regulators should look to support and encourage the development of educational DEPs, as additional regulation could have the unintended consequence of stymieing the flow of beneficial information to retail investors.

QUESTION 8: How can regulators better coordinate across jurisdictions to address the cross-border use of DEPs, particularly in cases where different regulatory standards apply? What mechanisms could enhance global regulatory alignment?

Given the rapid pace of technological development and the broad range of tools that could be considered DEPs, it is important (particularly for market intermediaries with global operations) that regulatory standards remain flexible, principle-based, technology agnostic, and interoperable. If highly prescriptive, specific standards for DEPs develop across jurisdictions, not only will it be difficult for market intermediaries to comply with fragmented regulatory standards, but also, such prescriptive standards will quickly become outdated as new technology allows further development of DEP applications. To better support global regulatory effectiveness and alignment, IOSCO should encourage its members to apply principle-based and technology agnostic frameworks to regulate the use of DEPs.

On behalf of SIFMA and SIFMA AMG, we appreciate the opportunity to provide comments on IOSCO's Consultation Report on Digital Engagement Practices. If you have any questions or wish to discuss our comments further, please do not hesitate to contact us by emailing Melissa MacGregor (mmacgregor@sifma.org) or Kevin Ehrlich (kehrlich@sifma.org). Thank you.