PSYCHIC INCOME & DEMOCRATIZED INVESTING

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INTRODUCTION 203
I. ACKNOWLEDGING PSYCHIC INCOME 205
A. Design Features 206
B. Role-Playing 207
C. Ideological Expression 208
II. IMPLICATIONS 209
CONCLUSION 212

INTRODUCTION

It is increasingly difficult to distinguish investing from entertainment or other consumer experiences. Perhaps the ultimate symbols of this convergence are new sports betting sites that emulate the stock market by depicting teams, athletes, or prop bets as tradable "stocks" like shares of Apple or GM.[1] By borrowing the imagery of the stock market to make gambling more entertaining, this product positioning turns the old investing-as-gambling metaphor on its head and speaks to the current playful atmosphere of retail investing. Complementing Professor Andrew Schwartz's thorough and insightful new book, *Investment Crowdfunding,* this essay brings to the forefront a range of nonfinancial, or "psychic," benefits from democratized investing.

As his book title suggests, Professor Schwartz focuses on crowdfunding investments in startups. The book chronicles the impressive momentum in the crowdfunding market since its regulatory blessing through the Jumpstart Our Business Startups Act ("JOBS Act") and Regulation CF. In the U.S., the number of investors in crowdfunding offerings rose from just over twenty thousand

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1. *See e.g.*, MOJO, https://www.mojo.com [https://perma.cc/8SEW-D2JY] (last visited Mar. 19, 2024); SPORTTRADE, https://getsporttrade.com/ [https://perma.cc/Q3ML-H57Z] (last visited Apr. 9, 2024); *see also* SIMBULL, https://simbull.com/ [https://perma.cc/8Y7H-QXCR] (last visited Apr. 9, 2024).

in 2016 to over five hundred thousand in 2021.[2] Markets in New Zealand and the U.K. are even stronger (per capita).[3] Professor Schwartz identifies several benefits to the crowdfunding model, including supporting local entrepreneurship and participation by diverse investors and founders.[4]

Crowdfunding can be viewed as part of a broader trend of increased investing by novice investors known as democratized finance. The other, and perhaps better known, channel is Robinhood, where users buy and sell public equities, crypto, and options through an online trading app.[5] By the time of its initial public offering ("IPO"), Robinhood had approximately eighteen million users, most of whom were first-time investors.[6] Scholars have identified several positive effects of Robinhood and its imitators, including hands-on financial education,[7] increased savings opportunities,[8] and improved governance through grass-roots corporate activism.[9] Robinhood, however, has also incurred record fines for compliance failures,[10] been at the center of controversial meme stock episodes that potentially destabilize the market,[11] and been associated with harmful investor behavior.[12]

This essay tries to offer something new by, in a sense, taking democratized finance *less* seriously. Instead of assuming that users of online trading apps and crowdfunding platforms are achieving or failing to achieve desired financial returns, this essay explores the wide range of nonpecuniary or psychic benefits that lure consumers

2. *See* ANDREW A. SCHWARTZ, INVESTMENT CROWDFUNDING 32 (2023).

3. *Id.* at 35.

4. *See id.* at 37–44 (discussing "inclusive entrepreneurship" and "inclusive investing").

5. *See* Abraham J.B. Cable, *Regulating Democratized Investing*, 83 OHIO ST. L.J. 671, 672–76 (2022).

6. *Id.* at 672.

7. *See* Sergio Alberto Gramitto Ricci & Christina M. Sautter, *The Educated Retail Investor: A Response to "Regulating Democratized Investing,"* 83 OHIO ST. L.J. ONLINE 205, 215–16 (2022).

8. *See* Jill Fisch, *GameStop and the Reemergence of the Retail Investor*, 102 B.U. L. REV. 1799, 1839 (2022) (describing inclusive capitalism); Gramitto Ricci & Sautter, *supra* note 7, at 205–06.

9. Fisch, *supra* note 8, at 1840–43; Sergio Alberto Gramitto Ricci & Christina M. Sautter, *Corporate Governance Gaming: The Collective Power of Retail Investors*, 22 NEV. L.J. 51, 53–54 (2021) (arguing that Robinhood users have a positive effect on governance and ESG considerations).

10. *See* Cable, *supra* note 5, at 675 (discussing fines from the Securities and Exchange Commission ("SEC") and Financial Industry Regulatory Authority ("FINRA")).

11. *See* Fisch, *supra* note 8, at 1822–25 (describing concerns about volatility, systematic instability, and capital misallocation associated with the GameStop frenzy); *see also* Sue S. Guan, *Meme Investors and Retail Risk*, 63 B.C. L. REV. 2051, 2056–58 (2022); James Fallows Tierney, *Investment Games*, 72 DUKE L.J. 353, 416–18 (2022).

12. Tierney, *supra* note 11, at 419–20.

to these sites.[13] Some of these benefits are potentially meaningful—such as political expression—but much of it is silly—like virtual bursts of confetti or pretending to be a venture capitalist. While psychic income might appropriately be ignored as incidental when billions, millions, or even thousands of dollars are at stake, the median democratized investor only invests *hundreds* of dollars.[14] In this context, small pleasures might have considerable explanatory value.

When it comes to regulatory policy, this focus on entertainment and other psychic value has surprisingly important implications. This is not because the psychic benefits are themselves so profound. Rather, their presence makes investing feel similar to other consumer experiences, leading to bewildering legal results. In the current environment, even a small stock investment is subject to heavy-handed regulation and restrictions compared to other consumer experiences that consumers might think of as alternatives. The resulting perception of arbitrariness may ultimately erode any perceived legitimacy of the regulatory system. Where possible, after giving due respect to regulators' legitimate concerns about compulsive or excessive use, we might learn to tolerate more frivolous investing in the name of regulatory consistency. The good news is that crowdfunding regulation already has an effective tool for achieving the desired balance—caps on individual investment amounts.

I. ACKNOWLEDGING PSYCHIC INCOME

A conventional view is that people engage in investment transactions for financial objectives. Sometimes those objectives are considered virtuous (saving for retirement) and sometimes they are less so (speculation).[15] Either way, from this traditional perspective, the success of a transaction is measured by financial benefit.

In recent years, there has also been growing acknowledgement that some investors have altruistic goals as well when they trade or invest. A variety of terms capture the basic concept: impact

13. To be clear, this is not the first piece of legal scholarship to consider nonfinancial benefits of democratized investing. In particular, Professor Tierney acknowledges in his sweeping analysis of Robinhood and gamification that some investors "trade rationally because they are trying to satisfy nonpecuniary preferences for entertainment or consumption." *See id.* at 387–89. This essay is an effort to build on that idea, extend it to crowdfunding, and tease out new policy insights.

14. *See infra* note 35 (describing the median account value on Robinhood and the median investment amount on Wefunder).

15. *See* Brad M. Barber et al., *Attention-Induced Trading and Returns: Evidence from Robinhood Users*, 77 J. FIN. 3141, 3142 (2022) (distinguishing speculation from traditional investment objectives such as "saving for retirement, meeting liquidity needs, harvesting tax losses, or rebalancing [a] portfolio").

investing, ESG investing, and socially responsible investing, among others.[16]

While these views explain much of what happens on crowdfunding platforms and trading apps, I perceive an additional phenomenon: participants in these new venues are deriving *psychic income* from their investment activities. More plainly, they simply enjoy the experience of using a trading app or crowdfunding site. As one early journalistic account opined, Robinhood may be "more financial entertainment than investment management or wealth building."[17]

The concept of psychic income may not figure largely in securities regulation, but it is well known in economic and legal scholarship. In labor economics, for example, it is widely accepted that people derive non-pecuniary benefits from their work.[18] Examples include prestige, friendship, and the feeling that one's work positively affects society. While the concept does have some overlap with socially responsible investing and the like, it is considerably broader and captures a wide range of subjective enjoyment that can range from deeply meaningful (friendship and self-actualization) to mostly aesthetic (enjoying a uniform or physical setting).

This Part identifies three categories of psychic income derived from democratized investing: pleasing design features, role-playing, and ideological expression.

A. Design Features

When viewing today's online trading apps and crowdfunding platforms, it is apparent that they have benefitted from decades of design learning. As described below, experts in user experience ("UX") design, information architecture, and digital engagement

16. *See* Susan N. Gary, *Best Interest in the Long Term: Fiduciary Duties and ESG Impact Integration*, 90 U. COLO. L. REV. 731, 736–47 (2019) (providing definitions of various forms of nontraditional investing).

17. Sheelah Kolhatkar, *Robinhood's Big Gamble*, THE NEW YORKER (May 10, 2021), https://www.newyorker.com/magazine/2021/05/17/robinhoods-big-gamble [https://perma.cc/VEN3-VD2K]; *see also* Tierney, *supra* note 11, at 387–89 (describing some retail trading as "entertainment or consumption").

18. *See* Lester C. Thurow, *Psychic Income: Useful or Useless?*, 68 AM. ECON. REV. 142, 142 (1978) (discussing methodological complications caused by the presence of psychic income). Psychic income also crops up in legal scholarship across a number of fields, including tax, public finance, and torts. *See* Daniel N. Shaviro, *Psychic Income Revisited: Response to Professors Johnson and Dodge*, 45 TAX L. REV. 707 (1990) (discussing how psychic income should affect tax policy); *see also* Martin J. Greenberg & Bryan M. Ward, *Non-Relocation Agreements in Major League Baseball: Comparison, Analysis, and Best Practice Clauses*, 21 MARQ. SPORTS L. REV. 7 (2010) (citing lost psychic income from team relocation as a justification for non-relocation agreements); Walter Block, *Ethics, Efficiency, Coasian Property Rights, and Psychic Income: A Reply to Demsetz*, 8 REV. AUSTRIAN ECON. 61 (1995) (discussing how psychic income complicates Coasian bargains and the traditional law and economics framework for torts liability).

have emptied their entire bag of tricks to create a rich and interactive experience.[19]

For trading apps, the most notable, or arguably notorious, design feature has been gamification.[20] A burst of confetti for completing a trade, or preferred access to new products for high levels of interaction with the app, gives the user a sense of accomplishment long before any calculation of financial benefits can be made.[21] While it may be tempting to dismiss these features as trivial, it is perhaps revealing that they have been at the center of regulatory criticisms and inquiries.[22] If gamification rewards are influential enough for regulators to worry about, doesn't that suggest they produce some nontrivial enjoyment for users?

For leading crowdfunding sites, such as Wefunder, a different design feature stands out. These sites are noticeably *social*. Users upload profile pictures, "follow" other users, and participate in message boards.[23] These are, of course, activities that people engage in routinely on social media sites or message boards without the need for any financial return at all because they are purportedly enjoyable. It is not hard to believe, then, that social engagement is at least a part of the "payoff" for some crowdfunding investors.

B. Role-Playing

The commercial success of games like *Dungeons & Dragons* suggests that people find role-playing to be a satisfying experience.[24] Some research even suggests concrete psychological benefits from this kind of identity experimentation.[25]

Since discount brokers first emerged in the 1980s, part of the appeal of investing was the chance to try on a high-status identity. An early profile of Charles Schwab describes customers visiting the brokerage's New York offices and entering trades into machines while stock symbols floated by, as if on the trading floor of a Wall Street firm.[26] Perhaps Robinhood continues the tradition, and trading apps are a chance to express one's inner Bobby Axelrod.

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19. *See* Cable, *supra* note 5, at 682–84 (discussing UX design principles); Tierney, *supra* note 11, at 363–68 (describing gamification features).

20. *See* Tierney, *supra* note 11, at 365–69; Kyle Langvardt & James Fallows Tierney, *On "Confetti Regulation": The Wrong Way to Regulate Gamified Investing*, 131 YALE L.J.F. 717, 722–24 (2022).

21. *See* Cable, *supra* note 5, at 684.

22. *See infra* notes 41, 50 (describing regulatory scrutiny of Robinhood).

23. *See e.g.*, *Follow,* WEFUNDER, https://wefunder.com/explore/investors [https://perma.cc/HR4Q-FVCC] (last visited Apr. 9, 2024) (allowing the user to follow top investors).

24. *See* Ian S. Baker et al., *Role-Play Games (RPGs) for Mental Health (Why Not?): Roll for Initiative*, 21 INT'L J. MENTAL HEALTH & ADDICTION 3901, 3903 (2023).

25. *See id.* at 3904–06.

26. *See* Cable, *supra* note 5, at 682 n. 69.

On crowdfunding platforms, users play the role of "angel investors," who have traditionally funded startups prior to venture capital investment.[27] WeFunder's site reinforces this experience by including videos with advice from startup superstars like Sam Altman and partners from leading accelerator Y Combinator.[28] Users even get to pair with experienced "lead investors" on due diligence teams.[29] It seems plausible that some users place significant value on the chance to feel a part of Silicon Valley, a socially significant institution.

C. Ideological Expression

In the subsection above, I suggested that Robinhood allows some users to play professional investor. At the same time, it is important to note that much of Robinhood's marketing exhibits a more subversive attitude towards Wall Street. In the company's origin story, the founders are inspired by an anti-establishment political movement: Occupy Wall Street.[30] Notable meme stock episodes, such as the run on GameStop stock in 2020, were framed as retribution against hedge funds for their perceived role in the Great Recession.[31]

Crowdfunding platforms similarly position themselves as part of a movement. Wefunder, for example, touts its status as a public benefit corporation attempting to "fix capitalism."[32] The company's impact report has a mix of libertarian and progressive overtones: "Laws that limit investments to the wealthy are paternalistic, widen the wealth gap, and perpetuate structural racism. We are all worthy of deciding the people or causes to invest in."[33] The company's Investor FAQ page emphasizes altruistic motivations for investing:

> Why should I invest in startups? It shouldn't be to make lots of money! This isn't the stock market. Startups are much riskier and more likely to fail. Greed is a wrong reason to invest. . . . Investing should not be solely about earning a

27. Darian M. Ibrahim, *The (Not So) Puzzling Behavior of Angel Investors*, 61 VAND. L. REV. 1405, 1416–20 (2008).
28. *Wefunder*, https://wefunder.com/school [https://perma.cc/6GV4-NY4M] (last visited Apr. 9, 2024).
29. *Investor FAQ's*, WEFUNDER, https://help.wefunder.com/#/investor/co-investing [https://perma.cc/GK77-3ZXD] (last visited Apr. 28, 2024).
30. *See* Cable, *supra* note 5, at 688.
31. *See id.*
32. *See Our Story*, WEFUNDER, https://wefunder.com/wefunder [https://perma.cc/QKP6-3WQP] (last visited Apr. 28, 2024).
33. *See Impact Report*, WEFUNDER, https://wefunder.com/pbc [https://perma.cc/KA23-L5R8] (last visited Apr. 9, 2024).

> return. To invest in something as risky as a startup, you should feel something extra beyond just the business model. For us, that 'something extra' is the fulfillment we feel helping a founder take 'their shot' at making our world slightly better.[34]

Maybe this is all just marketing fluff that should not be taken especially seriously. On the other hand, these companies are proving adept at user acquisition and retention in competitive markets while leaning heavily on this kind of messaging. It seems plausible that ideological expression is at least part of democratized investing's appeal.

II. IMPLICATIONS

If the above account is true, one implication is that democratized investing is not so different than a wide range of other consumer expenditures. Democratized investors pay money for an experience. That raises the question of why it is regulated so differently than those alternatives.

To make the point more vividly, consider that the median investment amount on Wefunder and the median account size on Robinhood are both about $250.[35] Imagine the median user's alternatives for those funds. They might include:

- Taking a family of four out to dinner at a moderately expensive restaurant in San Francisco;[36]
- Buying a premium subscription to Netflix for one year;[37]
- Making approximately two weeks of lease payments on a new Ford F-150 pickup truck;[38] or
- Taking a ride on a hot air balloon.[39]

34. *See Investor FAQ*, WEFUNDER, https://help.wefunder.com/#/investor/getting-started-for-investors [https://perma.cc/GK77-3ZXD] (last visited Apr. 9, 2024).

35. *See* Cable, *supra* note 5, at 685 (reporting the median account size on Robinhood is $240); *About*, WEFUNDER, https://wefunder.com/wefunder [https://perma.cc/QKP6-3WQP] (last visited Apr. 9, 2024) (indicating a median investment amount on Wefunder of $250).

36. *See San Francisco Bay Area Restaurants by Price*, TABLEAGENT, https://tableagent.com/san-francisco/price/ [https://perma.cc/V7LB-KCW7] (last visited Apr. 9, 2024).

37. *See Plans and Pricing*, NETFLIX, https://help.netflix.com/en/node/24926 [https://perma.cc/4GD7-5PKX] (last visited Apr. 9, 2024).

38. *See Pricing and Incentives*, FORD, https://www.ford.com/trucks/f150/pricing-and-incentives/ [https://perma.cc/S765-LJCE] (last visited Apr. 9, 2024).

39. *How Much Is a Hot Air Balloon Flight*, HOT AIR FLIGHT, https://hotairflight.com/blog/how-much-is-a-hot-air-balloon-ride [https://perma.cc/W4ST-VEFR] (last visited Apr. 9, 2024).

Although one can view these or other consumer experiences as alternatives to democratized investing from the consumer standpoint, the difference in regulatory treatment is stark. Because trading apps and crowdfunding fall under the umbrella of securities regulation, they operate in a highly regulated environment. As a registered broker-dealer, Robinhood is subject to extensive disclosure and record-keeping requirements, obligations to evaluate the users' sophistication and financial condition, scrutiny of pricing and transaction execution, and other obligations imposed by the SEC, FINRA, and state-level regulators.[40] In some cases, these regulators have suggested that gamification and other typical app features might be prohibited or leave Robinhood open to even more stringent requirements because of its status as a broker-dealer.[41] Crowdfunding platforms and transactions are also subject to considerable oversight even after Congress and the SEC cleared the way for equity crowdfunding through the JOBS Act and Regulation CF. Under current requirements, crowdfunding issuers must provide specified forms of disclosure to investors.[42] Crowdfunding platforms must be licensed with the SEC, conduct diligence on issuers, and provide communication channels for investors.[43] Crowdfunding transactions are subject to an overall offering limit (five million per issuer annually), a minimum threshold before any funds can be accepted, and a cap on how much an individual can purchase in crowdfunding transactions each year (generally five to ten percent of annual income or net worth, but it's complicated).[44] One can believe that U.S. securities regulation has been generally successful in advancing capital formation and investor protection while also acknowledging that it is a bit much for the small-scale, consumptive transactions that typify democratized investing.

But does it matter if we over-regulate the median democratized investment transaction? It may for at least two reasons. First, as previously discussed, there are benefits to democratized investing that we risk stamping out. Second, as explained further below, we

40. *See* Cable, *supra* note 5, at 688–96 (describing regulatory requirements applicable to Robinhood).

41. *See id.* at 696–98 (describing regulatory actions by the SEC and state regulators suggesting that digital engagement practices might constitute "recommendations" that trigger onerous suitability requirements for broker-dealers); *cf.* Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers, 88 Fed. Reg. 53960 (proposed July 26, 2023), https://www.sec.gov/files/rules/proposed/2023/34-97990.pdf [https://perma.cc/7YHZ-38YH] (describing a proposed rule that would require broker-dealers to "eliminate" or "neutralize" any digital engagement features that place "the firm's interest ahead of the investors' interest") [hereinafter *Proposed Rule*].

42. *See* SCHWARTZ, *supra* note 2, at 105–14.

43. *See id.* at 117–21, 130–31.

44. *See id.* at 121–29.

risk eroding the legitimacy of the law by treating basically similar conduct in vastly different ways.

The basic legitimacy argument is that inconsistent legal treatment of similar conduct makes the law appear arbitrary and ill-considered rather than fair and informed. What I have in mind here is not the kind of elaborate "coherentist" argument debated in the legal-philosophical literature.[45] Rather, I mean to express a common-sense preference for consistency in the regulatory treatment of comparable consumer activities where such consistency can be achieved alongside other important objectives.

Of course, regulators do have legitimate objectives other than consistency when policing democratized investing. One major concern is compulsive use. Massachusetts regulators, for example, identified Robinhood customers who engaged in nearly 100 trades in a single day.[46] It is plainly concerning when users lose themselves in an endless series of investment transactions.[47] It is also possible that some novice investors do harm to themselves when they engage in an especially large and complex transaction. This concern was most vividly demonstrated by the example of a young Robinhood user who committed suicide based on a mistaken belief that he had lost his family's savings in a complex option trade.[48] The optimal regulatory strategy, therefore, is not so simple as deregulating to the level of all comparable activities. Within reason, democratized investing could, and arguably should, have more guardrails than a Netflix subscription. The overarching goal should be to address the distinctive risks of each activity while avoiding particularly jarring differences in overall regulatory scrutiny.

It is at this point in the analysis that the two channels of democratized investing most sharply diverge, with crowdfunding regulation considerably outperforming the regulation of online trading apps, at least when judged by the consistency goal just stated. For purposes of this analysis, the most distinctive feature of crowdfunding regulation is a cap on the amount each individual investor can purchase (the "investor cap"). While Professor Schwartz presents

45. The "coherentist" philosophy is sometimes associated with Richard Dworkin and Ernest Weinrib. *See* Ken Kress, *Why No Judge Should Be a Dworkinian Coherentist*, 77 TEX. L. REV. 1375, 1376 (1999) ("Crudely put, Dworkin's view is that a purported proposition of law is valid if it follows from the most coherent set of principles that explains and justifies the settled, black-letter law.").

46. *See* Cable, *supra* note 5, at 696.

47. For a discussion of how compulsive trading might harm an investor, *see* Tierney, *supra* note 11, at 419–20.

48. Cable, *supra* note 5, at 674–75.

some valid criticisms of the specific form of cap in Regulation CF,[49] the idea is potentially game-changing for protecting retail investors. As I have argued elsewhere, this particular mechanism does an especially good job of allowing space for novice investors while protecting them from catastrophic loss.[50] No doubt, crowdfunding is still a regulated activity, but the SEC has learned to relax a bit when there is just a little mad money at stake.

The regulation of trading apps is another story. State regulators and the SEC have chosen to police ordinary features of contemporary online design.[51] One suspects the brokerage industry will litigate against, or innovate around, these restrictions. I have argued elsewhere that there may be some useful lessons from the example of crowdfunding, and that the SEC might take a more permissive approach with respect to small accounts while reserving more conservative approaches for more financially consequential segments of the market.[52] But that is not the direction of current proposals.

CONCLUSION

In sum, Professor Schwartz provides the definitive account of investment crowdfunding from a traditional corporate finance perspective, and he is justifiably optimistic about this new market's potential benefits. I would only add that individual investment caps, with their unique ability to stop (mostly) harmless enjoyment from becoming problematic behavior, should be featured more prominently as one of crowdfunding's crowning achievements.[53]

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49. I am particularly sympathetic to Professor Schwartz's criticism that the Regulation CF investor cap is convoluted. *See* SCHWARTZ, *supra* note 2, at 125. I am also open to Professor Schwartz's idea of a simplified "per offer" cap (rather than a cap on total crowdfunding investments) and fixed-dollar cap (rather than a cap based on a percentage of wealth or income). *See id.* at 181. I do not necessarily agree with Professor Schwartz's assertion that the SEC was "clearly" correct in exempting accredited investors from the investment cap in its 2020 amendments. *See id.* at 125. Accredited investor status is based on modest wealth standards and does not seem like a particularly good measure of sophistication, access to financial advice, or ability to absorb loss (because an accredited investor can squander his or her entire wealth if exempted from investor caps). *See* Abraham J.B. Cable, *Mad Money: Rethinking Private Placements*, 71 WASH. & LEE L. REV. 2253, 2280, 2291 (2014).

50. *See* Cable, *supra* note 49, at 2298–303 (arguing that investment caps can encourage helpful diversification and liquidity without some of the pitfalls of other private placement mechanisms); Cable, *supra* note 5, at 703–10 (arguing for a form of broker-dealer regulation that would emulate investor caps).

51. *See Proposed Rule*, *supra* note 41.

52. *See* Cable, *supra* note 5, at 703–07 (proposing a safe harbor from some regulations for accounts of $1,000 or less).

53. To be clear, Professor Schwartz does ultimately endorse a form of individual investment cap. But I sense that he does so as a tactical concession to regulators rather

than on the merits. *See* SCHWARTZ, *supra* note 2, at 180–81 (describing investment caps as "not strictly necessary" but potentially useful in "embolden[ing] a jurisdiction to adopt a more liberal regime").