

## TRANSACTIONS &amp; TECHNOLOGY / TECHNOLOGY

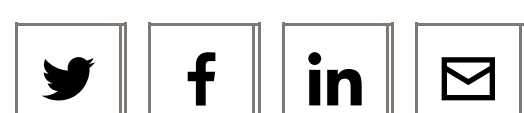
# How fintech regulators can get ready for Gen Z

Amy Caiazza, Neel Maitra and Jess Cheng | 18/01/2023 8:25 am



Image: Getty Images

In the fast-paced world of fintech, it seems regulators are always playing catch-up. To get ahead of the game, what factors should they focus on as the next generation enters the world of financial services? By Amy Caiazza, Neel Maitra and Jess Cheng of Wilson Sonsini Goodrich & Rosati.



Gen Z – those born after 1996 – is the **generation** that has never known a world without smartphones and social media; whose youth were shaped dramatically by two global upheavals – a financial crisis and a pandemic – that bred economic uncertainty; that is on track to be one of the most well-educated generations yet; that is enormously concerned about global warming and other environmental and social issues; and that looks to government to solve problems.

While members of this generation may be fluent in technology, their interactions with investment products and financial services are just beginning.

These changes provide regulators with a unique set of challenges and opportunities to revamp regulation in a way that accommodates the use of technology in the financial services industry. For those who have never known an analogue world, it is inevitable that technology such as machine learning, online gaming and social media will be an integral part of wealth-building, banking, and consumption of goods and services.

Regulators should get in front of this inevitable trend by proactively adopting policies that promote the benefits of new technologies in financial and commercial transactions while mitigating potential risks.

Despite the misgivings regulators may have about some or all of these technologies, they should recognise that Gen Z will embrace tech whether the regulators like it or not. Regulators should act accordingly. Below are a few recommendations for how this can happen.

## Don't fight the use of social media

Social media is here to stay. And while vilified in the wake of meme stocks like GameStop, social media platforms can be a way to share information and build sophistication around investing, particularly if investment professionals are allowed to participate and create content.

As a result, rather than viewing social media primarily as a way to defraud investors, regulation of social media within financial services should provide flexibility regarding its use by investors, consumers, and other users. It should encourage responsible involvement by intermediaries like investment advisers and brokers as potential thought leaders on social media platforms.

What might that look like? Perhaps there could be a special category of regulatory oversight for users of social media technology who act as influencers or similar content creators, but do not provide the full range of services that brokers, investment advisers, banks or other intermediaries do. The regulations applicable to the new category could primarily focus on the obligation of an influencer to provide a fair assessment of a recommendation and to mention any compensation they receive for making it.

This could allow influencers to lead discussion, distribute information, and potentially promote certain investment products without the bells and whistles that are associated with, for example, holding customer assets or managing an entire portfolio, among other things a broker, investment adviser, or bank might do – and would mitigate regulatory concerns associated with those types of activities.

Regulators could also issue more helpful guidance tailored to the use of social media by traditional regulated entities like brokers or investment advisers. Frequently, guidance relies on existing marketing or advertising rules that are not altogether on point – see the following section for more on this.

It is also critical that regulation of social media provides flexibility as technologies and platforms develop.

## Rethink how disclosure is presented

At least under US law, disclosure is a significant part of regulatory compliance for fintech companies. The result? Investors must scale mountains of (virtual) paper before they engage in just about any financial transaction.

Practically speaking, investors probably read almost none of that paper – and its intimidating bulk, particularly online, lessens the chance they will. Gen Z, which has grown up clicking through agreements on a daily basis, is arguably predisposed to ignore disclosure rather than read it.

Gen Z provides regulators an opportunity to completely rethink the current disclosure regime and instead provide more streamlined, readable and potentially powerful options for providing material information to investors.

Disclosure might, for example, allow the use of emojis to indicate the importance of a few key risk factors in a shortened disclosure document, or it could make liberal use of links allowing investors to explore topics in more depth. It could make use of gaming tools to encourage interaction with the material and the company providing it.

The **last time the public company disclosure regime** was overhauled in the US, there were no smartphones, and the internet was in its relative infancy. That overhaul resulted in a rulemaking so long and dense it was nicknamed the “aircraft carrier” release. It took seven years from proposal to adoption. It is high time for a new approach.

Ultimately, streamlining disclosure would benefit not just Gen Z – everyone from Boomers through Millennials and beyond would benefit as well.

## Use ESG-related disclosures as a starting point

Gen Z cares deeply about the environment and other economic, social and governance (ESG) issues, and is more focused on holding government and private companies accountable for their commitment to those issues. This provides an interesting opportunity to develop more useful templates for disclosure.

This could mean, for example, a significant reduction of carbon emissions being indicated by three tree emojis. The text companies provide could be short – perhaps limited in length, much like tweets are. These could be accompanied by linked text, to provide more information where investors seek it, but would allow a generation that scans to find relevant metrics quickly and easily.

Regulators could also provide ways to responsibly “crowdsource” information around a company’s ESG disclosures. Another experience that has permeated Gen Z’s lives is reliance on what the crowd thinks (see: Yelp). Allowing social media-like interactions such as ratings or comments could bring this experience to ESG disclosures. Could regulated influencers, perhaps, leave a **poop emoji** as a response to a poor disclosure?

The SEC’s newly issued, unwieldy **guidance** for public companies on ESG-related disclosures, in its current form, only adds to the volumes of text investors need to read that they probably will not. ESG issues offer the perfect chance to generate a new approach.

## Adapt to AI and other sophisticated tech in financial transactions

Sophisticated tech is increasingly used in financial transactions: brokers and advisers license algorithmic packages to help manage investor money or develop those packages themselves. On the investor and consumer side, a host of “bots” and other packages are available within a few clicks to construct and/or assess investment portfolios and provide trading recommendations.

These powerful new tools could provide access to the types of highly responsive and sophisticated trading tools that have historically only been available to large institutions. But many of them take the view that because they do not handle money, and their systems are not tailored to a particular user, they are not regulated in the same way a traditional broker or investment adviser would be.

There is merit to this argument, but it also means that investors and intermediaries are potentially making trades based on third-party advice without much regulatory oversight. And at the same time, there is another group of companies working in this area that have registered as investment advisers or brokers. These companies comply with a whole panoply of rules, including many that have no or little applicability to AI.

As with social media platforms, regulators could consider a particular form of regulation that governs providers of sophisticated technological packages who do not otherwise interact with investors or consumers.

This regulation could be designed to provide basic (and again, slim) disclosures and require the creators of tech packages to test and monitor the results of what they create, without requiring compliance with the same requirements imposed on brokers and banks, but that may not provide much customer protection given the nature of an AI-based advisory business.

This approach would also allow novel businesses to ease into regulation by taking on these additional potential business lines over time, and would level the playing field for companies in this space by clarifying that AI-based investment advice requires regulatory compliance.

## Encourage the benefits of gamification

“Gamification” refers to platforms that use tools like rewards, prompts, celebrations, competitions and other strategies to provide investment advice or other financial services. Research shows that **gamification can help knowledge building**.

Thus far, regulators have shown a fair amount of scepticism and **distrust** of gamification. They seem to dislike gamification in part because it makes certain investment activities fun, and express concern that it can encourage more frequent securities trading by rewarding it through points or badges. This may generate more commissions for brokers that sponsor gamification platforms without improving investor returns.

But fun can be a good thing. Gamification could be a way for consumers and investors to accumulate knowledge, become more engaged in their investments, and invest more for retirement or other long-term uses.

Regulators can promote these results by identifying and adopting policies that encourage responsible use of gamification models and foster its benefits. Regulation can still address the negatives of gamification, for example by prohibiting game sponsors from charging fees based on trading volume.

The point here is that regulation should not be crafted under the assumption that gamification is first and foremost bad for investors. Instead, regulation should provide flexibility for promoting its benefits.

## Prioritise more sophisticated regulatory scanning

Financial regulators are not known for their cutting-edge use of technology, but in a world where technology is driving seismic changes in the financial industry, regulators need to do more than keep up. They have to get ahead of new trends.

This means understanding the technologies used by individuals and intermediaries and figuring out ways to monitor them through regulators’ own technologies. The SEC, for example, may want to consider creating an office for new technologies that would focus both on keeping abreast of new technology, developing SEC systems that take advantage of it, and educating other departments.

As 2023 begins, and we move deeper into the 21st century, it is high time for regulators to adapt to inevitable generational change.



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