



## The rise of newly empowered retail investors

**How they're changing customer  
expectations and investing dynamics**

A report from the Deloitte Center for  
Financial Services

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# Emerging trends in retail investing: An introduction

Recent dynamics in retail investing suggest that there is an emerging class of individual investors with distinctive motivations and behaviors. Here, we take a closer look at the factors that contributed to the rise of these empowered investors and what they mean for financial institutions.

Millions of Americans now have mobile apps that allow them to trade stocks as easily as they share content on social media. In January 2021 alone, roughly six million Americans downloaded a trading app,<sup>1</sup> and retail brokerages reported record-high average daily volumes for equity and options trades.<sup>2</sup> This surge is in addition to the well over 10 million Americans who opened a new brokerage account in 2020,<sup>3</sup> which some have called “the year of the retail investor.” In early 2021, retail investors in the United States generated about as much equity trading volume as mutual funds and hedge funds combined.<sup>4</sup>

There are likely several reasons why so many new individuals have embraced stock investing. The pandemic no doubt contributed to the spike in interest. Millions of individuals suddenly found themselves with extra cash and more time on their hands. One out of five Americans invested in stocks or mutual funds between October and December, a 25% increase from the three months ending June 30.<sup>5</sup> In addition, a large proportion of online brokerage platform users report that they plan to continue investing any additional stimulus payments they receive in stocks as well.<sup>6</sup>

The unexpected retail investing frenzy was also fueled by the prevalence of easy-to-use investing apps, which are increasingly being integrated into payment apps, making money transfers even more seamless. Meanwhile, the gamification of investing on brokerage platforms and growing adoption of novel promotional tactics that encourage frequent trading are playing their own roles in popularizing digital investing services. These trends have been gathering speed for some time, but only recently has their impact become so apparent.

Retail investors seem to have reached a watershed moment in which access to real-time information and increasingly sophisticated investment tools have made them more empowered than ever before. This new source of empowerment may increasingly stem from the gathering of like voices in communal hubs, where flouting conventional wisdom and the willingness to go against orthodox trading approaches isn't just suggested, it's celebrated.

These social forces have had profound effects, including the ability to improve market liquidity, for instance.<sup>7</sup> In fact, retail investors acted as a stabilizing force when COVID-19 first disrupted markets in March 2020, since they didn't pull back when stock prices fell and more traditional investors balked.<sup>8</sup>

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Their impact on price discovery remains unclear, since off-exchange trading has expanded significantly with the concurrent growth in retail trading. In January 2021, the share of off-exchange trading represented 47.2% of total US equity trading volume, up from 41.5% last year and 37.3% in January 2019.<sup>9</sup>

Altogether, the trends outlined above precipitated some extraordinary trading activity by retail investors in early 2021, a firestorm that has prompted heightened legislative and regulatory scrutiny of the capital markets industry, as well as renewed attention on issues ranging from consumer protection to best execution concerns.

It may take a while to see if the outsize influence<sup>10</sup> retail investors have exerted on the markets in recent months will persist in the future. Individual investors, whether motivated by short-term trading or long-term investment goals, may permanently alter traditional market dynamics going forward, including the ways in which retail investors, market-makers, clearing firms, brokerages, wealth managers, and hedge funds interact.

It may be tempting to dismiss these new customers as gullible or clueless. However, ignoring them may be short-sighted for several reasons, not the least of which is that they could be an attractive customer segment down the road.

Adapting to this shift could be critical for financial institutions to continue serving the needs of their customers. As a first step, it is important for firms to consider how retail investing might continue to evolve. This will allow them to better anticipate what changes their businesses should make to their customer acquisition strategy, product mix, pricing, risk management, compliance protocols, and processes for anticipating and meeting funding requirements.



# Newly empowered investors: A developing portrait

For now, the emerging class of individual investors appears to be a different breed with distinctive motivations and behaviors that place them on the opposite end of the spectrum from traditional, advice-seeking customers.

This new segment of investors generally falls into two buckets. The first tends to be younger, first-time investors with limited discretionary income. As novices, they are not yet as knowledgeable and can be heavily influenced by various sources of information, including social media. The second bucket is comprised of savvier, more experienced investors with more money at their disposal. These individuals may hold accounts with traditional wealth management firms or other online brokers. Some revel in sharing their investment ideas and analysis on social media, especially with new entrants who can learn from their collective expertise. Their advice may be inappropriate and unhelpful, however.

## What's different about the new class of investors

A recent report from the Financial Industry Regulatory Authority (FINRA) Foundation and NORC (National Opinion Research Corporation), the University of Chicago's independent social research institution,<sup>11</sup> found that novice investors who opened their first retail brokerage account in 2020 share several distinctive characteristics. Typically, they are more racially diverse, have smaller account balances, and trade more frequently. They also tend to seek advice from financial professionals at about half the rate of experienced holdover account owners.<sup>12</sup>

For both groups of investors, social media tends to play an extremely vital role in how they receive and process information, as well as how they make investment decisions. Social media posts and commentary may be helping to boost investors' collective knowledge and providing a forum for individuals to share and hone their investing approach. Many of these investors take pride in eschewing conventional wisdom, but the venues they frequent can be fraught with misinformation, self-serving advice, and unsuitable recommendations. These exchanges may cause considerable harm to investors who are susceptible to outside influences and do not perform their own due diligence.

As a result, it is not uncommon to see these investors participate in sometimes confounding and anomalous trading activity. In general, however, they tend to prefer stocks that correspond to familiar, household names.<sup>13</sup> In addition to social media, their decisions can also be swayed by other channels, such as television commercials.<sup>14</sup> Despite extreme market events, there nevertheless appears to be an element of "crowd wisdom" in their overall portfolios.<sup>15</sup>

The newly empowered investors also often use sophisticated tools to execute more complex strategies, such as options trading. There is further evidence that a growing portion of newly empowered investors are becoming more aware and appreciative of market complexities, as well as the interconnectedness between different players in the financial services ecosystem.<sup>16</sup> Some retail investors, for example, have proven adept at finding market inefficiencies.

To cater to this emerging customer market, many financial institutions have been developing educational efforts with tools that promote financial literacy for self-directed investors. These programs include personalized coaching plans and software that allow users to scan the market and test strategies. Collectively, these trends have begun to expand knowledge and sophistication among retail investors as a whole.

Another notable consequence of greater retail participation is that newly empowered investors, who can trade from any place and at any time, are chipping away at the seasonality of investing and spurring more time-agnostic market activity.<sup>17</sup>

# A new breed of investors: New business models at the core of their revolution

One of the fundamental shifts fueling the retail investment boom is the growth of new digital trading platforms, and with them, the idea of **no-minimum investment accounts** that make investing accessible to individuals previously shut out of financial markets. About one-third of investors who opened a new account last year have a balance less than \$500.<sup>18</sup>

The no-minimum-balance approach was accompanied by **zero-commission trading**, which attracted a swath of new customers and prompted an explosion of trading activity.<sup>19</sup> Historically, a loss of revenue in trading commissions was partially offset by the industry practice of payment for order flow (PFOF). Order flow payments have likely made it possible for brokerages to adopt many of the innovative strategies that helped spark the rebirth of retail investing. Many reputable sources say they are a net positive for investors, since market-makers can access better prices than what are typically available on public exchanges, thus lowering execution costs.<sup>20</sup> The pressure to uphold zero-commission models amid declining revenue has forced some brokerages to consolidate.

The introduction of **fractional shares trading** has been another catalyst for the increased trading volumes by retail investors. Its rollout added so much fanfare to stock-buying during the pandemic that, by fall 2020, it had become a staple across several legacy brokerages. Not everyone is a fan, however. Many proponents of long-term investing have spoken out about fractional shares trading, arguing that it is not an effective way to build wealth over time. Their reasoning is that dollar-based investing may encourage more frequent trading and could foster speculative behavior.

As buying and selling on margin becomes more pervasive in the market, **margin trading** could become another area of focus for regulators.

**Options trading** has also risen dramatically, which may pose risks of its own for both individual investors and the overall market. Not all account holders are trading options contracts; much of the activity is conducted by a minority,<sup>21</sup> with new entrants using options less than their more experienced counterparts, according to FINRA data.<sup>22</sup> Experienced investors opening new accounts last year reported they were trading options at almost double the rate of new investors and were more likely to take on financial risks. Call options became particularly popular among this group for their potential to yield huge payouts. Last year, small investors commanded a larger share of the call-option contract market than the large investors who have historically dominated it.<sup>23</sup>

# Market regulation and consumer protection

Recent events in the news have forced regulators to increase their attention and focus on the products and services offered by interactive digital platforms. They are now tasked with determining whether additional regulation, supervisory policies, and examination techniques should be implemented to protect consumers, mitigate systemic risks, ensure fair market access, and strengthen the stability of market infrastructure.

Consumer protection, for instance, has become a priority for regulators, as evidenced by recent statements.<sup>24</sup> FINRA has also flagged several new risks related to products and services offered by interactive digital platforms. The regulator's exam unit stressed that many firms may not be adequately addressing risks posed by platforms with "game-like features"<sup>25</sup> that have been designed to encourage trading and promote frequent engagement. FINRA examiners have also raised concerns over the design of those platforms' interfaces and how those elements may impact the "opening of accounts, recommendations and the presentation of different investment choices" for users.<sup>26</sup>

Regulators are also checking to ensure that brokers are fulfilling Know Your Customer (KYC) requirements and onboarding obligations when accommodating the massive influx of accounts opened on electronic devices.<sup>27</sup> FINRA also plans to look deeper into which clients are granted access to make options trades and how those transactions are supervised.<sup>28</sup> This may lead to more rigorous evaluations of the processes firms use to scan books and records for red flags or other signs of misconduct.<sup>29</sup>

Finally, the Securities and Exchange Commission (SEC) and FINRA plan to examine whether distributors are acting in the best interest of their clients and check that they can demonstrate why certain investing decisions were appropriate for investors given their age, experience level, and financial situation, among other considerations.<sup>30</sup>

## Clearing and settlement infrastructure robustness

Regulators may also look into strengthening brokerages' funding requirements to avoid more market disruptions in the future. Congress has launched investigations into recent trading halts, and elected officials on both sides of the aisle have questioned the extent that they brought about investor harm.<sup>31</sup>

Market volatility in early 2021 has also reiterated calls<sup>32</sup> for shorter trade settlement times, with some firms arguing that the current two-day cycle may exacerbate the stress on clearing firms that must keep cash on reserve as they wait for trades to settle. A shorter cycle could provide more transparency on imminent capital demands and reduce the amount of collateral that brokers must provide to clearing firms during periods of volatility.

## The need for greater disclosure and transparency

Other potential issues that regulators could target include questions regarding the need for more disclosure on customer gains and losses. Also of great concern is assessing whether sophisticated actors were able to disguise their identity and spread false information online during trading debacles.

The Consolidated Audit Trail (CAT), a tool that brokers began using in July 2020 to report data on equity and options trading, could also be put to the test. Regulators may use it to track the sequence of events leading up to recent trading frenzies and to evaluate whether any individuals engaged in market manipulation.<sup>33</sup>

As order flow payments face increased scrutiny, some firms may look to provide more transparency on incoming revenue streams. This shift may already be in progress, as at least one fintech company has done away with payments for order flow entirely, opting instead to route customer trades directly to exchanges. Under this model, customers can voluntarily pay for trading through an optional "tipping" button.<sup>34</sup>

# Strengthening resilience and accelerating transformation

As outlined throughout this analysis, the growing influence of retail investors should have an enormous impact on established brokerage firms and their operations. To stay ahead of these transformative forces, brokerages should begin reviewing their processes for **onboarding new customers** and assessing whether they are gathering enough information to meet KYC requirements. Firms should also ensure they have protocols in place for determining which investments are suitable for new account holders and that they have a record-keeping process that can show their fiduciary obligations were fulfilled when recommending products and services to customers.

Some firms may choose to install **more investor protection** guardrails, such as creating policies that restrict the use of leverage and derivatives. They should also weigh adding more customer support functions, such as 24-hour help lines and other forms of **live assistance**, including the option to chat live with a registered broker.

Firms that are duly registered as broker-dealers and investment advisers may want to consider **additional staff training** on how to better engage with customers on the risks of buying securities experiencing high volatility. These businesses may also wish to put more explicit protocols in place to determine when customers should be prohibited from purchasing certain securities. Advisers can also learn effective ways of **initiating customer outreach** during periods of market turmoil.

Financial institutions should also consider reiterating sound investing principles with customers and providing them with information they might find helpful in periods of turbulence, such as adding warning labels to stocks experiencing extreme volatility. Some advocates have also suggested implementing mandatory annual continuing education requirements<sup>35</sup> to stem the tide of misinformation retail investors encounter online. Similarly, these institutions could channel their expertise in designing user-friendly and engaging features to promote investor education.<sup>36</sup> Many firms are already well down the path in developing novel applications to increase investment knowledge, including building virtual reality-powered learning modules and embedding lessons on key financial concepts in popular video games.<sup>37</sup>

Financial institutions should also challenge themselves to reimagine the customer experience they are providing across the full investment life cycle. While many empowered investors are self-reliant and well-versed in digital tools, they can also benefit from good, old-fashioned human interaction.

To capture this emerging customer group, firms should foster an experience that is simultaneously tech-forward and human-centric. To identify moments where one-on-one interaction would be the most helpful, brokerage firms can rely on the near-instantaneous data from multiple sources to determine whether changes in a customer's behavior or circumstances indicate an opportunity for investor outreach. They can then identify the most effective timing, content, and delivery method of marketing messages.

The nationwide buildout of wireless 5G technology can help firms push forward on many of these initiatives. Advanced mobile networks are expected to speed up transactions as a result of diminished latency times, making for a smoother customer experience with fewer glitches and delays on websites and multimedia platforms.<sup>38</sup>

Investment providers may also need to adjust their product lineup on account of retail investors' growing appetite for nontraditional and alternative investments, including cryptocurrencies, commodities, and private market assets. Firms should assess the full extent of demand before expending the resources needed to give customers access to these products.

Finally, some firms may need to **rethink their pricing models** as the result of zero-commission trading and its resulting downward pressure on revenue. One option could entail requiring premium subscriptions for accounts that allow complex transactions like derivatives trading.

# Bracing for a new phase in retail investing

The extreme levels of recent trading activity have put great stress on the trading infrastructure of retail investing platforms. Most have proven resilient, despite some temporary outages.<sup>39</sup> Firms can invest in fortifying these platforms and testing the processing power required to execute trades when trading volumes spike. In this regard, migrating to the cloud can provide opportunities to hyper-scale computing and “increase capacity on demand.”<sup>40</sup>

The recent market events have also pointed to a greater need for brokerages to strengthen their framework for data security, especially when it contains clients’ personal information. Firms should also explore new methods of risk sensing, including strategies for using alternative data to keep track of shifting market

dynamics. Employing this strategy can provide firms with more time to figure out how they can best prepare for and respond to extreme market fluctuation or dramatic price swings.

Ultimately, shoring up operational resilience could be key to withstanding the reverberating effects that empowered retail investors may have on the market and the entities who engage with it. While the degree to which empowered investors will be able to retain their growing influence once the pandemic subsides is unclear, it is safe to assume that many of these trends and behaviors are bound to persist. This shift is probably another step in the evolution of the retail investor.



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