BETTER MARKETS

SPECIAL REPORT

Unregulated Financial Influencers: Safeguarding Investors in the Digital Age

By BENJAMIN SCHIFFRIN

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Introduction

Kim Kardashian and Lindsay Lohan—when most people think of these celebrities, they don't think "crypto shill." But the SEC has sued both for promoting crypto without disclosing that they were paid for doing so. And they are not alone in using their social media presence to influence financial decisions. Just as with food, fashion, and other industries, there's a whole army of individuals dispensing financial advice on social media. These people are called "finfluencers."

Some finfluencers are celebrities who already have a platform. Most finfluencers are regular people trying to gain a following. All finfluencers use social media to induce people to invest in whatever product they are promoting, often on platforms like TikTok.

TikTok was created in 2016, but the primary federal law regulating investment advice, the Investment Advisers Act, was passed in 1940. Since that time, the way in which investors receive financial advice has changed dramatically. The concept of finfluencers was inconceivable until relatively recently. Unsurprisingly, therefore, the extent to which the Investment Advisers Act governs finfluencers is unclear. Yet the stakes are enormous: the Federal Trade Commission found that, in the ***first six months of 2023, investors lost $2.7 billion from investment-related fraud scams initiated on social media***.

Kim Kardashian is perhaps the most famous example of investor losses from "finfluencing." The SEC sued her for promoting a cryptocurrency called EthereumMax on social media without disclosing that she had been paid to do so. The SEC alleged that Kardashian's endorsement was part of a pump-and-dump scheme, where EthereumMax's creators wanted to artificially inflate the price of the token before selling it to investors.

A screenshotted portion of the Instagram story Kim Kardashian posted in June of 2021 to her millions of followers promoting EthereumMax.

Although Kardashian is not famous for providing financial advice, many individuals have become famous on social media for doing just that, even though they also lack the requisite qualifications to provide financial advice to investors. For example, Ben Armstrong, known as BitBoy, developed a following of one million YouTube subscribers by making videos about crypto despite having no professional qualifications. He then promoted a new cryptocurrency called BEN Coin, whose value plummeted. Investors filed a class-action lawsuit against Armstrong, alleging that they were induced to invest by the promise of substantial returns but suffered significant losses through fraud.

Other individuals have gained a following on social media for reasons having nothing to do with financial advice and then used their newfound fame to promote financial products. Haliey Welch became an influencer after a clip of her being interviewed went viral, and after growing her brand online helped launch a cryptocurrency called HAWK. The coin lost more than 95% of its value in a single day when it was launched on December 4, and investors have filed a lawsuit alleging that the coin was sold unlawfully.

In light of the risks to investors that finfluencers pose, our ability to regulate finfluencers is essential to maintain trust and confidence in, and the integrity of, the securities markets.

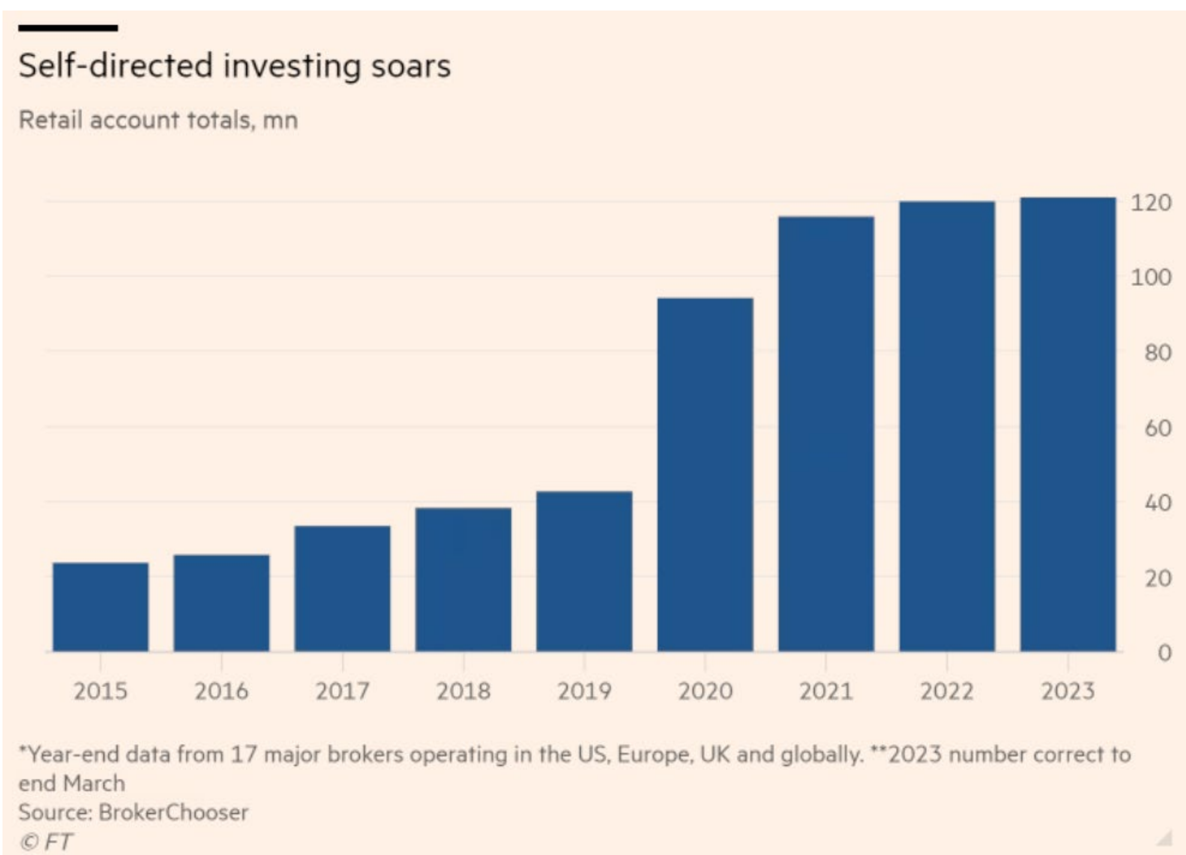
The Rise of Finfluencers

Many young people "are turning to social media and financial influencers, or 'finfluencers,'" for financial advice. Finfluencers "are online personalities who share financial advice, particularly on social media." As with other social media influencers, finfluencers are becoming increasingly important in their space.

A recent FINRA study found that ***over 60% of U.S. investors under age 35 use social media as a source of financial investment information compared to 57% who use financial professionals***. When including_only Gen Z investors—those born in or after 1997—48% of U.S. investors report using social media as an investing tool, and 37% consider finfluencers to be a significant factor in their decision to start investing. Another recent report found that Gen Zers are nearly five times more likely to say they get their financial advice—including stock tips—from social media than adults older than 40.

The statistics are similar outside the U.S. According to Deloitte, 25% of 18-24 year olds in the U.K. use social media when searching for financial guidance. Other studies found that 44% of investors in the U.K. use social media as an investing tool and 38% consider finfluencers to be a significant factor in their decision to start investing. Nearly two-thirds of 18- to 29-year-olds in the U.K. follow finfluencers, and 74% trust their advice.

The rise of finfluencers coincides with another trend: the rise of trading by retail investors. The pandemic led many young people to invest in the stock market for the first time. So did the GameStop/meme stock trading frenzy. That event "prompted many young individuals to become retail investors," which led to even higher numbers of new Millennial and Gen Z retail investors since the COVID-19 pandemic began. As a result, since the beginning of the pandemic, the number of self-directed investors has exploded:



The pandemic and the GameStop trading frenzy also made finfluencers more attractive.

> Around the time of the GameStop trading frenzy, a lack of trust in financial institutions coupled with the desire to save money led Millennials and Gen Zers to look for alternative sources of financial information. During the frenzy, 46% of Millennial and GenZ investors wanted more information about how to invest their money and went to social media to obtain it. In another survey, this percentage increased a few months later to 56%, showing a growing trend of younger generations turning to social media for financial information.

The trend continues to this day. Many retail investors are increasingly turning to finfluencers "to obtain information on investing in stocks." The confluence of these events means that more retail investors than ever before are participating in the securities markets at the same time as there are more potentially problematic sources of financial advice than ever before. That's because finfluencers, as a relatively new phenomenon, "are not currently subject to direct regulation in the United States." This means that finfluencers need not have any qualifications to provide investment advice; need not disclose if they are being paid for promoting specific products, and need not fear getting sued by regulators. This report highlights the risk of finfluencers, the consequences to retail investors who receive unqualified or conflicted financial advice, and the need for regulation in this space.

The Risks of Finfluencers

Finfluencers present "two key risks": the fact that they may not offer quality advice and the fact that their advice may suffer from undisclosed conflicts of interest.

With respect to the quality of their advice, the problem is that finfluencers' credentials "vary significantly—from self-taught to formal accreditation, making the quality of advice hard to distinguish for a novice investor." Indeed, the quality that most financial influencers share "is that they have no formal financial education at all." Yet the "absence of regulations for these finfluencers allows them to give large audiences financial advice despite a potential lack of knowledge and qualifications."

One of the biggest risks is that it is hard to distinguish finfluencers who know what they are talking about from those who do not. The same hashtags promote good and bad advice. Some finfluencers "'can make complex aspects of saving or investing accessible and engaging, helping people make better-informed financial decisions.'"

> However, there's a darker side, with significant risks of finfluencers spreading misinformation or promoting high-risk behaviors, such as day trading individual stocks without adequately explaining the risks involved."

So following some finfluencers will inevitably lead to investing in high-risk assets.

With respect to undisclosed conflicts of interest, the problem is that unscrupulous finfluencers "may have hidden agendas, aiming to profit at the expense of less seasoned investors by exploiting their inexperience through biased or self-serving advice." And even for more ethical finfluencers, there is an "inherent conflict" between providing good advice and receiving compensation. That is because two of the main ways finfluencers make money are ad revenue and corporate sponsorships.

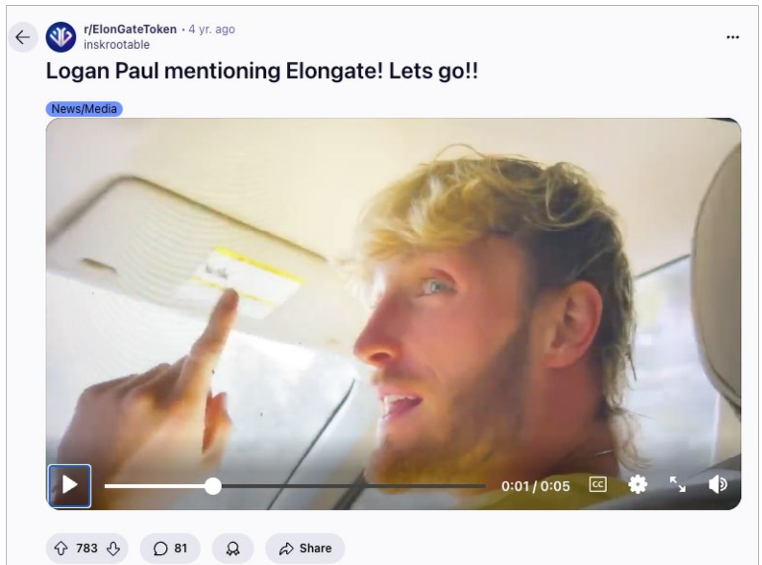
Since the first step for any finfluencer "is to gather as many fans and viewers as possible," this "can set up a conflict between providing sound advice and capitalizing on traffic that typically flows to posts promising quick solutions or guaranteed money." The conflict is all the more pronounced because posts that receive more traffic will yield more ad revenue. Indeed, finfluencers can earn more ad revenue by promoting risky trading strategies like options trading. Corporate sponsorships also lead finfluencers to "endorse products for payment, meaning their advice may not be objective." So through these compensation mechanisms, finfluencers "can earn six figures or more annually from brand partners or advertisements" by providing certain advice, but the advice will be infused with conflicts of interest "that are typically undisclosed or difficult to distinguish." All this means that it is hard for finfluencers "to earn back their costs, let alone a living, by posting nuanced, realistic advice."

The reality is that "social media is exposing a larger, younger and often less-educated audience to often unvetted personal financial advice." Indeed, "some influencers promote strategies that are inappropriate for many, if not most, investors." And despite the risks that advice from the more dubious finfluencers pose, uninformed investors have proven to be "fairly easy prey for the more unscrupulous finfluencers."

The Consequences to Investors

Indeed, due in part to finfluencers, a growing number of young people are falling victim to fraud. The reason is that social media platforms are "rife with scams." For example, the SEC alleges that a group of day traders built up fan bases on popular social media platforms by claiming expertise in penny stocks—stocks of small companies with share prices below $5. According to the SEC, group members were engaged in a pump and dump scheme in which they sought to inflate the price of the stocks so they could sell them at a profit. One member of the group pleaded guilty to securities fraud in 2023.

Penny stocks have always been magnets for fraud, but finfluencers have become more prominent at the same time as another speculative asset—crypto. "The volatility of cryptocurrency means that it can be difficult to predict the market—and yet many social media users have been led to believe that digital currencies are a good investment."



*A screenshot of Elongate's post on their reddit feed promoting Logan Paul's YouTube video where Logan states "Elongate made me rich." Elongate is a meme coin inspired by Elon Musk after a post he made on X "If there's ever a scandal about me, *please* call it Elongate."*

Celebrities who became famous through the internet have become especially prone to promoting crypto over social media. For example, after Logan Paul became a YouTube sensation, he promoted a cryptocurrency called Elongate. Paul, who has 23 million followers on YouTube, posted a video in which he said that "Elongate made me rich." Elongate's price then rose by 6,000%, but crashed after a few hours.

Similarly, Paul promoted a cryptocurrency called Dink Doink. He said he believed in it and that it was going to go crazy. This led to a huge influx of buyers, but the price subsequently fell by 96% in the next two weeks. Paul's finfluencing is paradigmatic of crypto, which is "a market driven to some extent by social media and influencers."

> 'A big guy with a lot of influence . . . someone like Logan Paul, buys a tonne of crypto and tells their followers about it. They're going to buy it too.'

Logan Paul is hardly the only celebrity to promote a crypto asset which subsequently lost its value. In 2020, rapper and actor T.I. settled SEC charges that he helped promote a fraudulent cryptocurrency.

He used his social media accounts to promote FLiK, an initial coin offering which turned out to be fraudulent and in which investors lost $2.4 million.

Unfortunately, investors are not only misled by world famous celebrities promoting crypto. The more typical situation is finfluencers who may not be "well known outside crypto circles," but "have large followings on social media," and who induce their followers to invest in dubious crypto offerings as a result. These finfluencers often promote "small-time, experimental crypto ventures" that fail way more often than they succeed.

> "For example, when Australian social media finfluencer Alex Saunders contacted one of his followers and offered him cryptocurrency investment opportunities, the follower, who was lured by his trust in the finfluencer, jumped at the chance and sent Saunders hundreds of thousands of dollars, which then disappeared into failed investments."

So the combination of trust in finfluencers by their followers and the volatile nature of crypto can have harmful consequences. But because finfluencers (and crypto) are largely unregulated, both finfluencers and crypto companies "'view this as the Wild West.'" There are few rules governing finfluencers, despite the fact that they are essentially offering individuals tailored advice on their crypto portfolios. This advice "takes on all the hallmarks of unregistered investment advice, including the adviser receiving a fee and giving tailored advice to an individual retail investor on their investment portfolio."

The potential consequences of trusting finfluencers are by no means limited to losses from crypto scams. "While losses resulting from online investment advice can be due to fraud, they can also result from legitimate advice about an investment that is not suitable for a particular investor." "When investment advice is not suited to the individual investor, it can have the same practical effect as outright fraud with resulting financial harm."

This has led to "increased regulatory scrutiny of the space," with the U.K.'s Financial Conduct Authority (FCA) announcing a crackdown on illegal finfluencers in October 2024. The FCA noted that finfluencers are often "unqualified to be giving financial advice to the younger and often very impressionable age groups who follow them."

> "There's real jeopardy here with unsuspecting and often vulnerable people losing substantial amounts of cash. Many of the victims of unscrupulous social media grifters will never get their money back. There's a reason financial advice is regulated and that is to protect people from being ripped off."

The unregulated nature of finfluencers means that finfluencers have every incentive to endorse investment strategies that will cause their number of followers to increase rather than endorse strategies that are sound for investors. This leads to a situation where finfluencers who provide money-losing advice but do so by promoting overly optimistic beliefs actually have more followers than skilled finfluencers, even though the unskilled finfluencers generate a -2.3% return. Indeed, a recent study found that 56% of finfluencers gave money-losing recommendations, and 16% provided no value at all. That's because, as it stands now, "finfluencers have no actual duty to dispense sound advice, and it's not necessary for finfluencers to be right to retain followers."

The Need for Regulation

The risks that finfluencers pose and the potentially harmful consequences to investors mean that regulators must pay greater attention to this space. Investors are increasingly receiving financial advice of questionable utility from online finfluencers, but these finfluencers are not subject to the same standards as registered investment advisers:

> It's a trend that carries numerous significant risks, creating a potential wild west atmosphere for investors on sites such as YouTube, TikTok, and Instagram. On these platforms, the transparency and ethical standards mandated in traditional financial services companies are often absent.

As demonstrated above, unregulated financial advice on social media "presents risks to consumers that are similar to the historical risks that led to heightened regulatory requirements for investment advisers in the Investment Advisers Act of 1940." In response to these emerging risks, our laws must be "modernized to mitigate the consumer protection gap presented by this unregulated investment advice on social media." Indeed, "regulation around the sector is key to ensure users are viewing content made by those acting in their best interests." Yet there is a "growing concern in the financial services sector over the potential of social media to enable powerful finfluencers to engage in 'wrongful activity such as fraud, misrepresentation, breach of fiduciary duty, and market manipulation.'" So regulators "should take steps to address the risks."

One step that regulators should take is clarifying whether finfluencers qualify as investment advisers. A lack of clarity exists as to whether an individual who receives compensation for providing investment advice on social media could be deemed to be an investment adviser subject to the same regulatory framework as traditional advisers. Generally, a person who is engaged in the business of providing advice about securities for compensation is an investment adviser. This means that "finfluencers who receive ad revenue from a platform such as YouTube, compensation through affiliate links, or payments from sponsored content could be considered advisors."

But finfluencers could also qualify for an exception for publishers who regularly provide only impersonal advice that is disinterested commentary rather than promotional material. As an example, Robert Plaze, a former deputy director in the SEC's Division of Investment Management, notes that the SEC "'doesn't regulate the financial columns of The Wall Street Journal.'" Still, there would seem to be a distinction between the Wall Street Journal and individuals who receive compensation, either in the form of ad revenue or corporate sponsorships, for providing investment advice on social media, and the SEC should clarify the status of finfluencers for the benefit of investors and finfluencers themselves. An even better, but less likely, step would be for Congress to "amend the Advisers Act to explicitly apply to social media investment advice" in order to "regulate finfluencers that are not paid directly by those consuming and heeding their advice."

Another step regulators could take would be to require disclosures by finfluencers. A recent study found that only 20% of finfluencer content that contained investment recommendations included some form of disclosure, such as professional status or whether the finfluencers received compensation for recommending certain products. So the SEC could adopt a rule "mandating some level of disclosure about how finfluencers receive compensation." For example, it could require that finfluencers disclose any material conflicts they have regarding the advice they provide and any compensation they receive for that advice. It could also require disclosures regarding the finfluencer's regulatory status, educational background, or business experience or lack thereof.

One problem with regulating finfluencers is that since so many people "are now making investment-related content 'it is literally not possible' for budget-constrained federal regulators to monitor and police all of it on all social media platforms." But that is no reason not to try. The SEC can't monitor and police everything that traditional investment advisers do all the time, but at least there are rules in place to govern their activities. The absence of such rules for finfluencers is pernicious. "With the lack of consistent global regulations around [finfluencer] content, the risk of making misguided investment decisions due to misinformation and fraud is greater than the risk would be if the advice was taken from traditional advice channels." Regulators must act to mitigate this risk.

Conclusion

Although finfluencers have "brought increased access to financial literacy and advice to many people, the quality can be inconsistent, surface level, and susceptible to fraud and manipulation." The reason for this is that the realm of finfluencers "lacks regulation in many jurisdictions." Given that finfluencers are relatively new, "investor protections related to social media influencer financial advice are nascent. Left unaddressed, this could have long-standing implications for many in the capital markets industry." So regulators must act to protect retail investors from the many risks that finfluencers pose.

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