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May 23, 2022

Alp Eroglu
International Organization of Securities Commissions (IOSCO)
Calle Oquendo 12
28006 Madrid
Spain

Subject: Public comment on IOSCO Retail Market Conduct Task Force Report

Dear Alp,

CFA Institute welcomes the opportunity to comment on IOSCO's Retail Market Conduct Task Force Report.

CFA Institute is the global association of investment professionals that sets the standard for professional excellence and credentials. The organization is a champion of ethical behaviour in investment markets and a respected source of knowledge in the global financial community. Our aim is to create an environment where investors' interests come first, markets function at their best, and economies grow. There are more than 170,000 CFA® Charter holders worldwide in 162 markets. CFA Institute has nine offices world-wide and 158 local member societies.

CFA Institute has been actively researching the evolving retail market trends over the past decade and their implications for investor trust and market integrity. In our fifth biennial Investor Trust Study 2022, we surveyed more than 3,500 retail and 976 institutional investors across 15 markets on their overall trust in financial services and their drivers, their use of digital platforms and opinions on gamification and crypto currencies. We found the overall trust in financial services is at an all-time high of 60%, and technology is a significant driver of investor trust.[1] In terms of demographics, younger investors are more likely to use digital trading platforms, trust digital nudges, and report that digital platforms increase their frequency of trading, compared to older investors. These findings have important implications for market integrity and investor outcomes.

Gamification and behavioural techniques can be a powerful tool for engagement, literacy, and driving positive outcomes, and it has been used wisely in a variety of industries from education to healthcare and financial services. However, as we have seen, its power can be misused by digital trading platforms to drive excessive trading or trading high volatility products, thereby profiting at the expense of clients. As

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[1] Please see our Earning Investors' Trust report for further details.

we consider these issues, regulators may be tempted to regulate or ban outright some of the riskier gamification techniques, as the report suggests.

As we discuss more fully below, we are of the view that to address gamification techniques, it is best if regulators outline broad principles, provide guidance on their implementation, and then enforce them. Our reasons for this view are two-fold: first, it is difficult to define the scope of current and potential gamification practices, and second, experience from other contexts suggests that some regulatory interventions are ineffective and that bad actors can circumvent them, as we explain further in our response.

The role of social media influencers is an increasing focus of regulators around the world. We commented on this issue in our response to the previous IOSCO consultation paper on retail distribution and digitalisation. [2] In that letter, we agreed with the IOSCO recommendation of requiring firm management to assume responsibility for the accuracy of the information provided to potential investors on behalf of the firm, including those provided by influencers. We also made clear that regulators should require full transparency on the remuneration that financial institutions provide to influencers for their advertisements via social media. Lastly, we called for greater clarity on how third parties, including influencers, should be held responsible in cases where they are independently offering opinions, or recommendations, or both regarding the performance of specific products and have no relationship with the firm marketing those products. We note that some jurisdictions like Australia are taking a firm stance against unlicensed influencers offering financial advice. Licensing requirements should be agnostic to platforms, but regulators could make a distinction between general and personal advice, with a limited licensing requirement for the former.

In addition, we would like to highlight the risks associated with fake accounts and social media messages driven by bots. While influencers making questionable product recommendations is quite problematic, it is worse when they also overstate their number of followers, which is a metric that implies a greater level of credibility. Also, artificial intelligence (AI) is becoming sophisticated enough for bad actors to employ AI-powered bots to amplify misleading messages. We call upon regulators to consider these issues within their scope of social media oversight.

CFA Institute has researched the topic of disclosures and product governance over the years. In 2017, we published *Designing a European Summary Prospectus using Behavioural Insights*.[3] In that report, we said the level of engagement is a first-order determinant of the success of the disclosure regime. Investor engagement, in turn, is largely dependent on the presentation of product information. We laid out broad principles that should underlie the presentation of product information including simplicity, salience, and standardization.

[2] Public comment on IOSCO Consultation Report on Retail Distribution and Digitalisation. 2022. https://www.cfainstitute.org/-/media/documents/comment-letter/2020-2024/20220323.pdf.

[3] *Designing a European Summary Prospectus using Behavioural Insights*. https://www.cfainstitute.org/-/media/documents/article/position-paper/designing-a-european-summary-prospectus.ashx

In our most recent study on MIFID II and PRIIPS, *The Brave New World of Product Governance in the EU Asset Management Industry (2020)*, we highlighted the pitfalls when these disclosure principles are not followed. For example, we reported that a majority of our members thought retail investors struggle to understand the information related to investment products due to the complexity of the disclosures.[4] Lastly, our Trust Study points to a significant gap between retail investors' expectations on disclosures of fees, as well as conflicts of interest, and advisors' delivery of those disclosures. We cover these points in detail in our response to the question on disclosures.

Finally, we support IOSCO's role in developing a standardised toolkit and a minimum baseline of regulations across markets. This effort is important to ensure that market participants do not take advantage of regulatory arbitrage when offering services across markets.

Set forth below are our responses to several of the questions included in the IOSCO Consultation Report.

Sincerely,

/s/ Josina Kamerling

Josina Kamerling

Head, Regulatory Outreach, EMEA

CFA Institute

/s/ Sivananth Ramachandran

Sivananth Ramachandran

Director, Capital Markets Policy India

CFA Institute

[4] The Brave New World of Product Governance in the EU Asset Management Industry. 2020. https://www.cfainstitute.org/-/media/documents/article/position-paper/cfa-product-governance-web-4pp.pdf. See section 7.4 How much investor information is enough, or when it is too much?

Responses to consultation questions:

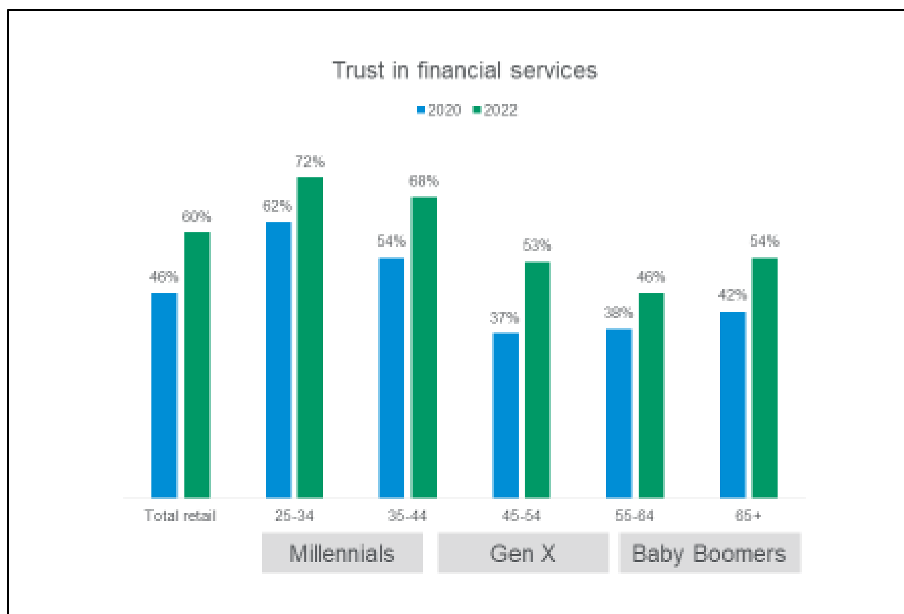
1. **In their risk analysis, should regulators specifically consider/target specific demographic profiles/groups for additional or enhanced investor protection measures? If so, should greater attention be focused on younger age groups or older age groups? Is there a tipping point in behaviours beyond which regulators should become concerned?**

   The consultation paper discusses the current market conditions and the technological transformations, which have accompanied the rise of self-directed trading by younger investors. However, when regulators analyse risks, it is best if they consider not only the behaviours of investors by different cohorts (younger versus older), but also their level of trust in financial services, the digital platforms, and attitudes towards risk.

   As noted in our letter, we recently released a report titled "Enhancing Investor Trust: 2022 CFA Institute Investor Trust Study.

   We found that among retail investors, not only are the trust levels higher today than two years ago, but trust levels have increased among every age cohort, including older investors (65+), although the absolute levels of trust among younger investors are still far higher than among older investors. These trust levels are summarized in Exhibit 1.

   Exhibit 1



   In our survey, not surprisingly, millennials have led the way in the use of retail trading accounts and apps. As shown in Exhibit 2, two-thirds of millennials have trading accounts compared to 54% of retail investors overall. But their high levels of trust in digital nudges is a cause for concern – a

full 92% of investors ages 25-34 trust digital nudges, compared to 33% of older investors (>65 years). Three-fourths of the millennials also reported that the use of digital platforms and apps increased their frequency of trading.

Exhibit 2: CFA Institute Trust Study 2022: Use of Trading Accounts and Attitudes towards Them

	Total	25-34	35-44	45-54	55-64	65+
Has retail trading account	**54%**	68%	66%	52%	38%	37%
Trust in digital nudges	**74%**	92%	86%	72%	51%	33%
Retail tools/apps enhance understanding of investing	**71%**	87%	82%	66%	49%	36%
Retail tools/apps increase frequency of trading	**57%**	75%	73%	56%	28%	10%

When asked if digital platforms and tools enhanced their understanding of investing, 87% of millennials (compared to 36% of older investors) responded yes. Therefore, we dismiss the significance of digital platforms in increasing access to broader market participation and reducing barriers to investing at our peril. However, precisely for this reason, the quality of knowledge imparted through trading platforms is worth scrutiny. When it comes to delivering information, context matters. For example, we take less time to process information on screen, and a smaller screen size is correlated with lower reading time and more time spent scrolling for information.[5] Other research suggests we learn far less watching a video on a small screen than on a large one.[6] Therefore, our survey captured the perceived level of learning, which might diverge from actual learning outcomes.

[5] Chae, Minhee, and Jinwoo Kim. "Do Size and Structure Matter to Mobile Users? An Empirical Study of the Effects of Screen Size, Information Structure, and Task Complexity on User Activities with Standard Web Phones." *Behaviour & Information Technology* 23, no. 3 (2004): 165-81. doi:10.1080/01449290410001669923.
[6] Maniar, Nipan, Emily Bennett, Steve Hand, and George Allan. "The Effect of Mobile Phone Screen Size on Video Based Learning." *JSW Journal of Software* 3, no. 4 (2008). doi:10.4304/jsw.3.4.51-61.

If trust without commensurate trustworthiness is a recipe for poor investor outcomes, then regulators must focus on younger investors as they have higher absolute levels of trust, high levels of trust in digital platforms and nudges, and trust that the platforms improve their investing knowledge. We must not ignore older investors, however, particularly those without advisors, given their relatively large asset levels and their shorter time horizons that limit their ability to recoup losses from poor investment decisions.

2. **Does the consultation report capture accurately the important retail trends and the reasons for increased retail trading? Are there any missing concerns or issues and other potential risk magnifiers? What may be the current and potential long-term implications of increased retail participation in markets in your view?**

   The consultation paper covers the important retail trends. We highlight one additional aspect – early market experience of retail investors.

   Early market experience could have a powerful influence on risk taking. In 2020, in a well-publicised study, Indian researchers shed light on how new investors might misinterpret their success, using a natural experiment involving Indian IPOs. Indian IPOs that are oversubscribed by retail investors are allotted via a lottery. Therefore, the treatment group that receives an allotment, and the control group which does not, share similar characteristics and are separated only by chance. The study's key finding is that retail investors who were randomly allocated shares in successful Indian IPOs viewed their good fortune as evidence of skill. That is, the treatment group that randomly received allotments in IPOs which subsequently had a first day pop, had trading volume that was 7.2% higher than that of the control group (which did not receive an allotment). The difference in trading activity fades over time but is still markedly higher six months after the IPO.[7]

   The implication of the study is that self-directed investors who began trading following the March 2020 market crash, and potentially made money within the following year, might not only mistake their luck for skill and increase their risk taking, but the risk-taking effects may linger for a long time.

3. **What may be the potential implications of self-directed trading and gamification from a retail risk and conduct perspective? Should high risk aspects of these activities be regulated or prohibited, for example, certain risky gamification techniques?**

   There is some evidence that gamification may magnify risk-taking. In a recent study,[8] researchers recruited 605 participants, a majority of them with self-directed trading experience, to trade a virtual asset on an experimental platform. The study found that gamification "nudges"

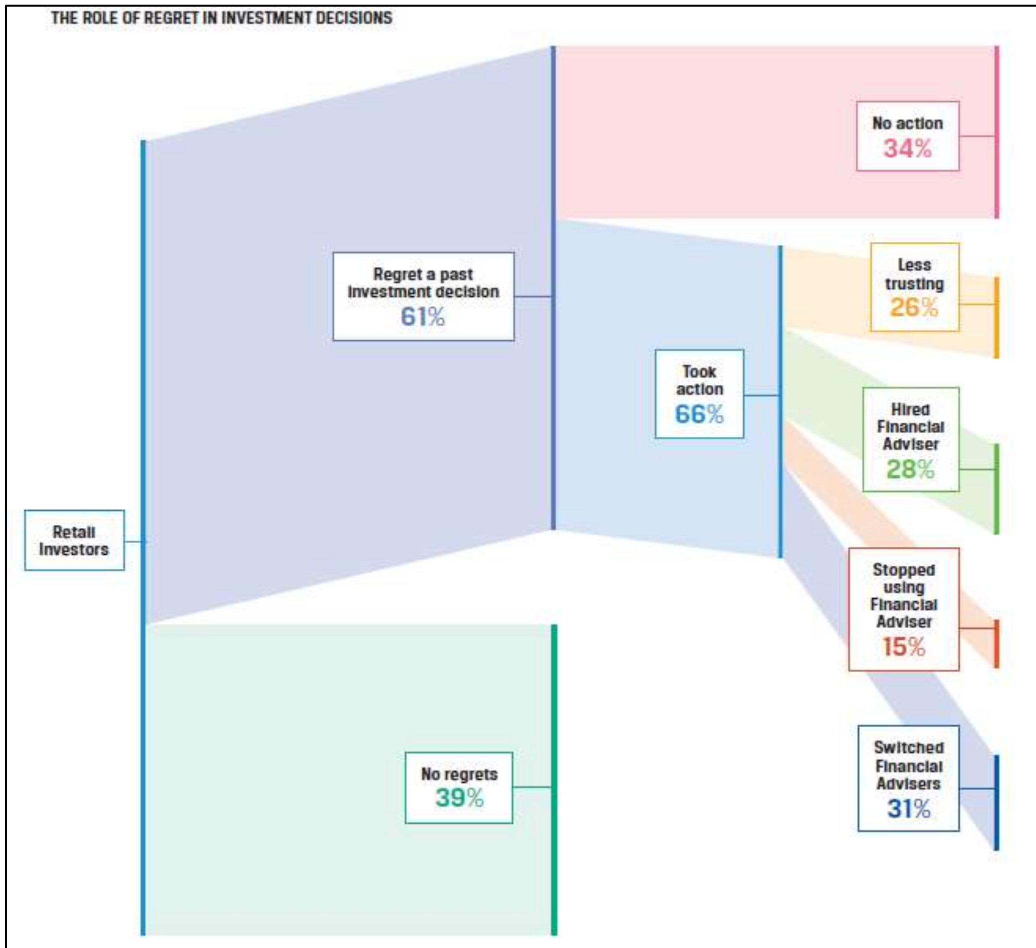
[7] Anagol et.al. 2020. Learning from noise: Evidence from India's IPO lotteries | VOX, CEPR Policy Portal (voxeu.org). Note that the study (like many others) uses trading volume as a proxy for overconfidence.
[8] Chapkovski et.al. 2021. Does Gamified Trading Stimulate Risk Taking? https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3971868

encouraged participants to take on more risks, particularly when trading high-volatility assets. The effect was stronger for inexperienced traders with lower financial literacy.

From a conduct perspective, the advertising by brokerages has undergone a subtle shift. Anecdotally, until recently, the emphasis was on the quality of service and research. Now, the narrative has broadly shifted towards convenience (ease of account opening and trading). Many advertisements feature a younger audience, keeping with the trends, and the theme is the democratisation of trading. In some markets, advertisements by mutual funds must be accompanied by the warning that these investments are subject to market risks and that investors should read the scheme-related documents before investing. **We recommend a similar warning label for brokerage advertisements, with the message that excessive trading may be injurious to financial health, to counteract the overly positive messaging that is currently being conveyed.**

A related behavioural theme relates to the role of regret in investing. Most investors at some point make investment decisions that they later regret. In a previous trust study, we asked retail investors if they regretted an investment decision, and what action they took afterwards. Exhibit 3 shows the findings. Sixty-one percent of our respondents said they regretted a past investment decision. Of those, 39% took a positive action (either hiring or replacing a financial advisor), 27% took a negative action (stopped using an adviser, or became less trusting of the markets), and 34% did nothing. In other words, the behavioural effect of regretting poor experience is complex, with some learning valuable lessons, and others making poor decisions as a result.

Exhibit 3



Source: CFA Institute Earning Investors' Trust 2020

Should high risk aspects of brokerage activities including risky gamification techniques be regulated or banned? Before we tackle that question, we acknowledge that gamification techniques can be beneficially applied, including within the online brokerage industry, and must be encouraged. For example, one of the largest Indian brokerages has its own nudge unit. At least two of its practices are worth highlighting. First, like the gambling industry's voluntary self-exclusion list, the trading app has a kill-switch, which can be voluntarily activated by traders who wish to step away from excessive trading. Once activated, the platform does not allow any trading for at least 24 hours. Second, this firm introduced a "sludge," which is the opposite of a nudge, since it slows down action in the form of a third-party authenticator (TPA) for trading penny stocks. Since traders of penny stocks are often impatient, the step of downloading a TPA, such as Google Authenticator, and the requirement to perform two-step authentication simply turns

most of them away from doing it altogether. More generally, as our trust study emphasizes, technology is a trust multiplier, and the focus should be on how to leverage it beneficially.

Some brokerages default customers into a margin account, and this default could trigger more risk taking. One way to tackle this is to regulate the architecture of choice in favour of investor interest. For example, some commentators suggest changing the default brokerage account to be a cash account rather than a margin account.[9] Research in other settings, however, has shown that firms can override defaults in their favour through advertising and sales techniques. When US regulators made the overdraft-free account the default, banks successfully countered the default option through behavioural techniques such as framing, making switching easy, and aggressive sales techniques.[10] Similarly, in 2000, Sweden introduced a premium pension plan with a default option, but mutual fund companies successfully persuaded a majority of savers to switch away from the default through aggressive advertising, including one ad featuring Harrison Ford offering investment advice.[11]

In our view, a complete ban on gamification techniques ("confetti regulation") is also problematic. Confetti – celebratory animations shown after completing a trade – is a feature that has come under scrutiny. Gambling slot machines shower confetti when the machine returns any cash, even if the net payoff is negative, which gives the gambler a misleading picture of his or her gains, and a positive reinforcement to continue playing. In brokerage platforms, the confetti feature encourages buying shares rather than making a thoughtful investment, irrespective of expected returns. However, banning confetti would not solve the problem. As techniques proliferate, it would be difficult for regulations to keep up.

Instead of banning confetti, regulators could outline the principle that nudges and techniques that encourage excessive trading or short termism would be construed as active recommendations, with associated responsibilities on, for example, enhanced due diligence and suitability requirements.

10. **What may be the concerns or issues that regulators should ask for disclosure of (at both firm and product level), keeping in mind the balance between quantity of disclosure and the ability of retail investors to absorb such disclosure? Should markets continue to seek to put in place special arrangements that could encourage companies during stressed market events to provide disclosures and updates that help retail investors better evaluate current and expected impacts of such events? If so, what may be the practical options to achieve this, including who**

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[9] Morningstar's Response to SEC Request for Information on Digital Engagement Practices. 2021. https://www.sec.gov/comments/s7-10-21/s71021-9316157-260072.pdf

[10] Disclosure: Why it shouldn't be the default - https://download.asic.gov.au/media/5303322/rep632-published-14-october-2019.pdf (page 31)

[11] Richard Thaler's Nobel Prize lecture. 2017. https://www.nobelprize.org/uploads/2018/06/thaler-lecture-slides.pdf.

should provide this information? Are there specific technological measures or non-technological measures (e.g., changing the timing, presentation of the information) you would suggest to enhance the ability of retail investors to process the disclosure?

CFA Institute has researched the topic of disclosures and product governance over many years. In 2017, for example, we published *Designing a European Summary Prospectus Using Behavioural Insights.*[12] We reproduce a section of the report below, which speaks to the ability of retail investors to absorb disclosures.

There are three main issues to consider when taking a behavioural approach to disclosure requirements:

1. *design of the summary disclosure,*
2. *engagement of consumers, and*
3. *presentation of product information.*

For the disclosed information to be useful to investors, those investors must be engaged with the disclosure, which means the level of engagement is a first-order determinant of the success of the disclosure regime. Investor engagement, in turn, is largely dependent on the presentation of product information. In other words, the success of the disclosure regime is heavily dependent on the presentation of product information. The broad principles that should underlie the presentation of product information are outlined below:

- *SIMPLICITY: An effort should be made to simplify the product disclosure, including the language used, as well as to limit its length;*
- *SALIENCE: The most important information should be where investors focus their attention. For example, headings are more engaging than the body of text, as are highlighted boxes, graphical representation of information, images, the front pages of documents (rather than the overleaf pages), notices to the right of the page, and those printed in a different colour;*
- *STANDARDISATION: The appearance and framing of disclosures should be standardised as far as possible to enable comparability across disclosures.*

A separate consideration relates to the medium through which disclosure is consumed: computer monitors and screens on portable devices. The key insight here is that presenting information on a screen in a vertical or portrait format causes readers to skim through the information. This suggests the necessity of having a design that is also optimized for mobile devices.

Disclosures are important to retail investors in creating a trusted relationship. In our trust study, we explored the importance of adviser trust factors and how well advisers are delivering on these trust factors. As shown in Exhibit 4, 88% of retail investors said fee disclosures are important, and 86% said that conflict of interest disclosures are important factors. However, only 59% and 57%,

[12] *Designing a European Summary Prospectus Using Behavioural Insights*. https://www.cfainstitute.org/-/media/documents/article/position-paper/designing-a-european-summary-prospectus.ashx

respectively, said advisers were delivering on these disclosure expectations, pointing to a significant gap between expectations and delivery. These results, which cover only a portion of firm and product level disclosures, are nonetheless instructive.

Exhibit 4