Comment On Regulatory Notice 22-08

I oppose the measures proposed in the Request for Comment in Regulatory Notice 22-08 (hereafter "RFC") that pertain to the investment products referred to as "complex products." (I express no opinion as to the remaining proposals concerning options.)

1. The Proposal is a "Solution" in Search of a Problem That Does Not Exist

The RFC, in broad brush, seeks, *inter alia*, necessarily to curtail the use of complex products such as, *e.g.*, leveraged, inverse and/or volatility-related exchange traded products (ETPs), by retail investors in self-directed accounts.

The RFC acknowledges that such products "can potentially expand the investment opportunities for retail investors and, if properly understood, offer favorable investment outcomes (*e.g.*, enhancing returns, limiting losses or improving diversification)." RFC, at 1.

The RFC further acknowledges, *inter alia*, that "[w]hile the number of geared ETPs [*i.e.* leveraged and/or inverse] and the market value they represent have remained fairly stable, some of these products are often among the most actively traded ETPs . . . [and] [i]t appears that retail investors continue to purchase these instruments." RFC, at 12.

Despite the potential advantages of these products – and I submit thus their extensive use by retail investors in self-directed accounts – the RFC nonetheless proposes to curtail their use by such retail investors.

The RFC, in broad brush, proposes that (a) only a much more limited subset of retail investors even be permitted to trade in these products in the first instance, and, (b) for that limited subset, only under continuing surveillance and supervision by a financial professional in what purportedly is a "self"-directed account.

However, the "parade of horribles" of harmed retail investors canvassed in the RFC exclusively are of situations where *financial professionals* recommended those products to the detriment of an investor who otherwise likely would not have invested in them. RFC, at 5. There is no parade of horribles canvassed in the RFC as to self-directed retail investors who themselves unilaterally sought out these products and made a decision to trade in them. There is no parade of horribles canvassed in the RFC with actual cases where droves of *self-directed* retail investors *failed to understand* the inherent risks in these products despite the extensive disclosures in the product literature and in the acknowledgments that brokers already currently require before the investor can trade in the products.

Frankly, the RFC's implicit assumption that these products are too complex and figuratively "toxic" for retail investors to trade without supervision is belied by the acknowledgments that "some of these products are often among the most actively traded ETPs, [and] it appears that retail investors continue to purchase these instruments." RFC, at 12. If these products were so incapable of being understood without a financial professional and thus so harmful to trade without professional supervision, retail investors would not continue to trade the products in such large numbers. Rather, the actual marketplace is demonstrating that these products instead indeed do "expand the investment opportunities for retail investors and . . . offer favorable investment outcomes (*e.g.*, enhancing returns, limiting losses or improving diversification)." RFC, at 1.

Significantly, no claim is made in the RFC that the disclosures in the product literature and the acknowledgments that brokers already require do not fully explain the risks in trading these products. The RFC instead is implicitly suggesting that retail investors nonetheless require supervision by a financial professional after being warned, and warned, and warned, to the nth degree, in multiple forms, about the risks in trading these products.

In this vein, there collectively are multiple existing specific and generally applicable requirements that limit the extent of both individual retail investor – and general systemic – risk from trading in these products.

First, as noted, brokers currently require that retail investors trading in these products execute a detailed acknowledgment of the risks involved – and require that they periodically renew that acknowledgment before being able to continue to trade the products. Second, in non-margin accounts, under good faith trading rules, the funds used in the trade cannot be round-trip traded again until the T+2 interval has elapsed. Third, even in margin accounts, brokers impose increased margin requirements, or "special maintenance requirements," that sharply limit additional leverage on an often already intrinsically leveraged product. Fourth, if a retail investor crosses the day-trading frequency threshold required to be labeled as a pattern day trader, they are required to maintain additional minimum equity requirements in their account.

These multiple already existing "control rods" adequately limit the extent of both individual – and systemic – risk from trading in complex products.

To be sure, one can lose money on a trade or trades, which is hardly unique to this type of investment vehicle in comparison to others. But, in contrast to some types of option trades, the potential loss is limited to the amount invested. There is no financial accelerant leading to potentially unlimited liability thus implicating an either individual – or systemic – existential risk that transcends the capital invested.

So, at the very outset, the underlying operating premise of the RFC – that these products cannot be safely traded by retail investors in self-directed accounts without professional oversight and supervision – is subject to substantial question.

2. The Proposal Will Increase Wealth Inequality and Disproportionately Impact Minority and Women Retail Investors

The proposal in the RFC further is subject to adverse unintended consequences.

The first adverse unintended consequence follows from the proposal specifically to limit trading in complex products to high net-worth individuals, which typically is regarded to mean individuals with more than $1,000,000.00 in financial assets. *See* RFC, at 13.

Such a limitation would tend to exacerbate wealth inequality by barring persons below this threshold from trading in instruments that are acknowledged by the RFC "to expand the investment opportunities for retail investors and . . . offer favorable investment outcomes (e.g., enhancing returns, limiting losses or improving diversification)." RFC, at 1.

Moreover, given the current thesis that legacy wealth inequality disproportionally benefits white males to the detriment of minorities and/or women, the proposal in this respect thus would tend to disparately impact minorities and women by denying them access to these potentially effective wealth-building tools. That is, disproportionately, white males holding legacy wealth would have the benefit of these investment tools to potentially increase that wealth, while minorities and women lacking the same legacy wealth advantages would be shut out.

That disparate impact most certainly is not a desired or intended outcome by the agency, but that unintended but probable consequence strongly counsels against adopting a high net-worth individual limitation on the ability to trade in complex products.

3. The Proposal Will Limit the Resources Currently Available to Retail Traders

Another unintended consequence of the overall proposal – to curtail trading in these products by retail investors – ultimately will be a sharp reduction of the resources currently available to investors concerning these products.

Because these products "are often among the most actively traded ETPs, [and] it appears that retail investors continue to purchase these instruments," RFC, at 12, a robust "cottage industry" has developed with paid and unpaid resources for investors.

There are extensive resources on the internet generally and social media in particular for retail investors to access to learn about the practical ins and outs of trading in these products.

I'm not talking about posters on Reedit pushing meme stocks, which seems to be all that captures the attention of reporting in the financial press.

No, there is extensive, quality input concerning the trading of these products available to retail investors, in paid-for services as well as for free on social media.

Naturally, if trading volume in these products and the number of retail investors trading that volume both are substantially reduced, there will tend to be a concomitant substantial reduction in the number of resources providing information regarding trading in these products. That is, a – forced – quantitative reduction in demand naturally will lead to a reduction in available resources – leaving investors with less, not more, resources concerning these products.

The 21st Century has been typified by disruptive (in the good sense) businesses providing efficient and decentralized broadbased access to resources.

And, as elaborated in the next section below, there is a reason why so many retail investors migrate to self-directed accounts rather than so-called full-service brokerage accounts, as the latter so often arguably can tend to serve the broker's interests more so than the investors.

The proposal would revert what now is a substantial facet of retail investing – the trading of these complex products – back to a more outdated mid-20th Century model where investors could access the markets only via the supervision of a limited and functionally centralized group of financial professionals.

I encourage the agency to not – forcibly – revert retail investing in these products back to more of the model prevailing in the 1950's, where one could not trade in the markets without the active intermediation of a financial professional.

I encourage the agency to instead move forward with a 21st Century decentralized approach that does not limit retail investors' access to the markets in this manner.

Investors at times will sustain losses. That's basically a given for anyone in the markets to any substantial extent. As the "parade of horribles" canvassed in the RFC amply illustrates, however, interaction with a financial professional provides no guarantee against loss, sometimes quite the opposite.

Let's move forward on into the 21st Century, not *decades* backwards to a model – required interaction with and supervision by a financial professional – that retail investors have moved on from in droves, and often with good reason.

4. The Proposal Inadvisably Would Eliminate the Self-Directed Nature of Self-Directed Accounts Vis-á-Vis Complex Products

Separate and apart from a possible high net-worth limitation, the proposal would require that, in order to be able to continue to trade these products, retail investors must (a) first satisfy a financial professional that they fully understand the products; and (b) then, continuously forevermore thereafter, be subject to continued surveillance and supervision by the financial professional, who can terminate their ability to trade in the products at any time if the professional disagrees with the retail investor's risk assessments. RFC, at 13-15. And that's in ostensibly *self-directed* accounts.

That is an unprecedented sea change in regulation of self-directed accounts, at least apart from options trading where losses can be exponentially unlimited and exceed the capital initially placed at risk.

Retail investors are not migrating *en masse* to self-directed accounts simply to get low commissions and fees.

Low commissions and fees constitute just a collateral bonus benefit.

Rather, we trade in self-directed accounts *precisely to get away from the recommendations of a "financial professional" pursuing their own interests* – most typically in pushing products that serve the interests of the broker more so than necessarily the retail investor.

And the incentives for the broker/financial professional created by this proposal would be markedly skewed in one direction.

There simply is no significant upside for the broker in effectively signing off on any investing strategy followed by the retail investor with complex products that involves any degree of risk. The extremely minimal fees and commissions received on trades in self-directed accounts these days provide absolutely no incentive of substance to the broker to approve the trading and/or to try to keep the retail investor from moving to another broker.

In contrast, the broker faces significant downside enforcement risk if the agency subsequently reviews the matter and concludes that the financial professional, in the agency's view, improperly allowed the retail investor to take on what is alleged after the fact to be too much risk with these products.

This skewed scenario virtually assures that – even when all else is equal – a broker's denial of permission to trade the products will be more forthcoming than an approval.

Now, that perhaps may align with the proposal's perhaps ultimate goal, to curtail retail trading in these products regardless, by one means and/or another.

But the proposal would do so by making unprecedented inroads into the theretofore autonomy of self-directed accounts.

We open self-directed accounts precisely *to get away* from broker input, which we have found to often not be in our best interest as opposed to that of the broker.

Now the proposal would put brokers in control of whether retail investors can trade in products that: (a) "can potentially expand the investment opportunities for retail investors and, if properly understood, offer favorable investment outcomes (*e.g.*, enhancing returns, limiting losses or improving diversification)"; and (b) thus "are often among the most actively traded ETPs" purchased, including by retail investors. RFC, at 1 & 12.

In my own case, I most likely would be dealing with a financial professional who had decades less experience in the overall markets – including having gone through multiple market cycles – and years less actual direct experience with the trading of these financial products. Yet that professional will have the final say – continuously – over whether I can continue to trade in these products – in a situation where the proposal puts the broker in a situation where the safest tack – for the broker's own interests – is to deny permission to trade the products.

That is not an incremental change. That is a sea change in the regulatory approach to ostensibly self-directed accounts, putting them under – continuous and unending – broker supervision with respect to trading these products.

If this proposal goes through, and so sharply curtails the theretofore inherent autonomy of self-directed accounts, I would not at all be surprised to see this issue then reach the halls of Congress. The change being contemplated by the agency is a sea change with respect to regulation and supervision of self-directed accounts.

Again, investing inherently involves a risk of loss, sometimes substantial loss. One need go no further than the bluest of the blue chip Dow 30 to find times where even the ostensibly most stable or reliable of investments can go – deeply – into the red.

Risk of loss, however, does not counsel in favor of putting a theretofore otherwise autonomous self-directed account functionally under the – continuing – supervision of a broker with respect to the trading of complex products.

I strongly oppose this proposed sea change in the regulation of self-directed accounts.

With respect, regulators should focus, in regard to complex products, instead on: (a) assuring the adequacy of disclosures to and risk acknowledgments by retail investors with regard to the products; and (b) more closely overseeing ETP issuers' consistency in managing issuance of ETP units to assure that price action does not become unmoored from the underlying index due to unanticipated suspensions in issuance of units.

A regulatory focus instead on those issues will increase public confidence in these financial products and help protect the interests of retail investors.