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EQUAL ACCESS TO INVESTMENTS: AT WHOSE EXPENSE?

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I. INTRODUCTION

On June 12, 2020, Alexander E. Kearns “rode to a railroad crossing on his bicycle and ran in front of an incoming train, killing himself.”¹ In the note he left for his family, he stated, “How was a 20-year-old with no income able to get assigned a million dollars’ worth of leverage?”² Kearns’ Robinhood account showed a loss of \$730,165.72 at the time of his death, which did not reflect the reality of his financial position.³ Aside from the misleading nature of Robinhood’s communications to Kearns, the bigger issue was how an amateur trader—with very little background in investing—was allowed to trade high-risk options on a huge margin.⁴

A combination of Fintech and investment opportunities during a period of social isolation imposed by the COVID-19 pandemic created a large influx of inexperienced investors looking to capitalize on the downturn in the stock market as a generational-buying opportunity.⁵ COVID-19 forced many people to succumb to boredom,⁶ which, combined with other factors such as the itch to gamble,⁷ virality,⁸ and

¹ Complaint at ¶ 9, *Kearns v. Robinhood Fin.*, (Super. Ct. of Cal. Feb. 8, 2021), <https://www.courthousenews.com/wp-content/uploads/2021/02/robinhood-1.pdf>.

² *Id.* at ¶ 1; see Bill Brewster @BillBrewsterSCG, TWITTER (June 17, 2020, 12:31 PM), <https://twitter.com/BillBrewsterSCG/status/1273292130769932288> (showing “paragraph 1 of the suicide note”).

³ *Id.* at ¶ 73. (“In reality, Alex did not owe any money; he simply needed to close out his position. Had Robinhood acted responsibly and properly, it either never would have allowed Alex to make these trades he didn’t understand, would not have allowed such an email to be sent (to a young and inexperienced customer, no less), or, at the very least, it would have ensured that someone from the company would respond to Alex to clarify the meaning of the emails.”); see Bill Brewster @BillBrewsterSCG, TWITTER (June 17, 2020 12:31 PM), <https://twitter.com/BillBrewsterSCG/status/1273008513950928896> (showing a screenshot of Alex’s phone).

⁴ Tiziana Celine, *College Student Commits Suicide after Online Trading Platform Robinhood Showed his Negative \$730,000 Debt*, TECH TIMES (June 18, 2020, 4:06 AM), <https://www.techtimes.com/articles/250416/20200618/college-student-commits-suicide-after-online-trading-platform-robinhood-showed-his-negative-730-000-debt.htm> (“According to his family, Kearns had only recently started trading as an antidote to boredom during the pandemic and was enthusiastic as he learned more about the markets and different trading strategies.”).

⁵ *Id.*

⁶ Sydney Ember, *The Boredom Economy*, N.Y. TIMES (Feb. 20, 2021), <https://www.nytimes.com/2021/02/20/business/gamestop-investing-economy.html> (explaining boredom’s economic influence on amateur traders).

⁷ Richard Henderson, *Frustrated Sports Punters Turn to US Stock Market*, FIN. TIMES (May 19, 2020), <https://www.ft.com/content/4be0d6d3-ccab-48df-83e4-0b726273ccac> (“Gamblers who cannot bet on professional sport because fixtures have been scrapped are flocking instead to the US stock market, creating a new class of customer for online brokerages and adding fuel to the market rally.”).

⁸ Ethan Wolff-Mann, *28% of Americans Bought GameStop or Other Viral Stocks in January: Yahoo Finance-Harris Poll*, YAHOO! FIN. (Feb. 9, 2021),

stimulus payments,⁹ helped young people like Kearns discover a newfound interest in the investing space.¹⁰ During the first quarter of 2020, the largest brokerages saw a 150% increase in new traders.¹¹ By early 2021, Robinhood reached approximately 13 million customers on its platform.¹² On January 17, 2021, Robinhood's app was downloaded 120,000 times in a single day.¹³ Moreover, Robinhood was not the only investment platform to experience this boom.¹⁴

In the wake of Kearns' tragic suicide and in light of the exceptional growth of new, generally inexperienced entrants into financial markets, leaders in Congress sent a letter to Robinhood questioning its gamified

<https://finance.yahoo.com/news/gamestop-amc-reddit-investing-213609595.html> (“Over a quarter of American adults say they bought GameStop (GME) or another viral stock in January, according to a new survey from Yahoo Finance and The Harris Poll.”).

⁹ Lorie Konish, *Many Americans Invested their \$1,200 Stimulus Checks. What the Pros Say you Should Know Before you Trade*, CNBC (Aug. 25, 2020, 10:30 AM), <https://www.cnbc.com/2020/08/24/many-people-invested-their-stimulus-cash-what-to-know-before-you-do.html> (“[T]rading was among the more common uses for the \$1,200 stimulus cash. That was especially true for people who earn between \$35,000 and \$75,000 per year, who increased stock trading by 90% in the week after receiving their stimulus checks. Those with annual incomes between \$100,000 to \$150,000 increased trading by 82%, while people earning more than \$150,000 increased that activity by 50%.”).

¹⁰ Regina Ortmann et al., *COVID-19 and Investor Behavior* 5 (Fin. Res. Letters, Working Paper No. 54-04, 2020), <https://ssrn.com/abstract=3589443>.

¹¹ *Id.*; see Matt Phillips, *Trading Sportsbooks for Brokerages, Bored Bettors Wager on Stocks*, N.Y. TIMES (June 14, 2020), <https://www.nytimes.com/2020/06>

[/14/business/sports-gamblers-stocks-virus.html](https://www.nytimes.com/2020/06/14/business/sports-gamblers-stocks-virus.html) (“TD Ameritrade reported a record 608,000 new funded accounts during the first quarter, more than triple last year's pace. Schwab set a record, too, with 609,000 — including 280,000 in March alone. E-Trade had 363,000 new accounts, more than double the same period last year and another record. And in early May, Robinhood said it had added more than three million accounts this year.”).

¹² *Testimony of Vlad Tenev, CEO of Robinhood: Hearing Before the H. Comm. on Fin. Serv.*, 117th Cong. 2 (2021), <https://context-cdn.washingtonpost.com/notes/prod/default/documents/68530c1f-5838-4653-9147-5a342335ea6e/note/a18d56f0-fd03-4dd9-b66b-988ebe166e9f.#page=1> [hereinafter *Tenev Written Testimony*].

¹³ Sarah Perez, *Robinhood and Reddit Top the App Store, as Trading Apps Surge Following GameStop Mania*, TECHCRUNCH (Jan. 28, 2021, 11:05 AM), <https://techcrunch.com/2021/01/28/robinhood-and-reddit-top-the-app-store-as-trading-apps-surge-following-gamestop-mania/?guccounter=1> (“The app store intelligence firm also found that Robinhood had its best day ever in terms of single-day downloads on Wednesday, Jan. 27, 2021 when 120,000 new users downloaded the stocks app for the first time across both iOS and Android. Robinhood also broke records for its highest number of daily active users on mobile at 2.6 million.”).

¹⁴ Avi Salzman, *The Under-40 Set Discovers Day Trading*, BARRONS (June 12, 2020, 6:46 PM), <https://www.barrons.com/articles/young-adults-turn-to-stock-trading-in-the-wake-of-the-markets-march-meltdown-51592001988>.

platform, option approval process, and response to Kearns' death.¹⁵ Congressional leaders also sent a letter to the Financial Industry Regulatory Authority ("FINRA") and the Securities and Exchange Commission ("SEC"), which boiled down to three questions: (1) are FINRA rules being applied inside of Fintech investing companies; (2) is the gamification of investing a concern and is there legal authority to fight it; and (3) are disclosures being properly targeted to young investors?¹⁶

This article focuses on Robinhood's space within the broker-dealer environment, and specifically, whether current regulations and rules apply to Robinhood's platform. Part II introduces Robinhood as a company and looks at how current FINRA rules and SEC regulations are situated to protect the new group of retail investors who are opening self-directed brokerage accounts for the first time. Next, Part III explores how Robinhood's mobile application potentially makes "recommendations" within the current regulatory framework. Finally, Part IV recommends a regulatory framework that balances giving investors equal access to investing tools with adequate protection from casino-style investing platforms.

II. FINRA RULES AT PLAY

A. What is Robinhood?

Robinhood is a brokerage that provides access to financial markets through a mobile-based trading platform.¹⁷ It was founded in 2013 with a self-stated mission to "democratize finance for all,"¹⁸ with the "belief" and "dream" to make "investment more accessible, especially to people

¹⁵ Letter from Congress to Vladimir Tenev & Baiju Bhatt, Co-CEOs, Robinhood (July 13, 2020), <https://underwood.house.gov/sites/underwood.house.gov/files/Underwood%20Letter%20to%20Robinhood%20re%20Investor%20Protections.pdf>.

¹⁶ Letter from Congress to Jay Clayton, Chairman, SEC & Robert W. Cook, CEO, FINRA (Sept. 18, 2020), <https://casten.house.gov/sites/casten.house.gov/files/2020-09-18%20FINRA%20SEC%20ltr%20re%20Online%20Trading%20Platforms%20FINAL.pdf>.

¹⁷ Robinhood Markets, Inc., *Form S-1 Registration Statement 1* (July 1, 2021), <https://www.sec.gov/Archives/edgar/data/1783879/000162828021013318/robinhood-s-1.htm> [hereinafter Robinhood IPO Filing].

¹⁸ Robinhood IPO Filing, *supra* note 17, at 1 ("Our mission is to democratize finance for all. Robinhood was founded on the belief that everyone should be welcome to participate in our financial system. We are creating a modern financial services platform for everyone, regardless of their wealth, income or background."); Reply from Robinhood to Congress, (Aug. 7, 2020) (signed by David Dusseault), <https://s.wsj.net/public/resources/documents/RobinhoodReplyToCongress.pdf> [hereinafter Robinhood Reply].

without a lot of money.”¹⁹ Robinhood has revolutionized commission-free trading by eliminating the financial barriers to entry for first-time retail investors.²⁰ It evolved the idea of social investing,²¹ which puts typical inexperienced investors at the heart of picking “the next great stock.”²² The platform’s original goal was to “put investment advisors out of business and give their jobs to the crowd who can walk each other through smart bets.”²³ Robinhood’s claim at the time was that crowdsourced financial intelligence could predict stock movement better than professionals.²⁴ The average age of a Robinhood user is thirty-one years old,²⁵ and the average account size is \$5,000 with the median account holding a mere \$240.²⁶ This dwarfs other brokerages’ average account sizes, with TD Ameritrade, E-Trade, and Charles Schwab standing at \$110,000, \$100,000, and \$240,000, respectively.²⁷

Robinhood users have self-directed brokerage accounts.²⁸ A self-directed brokerage account is “designed for investors ‘who wish to make their own investment choices in a brokerage account.’”²⁹ In a self-directed account, a brokerage serves only as an executor of the account’s trades and the customer agreement typically contains a statement that the brokerage will not provide any “investment advice, including any recommendations, or offer any opinion regarding the suitability of any security, order, transaction, or strategy in” for such

¹⁹ *Tenev Written Testimony*, *supra* note 12, at 1; *Game Stopped? Who Wins and Loses When Short Sellers, Social Media, and Retail Investors Collide: Hearing on GameStop Part 1 Before the H. Comm. on Fin. Serv.*, (statement of Vladimir Tenev at 18:38), C-SPAN (Feb. 18, 2021), <https://www.c-span.org/video/?508545-1/gamestop-hearing-part-1> [hereinafter *GameStop Hearing Part 1*].

²⁰ *GameStop Hearing Part 1*, *supra* note 19, at 17:32.

²¹ Josh Constine, *Win the Stock Market with Crowdsourced Advice from New App Robinhood*, TECHCRUNCH (Apr. 18, 2013), <https://techcrunch.com/2013/04/18/robinhood-app/> [hereinafter *Constine Win the Stock Market*].

²² Josh Constine, *As Morgan Stanley Buys E-Trade, Robinhood Preps Social Trading*, TECHCRUNCH (Feb. 20, 2020), <https://techcrunch.com/2020/02/20/robinhood-profiles-morgan-stanley-etrade/>.

²³ Constine *Win the Stock Market*, *supra* note 21.

²⁴ *Id.*

²⁵ *Tenev Written Testimony*, *supra* note 12, at 4.

²⁶ *Tenev Written Testimony*, *supra* note 12, at 4.

²⁷ David Curry, *Robinhood Revenue and Usage Statistics (2021)*, BUS. OF APPS (July 11, 2021), <https://www.businessofapps.com/data/robinhood-statistics/> (showing Robinhood’s average account size was \$3500, compared to its peers S– TD Ameritrade (\$110,000), E-Trade (\$100,000), and Charles Schwab (\$240,000)).

²⁸ *Investments You Can Make on Robinhood*, ROBINHOOD, <https://robinhood.com/us/en/support/articles/investments-you-can-make-on-robinhood/> (last visited July 19, 2021).

²⁹ *Valelly v. Merrill Lynch, Pierce, Fenner & Smith Inc.*, 464 F. Supp. 3d 634, 638 (S.D.N.Y. 2020) (citation omitted).

account.³⁰

B. Protections for Self-Directed Brokerage Accounts

There are very few rules that protect investors operating self-directed brokerage accounts.³¹ The securities community maintains a longstanding belief that retail investors are allowed to take as much risk as they want without any protections³²—no matter how inexperienced the investor is—so long as a recommendation is not being made.³³ However, there are two rules that do not rely on a recommendation and apply to self-directed brokerage accounts: FINRA Rule 2090 and

³⁰ *Id.*

³¹ See Frederick Mark Gedicks, *Suitability Claims and Purchases of Unrecommended Securities: An Agency Theory of Broker-Dealer Liability*, 37 ARIZ. ST. L.J. 535, 541-42 (2005) (“[I]n the absence of a recommendation, broker-dealers owe their customers no more than prompt, fair, and effective execution of purchase orders as and when they are received.”).

³² See *Joint Statement Regarding Complex Financial Products and Retail Investors*, SEC (Oct. 18, 2020), <https://www.sec.gov/news/public-statement/clayton-blass-hinman-redfean-complex-financial-products-2020-10-28> (“Regulation Best Interest and an investment adviser’s fiduciary duty do not apply where a retail investor invests on his or her own accord in complex products through a self-directed account.”); see also Tim Foley, *SEC Weighs Protections for Self-Directed Trades*, BL (Dec. 31, 2020, 4:01 AM), <https://news.bloomberglaw.com/securities-law/sec-weighs-protections-for-self-directed-trades>.

³³ The Securities Exchange Commission and FINRA have repeatedly offered no form of protection for self-directed brokerage accounts without the presence of a recommendation. Dating all the way to 1989, in a Release Notice, which stated “[o]ne of the major requirements of the Rule is the suitability determination involved in approving an account for transactions in Designated Securities, and the NASD and other suitability rules have long applied *only to* ‘recommended’ transactions.” S.E.C. Release No. 34-27160 (Aug. 22, 1989) 1989 SEC LEXIS 1603, at p. *51 (emphasis added). In 1996, the NASD issued a notice to its members reaffirming the SEC’s position: “A member’s suitability obligation under Rule 2310 applies *only to* securities that have been recommended by the member. It would not apply, therefore, to situations in which a member acts solely as an order-taker for persons who, on their own initiative, effect transactions *without a recommendation* from the member.” 1996 NASD LEXIS 76, at *2, 1996 Notice to Members 60 (emphasis added). FINRA’s current rule, 2310, modeled after NASD Rule 2310, also “continues to use a broker’s ‘recommendation’ as the *triggering* event for application of the rule.” *SEC Approves Consolidated FINRA Rules Governing Know-Your-Customer and Suitability Obligations*, Regulatory Notice 11-02, FINRA (Oct. 7, 2011), <https://www.finra.org/rules-guidance/notices/11-02> (emphasis added). SEC Reg Best Interest (“Reg BI”) continues to evaluate a recommendation based on principles such as “call to action” and “specific facts and circumstances.” *Regulation Best Interest*, SEC, <https://www.sec.gov/info/smallbus/secg/regulation-best-interest> (last visited July 16, 2021). No subsequent notices have changed such triggering condition, although discount brokerages still lobby for adoption of a rule that would allow for strict immunity without a recommendation. Gedicks, *supra* note 31, at 543.

FINRA Rule 2360.

1. *Know Your Customer: FINRA Rule 2090*

At first glance, Know Your Customer, FINRA Rule 2090 (“KYC”) appears to be an avenue to enforce brokerages’ obligation to understand an investor’s objectives and knowledge upon opening an account. In its 11-02 disclosure, FINRA states “[t]he know-your-customer obligation arises at the beginning of the customer-broker relationship and does not depend on whether the broker has made a recommendation.”³⁴ The rule itself reads:

[E]very capital acquisition broker shall use reasonable diligence to know (and retain) the essential facts concerning every customer and concerning the authority of each person acting on behalf of such customer. For purposes of this Rule, facts “essential” to “knowing the customer” are those required to (a) effectively service the customer, (b) understand the authority of each person acting on behalf of the customer, and (c) comply with applicable laws, regulations, and rules.³⁵

However, courts have carefully noted that KYC does not impose any duty on the broker-dealer beyond obtaining the essential information of their retail customer.³⁶ The essential information does not include the “kind of information necessary to evaluate the suitability of each transaction” when the broker-dealer is a “mere order taker that makes no recommendations to the customer.”³⁷ Generally, reasonable diligence only requires “asking” the customer to supply information (age, identity, social security, etc.).³⁸ KYC was founded as an anti-fraud

³⁴ *Know Your Customer and Suitability: Regulatory Notice 11-02*, FINRA, <https://www.finra.org/sites/default/files/NoticeDocument/p122778.pdf> (last visited July 16, 2021).

³⁵ *Rule 209: Know Your Customer*, FINRA, <https://www.finra.org/rules-guidance/rulebooks/capital-acquisition-broker-rules/209> (last visited July 16, 2021).

³⁶ “To the extent that [defendant] contends the know-your-customer rule implies or creates a duty on the part of the broker to monitor a self-directed customer’s trading for suitability, we reject the contention.” *Peters v. Smith*, No. E058163, 2015 Cal. App. LEXIS 5824, at *35 (Cal. Ct. App. Aug. 13, 2015).

³⁷ *Id.* at *36.

³⁸ *Regulatory Notice 12-25: Additional Guidance on FINRA’s New Suitability Rule*, FINRA (July 9, 2012), <https://www.finra.org/rules-guidance/notices/12-25> (“Although the reasonableness of the effort will depend on the facts and circumstances, asking a customer for the information ordinarily will suffice.”).

and money laundering prevention mechanism,³⁹ so it logically follows that its application is confined to validating identity rather than decision-making protection for retail investors.

In practice, however, KYC has become a simple account opening questionnaire which merely attempts to validate a trader's identity.⁴⁰ In Robinhood's case, this questionnaire is a five-minute mobile "signup" page in which a user clicks "Claim your free stock now" to proceed to the signup process.⁴¹

2. *Opening and Approval of Options Accounts: FINRA Rule 2360(b)(16)*

FINRA Rule 2360 focuses on the rules governing the trading and opening of options accounts.⁴² Options are a risky investment strategy that allows an investor to engage in higher return trading typically accompanied with a margin account.⁴³ Rule 2360 requires a brokerage to do its due diligence on an investor's objective.⁴⁴ Specifically, "[i]n approving a customer's account for options trading, a member or any person associated with a member shall exercise due diligence to ascertain the essential facts relative to the customer, his financial situation and investment objectives."⁴⁵ A survey of FINRA enforcement actions provides little guidance on defining what due diligence requires.⁴⁶ At a minimum, it likely requires an investor to have some investment experience and to have the brokerage explicitly approve their account for option trading.⁴⁷ However, FINRA does not

³⁹ *Know Your Customer*, IDOLOGY, <https://www.idology.com/blog/know-your-customer-kyc-infographic/> (last visited July 16, 2021).

⁴⁰ *See The KYC Process Explained*, SWIFT, <https://www.swift.com/your-needs/financial-crime-cyber-security/know-your-customer-kyc/kyc-process> (last visited July 16, 2021).

⁴¹ ROBINHOOD, https://join.robinhood.com/robinhood/?back_to_signup=1 (last visited July 5, 2021); *see also* Robinhood IPO Filing, *supra* note 17, at 138 (explaining Robinhood's referral program, free stock program, increased marketing cost by \$31.9 million, for the three months ended March 31, 2021, compared to the year prior).

⁴² *Rule 2360: Options*, FINRA, <https://www.finra.org/rules-guidance/rulebooks/finra-rules/2360> (last visited July 16, 2021).

⁴³ *Id.*

⁴⁴ *Id.*

⁴⁵ *Id.*

⁴⁶ Only one reported action discovered after surveying FINRA enforcement actions with keyword "FINRA Rule 2360(b)(16)." e.g., *Department of Enforcement v. Jordon S. Trice*, at 4, (Default Decision), (Aug. 19, 2005) https://www.finra.org/sites/default/files/fda_documents/2012030670603_FDA_JG41633%20%282019-1563070756941%29.pdf.

⁴⁷ *Cf. id.* "In January 2011, customer MC opened a new account at the Firm. MC's new account form indicated that she was a homemaker with no experience with options. MC's account was never approved by anyone at the Firm for any type of

set the amount of verified investment experience to trade options,⁴⁸ and brokerages incorporate their own analysis and eligibility criteria in the approval process.⁴⁹ Notably, FINRA does not require nor define any sort of sophistication or suitability analysis for the options approval process.⁵⁰

An SEC Investor Bulletin outlined what an investor should expect when opening an options account and stated:

[I]n an options agreement, you will need to provide information that will assist your broker in determining your knowledge of options and trading strategies, as well as your general investing knowledge and your financial ability to bear the risks of options trading. Based on the information you provide, your broker will determine whether options trading is suitable for you and, if so, what types of options trading may occur in your account.⁵¹

The SEC seems to insist that a type of suitability analysis must occur before approving options trading.⁵² In a February 2021 Congressional hearing, Robinhood CEO Vladimir Tenev was asked, “what level of sophistication do you think a detailed trader should have before buying options?”⁵³ Tenev responded by saying that there are “strict FINRA rules and regulations governing who gets access to options that, of course, Robinhood complies with.”⁵⁴ However, after Kearns’ death, Robinhood noted that it was considering making several changes to its approval process for options trading.⁵⁵ In response to Congress’

options transactions Accordingly, the Hearing Officer concludes that Trice violated FINRA Rule 2360(b)(16)(A).”

⁴⁸ *Rule 2360*, *supra* note 42.

⁴⁹ *Investor Bulletin: Opening an Options Account*, SEC (emphasis added), sec.gov/oiea/investor-alerts-bulletins/ib_openingoptionsaccount.html (last updated Feb. 6, 2017).

⁵⁰ *Id.*

⁵¹ *Id.*

⁵² *Id.*

⁵³ *Game Stopped? Who Wins and Loses When Short Sellers, Social Media, and Retail Investors Collide: Hearing on GameStop Part 2 Before the H. Comm. on Fin. Serv.* (statement of Rep. Jake Auchincloss at 2:45:37-43), C-SPAN (Feb. 18, 2021), <https://www.c-span.org/video/?508545-2/gamestop-hearing-part-2>. [hereinafter *GameStop Hearing Part 2*].

⁵⁴ *Id.* at 2:45:47-54 (statement of Vladimir Tenev).

⁵⁵ Vladimir Tenev & Baiju Bhatt, *Commitments to Improving Our Options Offering*, ROBINHOOD (June 19, 2020), <https://blog.robinhood.com/news/2020/6/>

question, Robinhood reported that it would implement “additional criteria for customers seeking Level 3 options authorization, which includes spreads trades. For example, [Robinhood is] considering enhanced financial requirements for Level 3 options trading access.”⁵⁶

In reality, the due diligence requirement in Rule 2360 functions similarly to the reasonable diligence requirement in the KYC rule.⁵⁷ The due diligence requirement only modifies information acquisition and does not require a sophistication analysis.⁵⁸ Tenev described this process in his testimony to Congress:

[W]ith respect to options trading, under FINRA rules, broker-dealers are required to collect certain information about a customer to determine whether to approve that customer’s request to trade options. Specifically, Robinhood requires customers to disclose, among other things, stated investment experience and knowledge, age, investment objectives, employment status, estimated annual income from all sources, estimated net worth, estimated liquid net worth, and number of dependents. Robinhood conducts an assessment of

19/commitments-to-improving-our-options-offering (“We are considering additional criteria and education for customers seeking level 3 options authorization to help ensure customers understand more sophisticated options trading.”).

⁵⁶ Robinhood Reply, *supra* note 18, at 9; see *Regulatory Notice 12-44: Margin Requirements*, FINRA (Oct. 2012) <https://www.finra.org/rules-guidance/notices/21-15>. <https://www.finra.org/sites/default/files/NoticeDocument/p193921.pdf> (“In general, option spread strategies allow investors to realize limited reward in exchange for limited risk, and consist of combinations of “long” and “short” call option contracts or put option contracts or combinations of call and put option contracts. Option spreads can be paired in such ways that they offset each other in terms of risk. The total risk of the combined spreads is less than the sum of the risk of such spread positions if viewed as stand-alone strategies.”).

⁵⁷ It requires a brokerage to *gather* user-reported information. *Regulatory Notice 21-15: FINRA Reminds Members About Options Account Approval, Supervision and Margin Requirements*, FINRA (Apr. 9, 2021), <https://www.finra.org/rules-guidance/notices/21-15>.

⁵⁸ *Id.* at n.6. The term sophistication analysis refers to a broker firm’s undertaking in analyzing a customer’s level of education and experience in trading options to gauge what type of options is appropriate for them. See *generally* Chang, Chuang-Chang, et al. “Sophistication, Sentiment, and Misreaction.” *The Journal of Financial and Quantitative Analysis*, vol. 50, no. 4, [Cambridge University Press, University of Washington School of Business Administration], 2015, pp. 903, 926, <http://www.jstor.org/stable/43862278> (“[O]ur findings confirm that the anomalies in the options market are largely dependent on the level of sophistication of the associated investors and that investor sentiment affects the strength of these anomalies.”).

information collected in deciding whether to approve a customer account for options trading.⁵⁹

Note that Tenev's testimony never describes the standards that Robinhood applies in approving options trading. Tenev refers to "strict" FINRA rules, while the standard, assessment, and sophistication analysis is set by the brokerage itself, not by FINRA.

In a complaint against Robinhood filed by the Massachusetts Securities Division on December 15, 2020,⁶⁰ Massachusetts described a lax approval process for Robinhood users who wished to engage in options activity.⁶¹ The complaint stated, "out of the more than 71,744 Massachusetts residents that Robinhood identified as being approved for options trading during the Relevant Time Period, at least 14,439 customers had *no investment experience* and 34,374 customers had *limited investment experience*."⁶² Users on Reddit reported a similar sentiment, stating that they filled out a quick questionnaire and typically received instant approval for options trading despite having very little investment experience.⁶³ Robinhood does not appear verify a customer's actual investment knowledge and only performs an assessment based on self-reported data.⁶⁴

Additionally, on April 9, 2021, FINRA released Regulatory Notice 21-15 "reminding [broker-dealers] about options accounts approval, supervision, and margin requirements."⁶⁵ The guidance pushes towards a requirement for a more in-depth eligibility analysis by brokerages stating:

[FINRA Rule 2360(b)(16)] sets forth the steps that must be taken as part of that approval. [The rule] requires a member to exercise due diligence to ascertain the essential facts relative to the customer. Specifically, the

⁵⁹ *Tenev Written Testimony*, *supra* note 12 at 4.

⁶⁰ Administrative Complaint, In the Matter of: Robinhood Fin., LLC, (Mass. Sec. Div. Dec. 16, 2020), No. E-2020-0047, 2020 WL 7711667 [hereinafter *Mass. Complaint*].

⁶¹ *Id.*

⁶² *Id.* at *5 (emphasis added).

⁶³ See Financial Industry Regulatory Authority Letter of Acceptance, Waiver, and Consent No. 2020066971201, <https://www.finra.org/sites/default/files/2021-06/robinhood-financial-awc-063021.pdf> [hereinafter *FINRA AWR*]; \Getting Approved Options, REDDIT, (r/RobinhoodOptions) https://www.reddit.com/r/RobinhoodOptions/comments/gakwjs/getting_approved_for_options (showing a discussion among redditors on the ease of getting approved for option trading and how other brokers are less "lenient.").

⁶⁴ *Id.* at 17, 26-27.

⁶⁵ *Regulatory Notice 21-15*, *supra* note 57.

member must seek to obtain and consider detailed customer information, including, among others, the customer's knowledge, investment experience, age, financial situation and investment objectives. Based upon this information the member must determine whether it is appropriate to approve the customer to trade options. This approval process must consider the appropriateness of the full range of options trading being approved for the customer. . . . Members are responsible for establishing policies and procedures for options account approval, based on the information provided by the customer and consistent with the firm's supervisory framework. . . . Members must also verify the background and financial information by giving the customer the opportunity to correct any information.⁶⁶

FINRA does not define "appropriate" in its guidance. However, it does allude to possible stricter enforcement actions for due diligence in the options approval process. FINRA may be leaning towards expanding Rule 2360's interpretation of due diligence or creating new rules in the future around this issue.⁶⁷ Yet, the guidance continues to reinforce the principle that brokerages are on their own regarding approval standards,⁶⁸ which is a precarious situation because the only way brokerages can know what FINRA expects of them is through enforcement actions.⁶⁹

This principle was exemplified in FINRA's Letter of Acceptance, Waiver, and Consent ("AWR") action against Robinhood. Notably, a SEC filing from Robinhood in February 2021 foreshadowed FINRA's AWR. Robinhood reported:

[T]he SEC staff is conducting an examination, and FINRA and certain state regulatory authorities are conducting investigations, regarding RHF's options trading and related customer communications and displays. The SEC staff, FINRA staff and staff of such state regulatory authorities are reviewing, among other things, how RHF displays cash and buying power to

⁶⁶ *Id.* (emphasis added).

⁶⁷ *Id.*

⁶⁸ *Id.*

⁶⁹ *Enforcement*, FINRA (2021), <https://www.finra.org/rules-guidance/enforcement>.

customers and its options trading approval processes. RHF is cooperating with the regulators' requests.⁷⁰

On June 30, 2021, FINRA concluded its investigation and issued financial penalties against Robinhood in a record amount.⁷¹ The FINRA AWR letter revealed some of Robinhood's practices that did not meet the due diligence standard under Rule 2360.⁷²

In summary, pertaining to the options approval process of the settlement:

FINRA found that since Robinhood began offering options trading to customers in December 2017, the firm has failed to exercise due diligence before approving customers to place options trades. The firm relied on algorithms—known at Robinhood as “option account approval bots”—to approve customers for options trading, with only limited oversight by firm principals. Those bots often approved customers to trade options based on inconsistent or illogical information. As a result, Robinhood approved thousands of customers for options trading who either did not satisfy the firm's eligibility criteria or whose accounts contained red flags indicating that options trading may not have been appropriate for them.⁷³

Here, FINRA notified brokerages of two things: (1) a firm's self-set eligibility criteria must be satisfied when approving options; and (2) red flags indicating lack of appropriateness to trade options may be enforceable.⁷⁴ The charges against Robinhood—explored in FINRA's AWR—present a quasi-compliance guide, outlining what likely does

⁷⁰ *Annual Audited Report*, ROBINHOOD FIN., LLC (Dec. 31, 2020) (emphasis added), <https://www.sec.gov/Archives/edgar/data/1561014/000162828021003429/fy20rhfshortfinal.pdf>.

⁷¹ *FINRA Orders Record Financial Penalties Against Robinhood Financial LLC*, FINRA (June 30, 2021), <https://www.finra.org/media-center/newsreleases/2021/finra-orders-record-financial-penalties-against-robinhood-financial> (“FINRA [] fined Robinhood Financial LLC \$57 million and ordered the firm to pay approximately \$12.6 million in restitution, plus interest, to thousands of harmed customers. The sanctions represent the largest financial penalty ever ordered by FINRA and reflect the scope and seriousness of the violations.”).

⁷² *Id.*

⁷³ FINRA AWR, *supra* note 63.

⁷⁴ *Id.* at 4.

not amount to due diligence.⁷⁵ The AWR gives an instructive list of some of its findings:

- Robinhood’s system for approving customers for options trading does not consider all information available to the firm.
- Robinhood conducts minimal review of its automated system for options approval.
- Robinhood has approved customers for options trading who have not satisfied the firm’s eligibility criteria or whose accounts have contained red flags that options trading was not appropriate.
- Robinhood approved customers to trade options even when other information available to the firm raised red flags that options trading was not appropriate for them.⁷⁶

FINRA’s AWR will likely put companies like Robinhood on notice of the level of attention required in the option approval process for brokerages. Still, the AWR leaves much to be desired as far as what is “appropriate,” what counts as “limited oversight,” and if there are minimum criteria for “eligibility requirements.”

III. DOES ROBINHOOD’S PLATFORM MAKE RECOMMENDATIONS?⁷⁷

As described above, FINRA rules and SEC regulations do little to protect investors in self-directed brokerage accounts. Courts, enforcement actions, and regulatory guidance have consistently protected broker-dealers from the bad investment decisions of independent traders on their platforms.⁷⁸ Lawsuits filed against

⁷⁵ *Id.* at 3-4, 17.

⁷⁶ *Id.* at 17-20.

⁷⁷ Mass. Complaint, *supra* note 60, at *8. (“Robinhood does make recommendations of trading strategies and investment plans that would bring it within the purview of the Rule by, among other things, encouraging frequent trading, encouraging and repeatedly offering options trading, rewarding customers for frequent trading, publishing and sending to customers lists of popular stocks or stocks that are moving price-wise, and similar actions.”); In Robinhood’s IPO filing, under one of its risk factors, it states “[a]pplication of fiduciary or best interest standards (including the interpretation of what constitutes an “investment recommendation” for the purposes of the SEC’s “Regulation Best Interest” and state securities laws) . . . increase our costs and damage our reputation.” Robinhood IPO Filing, *supra* note 17, at 45.

⁷⁸ *See, e.g.*, In re Thomas E. Warren, III, 51 S.E.C. 1015, 1019 n.19 (1994) (“We do not believe the suitability claims brought against the Applicant are supported by the record. There is no evidence that Warren recommended the transactions that were effected in these accounts.”), *aff’d*, 69 F.3d 549 (10th Cir. 1995); *Peters v. Smith*, No. E058163, 2015 Cal. App. LEXIS 5824, *30 (Cal. App. 4th Dist. Aug. 13, 2015)

Robinhood have explored legal theories that attempt to break down the existing broker-dealer protections and find alternative ways to force a heightened requirement to protect inexperienced investors—based on a “duty of care” and “negligence”—trading certain securities.⁷⁹ However, these arguments will likely fail, and the real question becomes whether or not Robinhood’s platform and the technological communications therein serve as a recommendation to its users.

A. What is a Recommendation?

In 1996, the National Association of Securities Dealers (“NASD”) stated that transactions “will be considered to be recommended when the member or its associated person brings a specific security to the attention of the customer through any means, including, but not limited to, direct telephone communication, the delivery of promotional material through the mail, or the transmission of electronic messages.”⁸⁰ In 2001, “in light of the dramatic increase in the use of communication between broker/dealers and their customers” the NASD issued a Notice to Members that created guidelines for what would be and would not be considered a recommendation.⁸¹ These guidelines have remained relevant since.

The existence of a recommendation “has always been based on the facts and circumstances of the particular case.”⁸² FINRA has refused to explicitly define what a recommendation is because—in its words—it would be “unnecessary and would raise many complex issues.”⁸³ Put differently, regulators do not like to put a square peg into a round hole. If the term “recommendation” were simply defined, then enforcement would be limited and the word would not have the elasticity to adapt to the changing broker-dealer environment.

(“Based on the foregoing, in order for Peters to have a meritorious claim against Scottrade based on unsuitability, she would need to show that her imprudent trading decisions were based on Scottrade’s recommendations.”).

⁷⁹ One lawsuit argues because Robinhood is “deliberately engineered” to target young investors, it owed a duty to inform its users of what a T1 halt was when those users bought Hertz during such halt and subsequently lost money. Complaint at 2, *Pinchasov et al. v. Robinhood Fin. LLC*, No. 1:20cv24897, 2021 US. Dist. LEXIS (S.D. Fla. Nov. 30, 2020), <https://www.classaction.org/media/pinchasov-v-robinhood-financial-llc.pdf>.

⁸⁰ NASD Notice to Members 96-60 (Sept. 1996) [1996 NASD LEXIS 76, at *2].

⁸¹ *NASD Notice to Members 01-23: Suitability Rule and Online Communications*, FINRA, (Apr. 2001), <https://www.finra.org/rules-guidance/notices/01-23> [hereinafter *FINRA 2001 Notice*].

⁸² Regulatory Notice 11-02, *supra* note 34.

⁸³ *Id.* at 7 n.10.

One guiding principle underlies this inquiry: would the communication be “viewed as ‘call to action,’ or suggestion that the customer engages in a securities transaction?”⁸⁴ Such an inquiry “requires an analysis of the content, context, and presentation of the particular communication.”⁸⁵ Factors previously considered by the SEC in determining if a recommendation is made are: (1) the nature and relationship between dealer and his customer; (2) reliance on dealer; (3) nature of specific communications; and (4) initiation of the subject.⁸⁶ In *Siegel v. SEC*,⁸⁷ the D.C. Circuit approved of these factors in ultimately analyzing whether the “communications with the [customer] could be perceived by a reasonable person in the [customer’s] position as a suggestion to invest.”⁸⁸

On June 5, 2019, the SEC adopted Regulation Best Interest (“Reg BI”) under the Securities Exchange Act of 1934 (“Exchange Act”).⁸⁹ “Reg BI established a ‘best interest’ standard of conduct for broker-dealers and associated persons when they make a recommendation *to a retail customer of any securities transaction or investment strategy involving securities, including recommendations of types of accounts.*”⁹⁰ “Among other things, Reg BI incorporates and enhances principles that are also found in FINRA Rule 2111 Suitability.”⁹¹ FINRA stated that Rule 2111 “does not apply to recommendations that are subject to Reg BI.”⁹² Regulation BI adopted similar guidelines on recommendations and will not define it with a “bright line” rule.⁹³

⁸⁴ FINRA 2001 Notice, *supra* note 81 (“Members should bear in mind that an analysis of the content, context, and manner of presentation of a communication requires examination of the underlying substantive information transmitted to the customer and consideration of any other facts and circumstances, such as any accompanying explanatory message from the broker/dealer.”).

⁸⁵ Michael Frederick Siegel, Exchange Act Release No. 58737, at 10 (Oct. 6, 2008).

⁸⁶ *Id.*

⁸⁷ *Siegel v. SEC*, 592 F.3d 147, 149 (D.C. Cir. 2010).

⁸⁸ *Id.* at 149–155.

⁸⁹ 17 C.F.R. § 240.151-1 (2019).

⁹⁰ *SEC Regulation Best Interest (Reg BI)*, FINRA, <https://www.finra.org/rules-guidance/key-topics/regulation-best-interest> (last visited Apr. 14, 2021) (emphasis added).

⁹¹ *Regulatory Notice 20-18: Reg BI-Related Changes to FINRA Rules*, FINRA (June 19, 2020), <https://www.finra.org/sites/default/files/2020-06/Regulatory-Notice-20-18.pdf>.

⁹² *Id.*

⁹³ *Regulation Best Interest: A Small Entity Compliance Guide*, S.E.C., <https://www.sec.gov/info/smallbus/secg/regulation-best-interest> (“The determination of whether a broker-dealer has made a recommendation that triggers application of Regulation Best Interest turns on the facts and circumstances of a particular situation, and therefore, whether a recommendation has been made is not susceptible to a bright line definition. Factors considered in determining whether a recommendation has

Without clear additional guidance on how Reg BI will differ from past interpretations the recommendation rule, this article will apply some of the previous guidelines and enforcement actions defining recommendation under FINRA and NASD rules. However, if a recommendation is made by Robinhood to its users, the suitability standard is inapplicable, and a stricter REG BI analysis would apply instead.

B. Can Communications within Robinhood’s Platform be Considered a Recommendation?

Any recommendation inquiry starts with the “facts and circumstances.”⁹⁴ In Robinhood’s response to Kearns’ death, its co-founders wrote:

[I]t is not lost upon us that our company and our service have become synonymous with retail investing in America and that this has led to *millions of new investors making their first investments* through Robinhood. We recognize this profound responsibility, and we don’t take it lightly. Our aspiration is to innovate, lead, and go beyond the status quo.⁹⁵

From its infancy, Robinhood praised itself for providing equal access to investments for all people.⁹⁶ With its commission-free trading platform, no minimum deposit, and some of the lightest eligibility and sophistication requirements seen in the brokerage world for options and margin trading,⁹⁷ the normal barriers to entry for small-time investors vanished.⁹⁸ Young adults—obsessed with opening loot boxes on video

taken place include whether the communication “reasonably could be viewed as a ‘call to action’” and “reasonably would influence an investor to trade a particular security or group of securities.”) (last updated Sept. 23, 2019).

⁹⁴ *Id.*

⁹⁵ Tenev & Bhatt, *supra* note 55 (emphasis added).

⁹⁶ Kane Pepi, *Robinhood Review 2021 – Pros & Cons Revealed*, TRADINGPLATFORMS (July 16, 2021), <https://tradingplatforms.com/robinhood-review/>.

⁹⁷ *Id.*

⁹⁸ See Brad M. Barber et al., *Attention Induced Trading and Returns: Evidence from Robinhood Users* 1 (Feb. 2, 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3715077.

games during their childhood—⁹⁹ discovered a gambling casino in Robinhood’s platform.¹⁰⁰

The trail Robinhood’s knowledge starts with its userbase. For the most part, Robinhood users do not fare well in the market.¹⁰¹ A Barclay’s note, using data from Robintrack.net,¹⁰² found that “more Robinhood customers moving into a stock has corresponded to lower returns, rather than higher.”¹⁰³ The note also found that a negative correlation exists between daily holding changes and daily returns.¹⁰⁴

These findings were reiterated by a research paper co-authored by behavioral finance expert Brad Barber, of University of California, Davis, Graduate School of Management.

[U]sing data from Robinhood, we find that Robinhood investors engage in more attention-induced trading than other retail investors, and Robinhood outages disproportionately reduce trading in high-attention stocks. The evidence is consistent with Robinhood attracting relatively inexperienced investors. However, we show that it can also be *partially driven by the app’s unique features*. Consistent with models of attention-induced trading, intense buying by Robinhood users forecast negative returns. Average 20-day abnormal returns are -4.7% (-19.6%) for the top stocks purchased each day (extreme herding events).¹⁰⁵

Robinhood published data for over two years that showed the number of customers who held a particular stock on Robinhood.¹⁰⁶ A site called

⁹⁹ Isobel Asher Hamilton, *There’s a Debate Raging in Video Games over Whether Loot Boxes Should be Classified as Gambling*, INSIDER (Jul 5, 2020, 5:22 AM), <https://www.businessinsider.com/classifying-video-game-loot-boxes-as-gambling-2020-7> (“[T]here is a correlation between spending money on loot boxes and problem gambling.”).

¹⁰⁰ See generally, *GameStop Hearing Part 2*, *supra* note 53.

¹⁰¹ Michael Wursthorn, Mischa Frankl-Duval & Gregory Zuckerman, *Everyone’s a Day Trader Now*, WALL ST. J. (July 25, 2020, 12:01 AM), <https://www.wsj.com/articles/everyones-a-day-trader-now-11595649609> (“Barclays examined trades by Robinhood customers between March and early June and concluded that the more they bought a specific stock, the worse that stock performed.”).

¹⁰² ROBINTRACK, <https://robintrack.net/> (last visited Aug. 22, 2021).

¹⁰³ John McCrank & David Randall, *Robinhood users’ favorite stocks roar back after selloff*, REUTERS (June 12, 2020, 1:24 PM), <https://www.reuters.com/article/Aerospace/idINKBN23J2MR?edition-redirect=ca> (quoting Barclay’s note).

¹⁰⁴ *Id.*

¹⁰⁵ Barber et al., *supra* note 98 (emphasis added).

¹⁰⁶ Jeff J. Roberts, *Robinhood Will No Longer Share Stock ‘Popularity Data’ with Sites Like Robintrack*, FORTUNE (Aug. 10, 2020, 3:04 PM),

Robintrack.net would aggregate and graph that data to make it easy for researchers and financial analysts to use.¹⁰⁷ Robinhood eliminated the feature in August of 2020, stating that most of its userbase is “buy and hold” investors and “thoughtful participants in the markets.”¹⁰⁸ In a Senate Hearing in February 2021, Tenev repeated this claim multiple times,¹⁰⁹ evidenced by a low percentage of active options trading within its platform.¹¹⁰

In reality, Robinhood’s own data about its userbase’s investment decisions allowed researchers to conclude that users were inexperienced investors making decisions that ultimately resulted in negative returns.¹¹¹ Robinhood, faced with this reality, shut down the disclosure of its data that allowed *Robintrack.net* to aggregate and graph information.¹¹² This suggests Robinhood knows two essential facts: 1) its userbase is filled with amateur investors making their “first investments;” and 2) its userbase is filled with traders who are more apt to be induced to trade in momentum events by Robinhood’s “unique features.”¹¹³

<https://fortune.com/2020/08/10/robinhood-popularity-data-robintrack-stock-market-trading-tracker/>.

¹⁰⁷ *Id.*

¹⁰⁸ *Id.* (“[A] [Robinhood] spokesperson stressed that the majority of the site’s users were ‘buy and hold’ investors who acted as ‘thoughtful participants in the markets.’”); *see also GameStop Hearing Part 1, supra* note 19 (statement of Vladimir Tenev at 1:22:14 & 1:32:11), (stating “the vast majority of our customers are engaging in buy and hold activities and long-term investing on our platform,” and “[m]ost people use Robinhood to build up portfolios over time”).

¹⁰⁹ *GameStop Hearing Part 1, supra* note 19 (statement of Vladimir Tenev at 00:18:50, 01:22:14, & 01:32:11).

¹¹⁰ About thirteen percent of Robinhood users option trade. *Tenev Written Testimony, supra* note 12, at 3. However, option trading activity is one small variable when analyzing whether customers are “buy and hold.” can be short-term traders in regular security buying, just as they can be in option trading. Vladimir Tenev said in a 2017 interview that Robinhood users, “trade a little bit more than sort of the average customer of a typical online brokerage.” *The NYSE is ‘Basically A Museum’: Robinhood’s Tenev on the Road Ahead and the Startup’s Plan to Make Money*, CBINSIGHTS (June 29, 2017), <https://www.cbinsights.com/research/robinhood-brokerage-customer-services-revenues-future-fintech/>.

¹¹¹ *See generally* Barber et al., *supra* note 98 (using Robinhood data, authors determined that ultimate negative returns were due to relatively inexperienced users as well as attention-induced trading).

¹¹² Roberts, *supra* note 106.

¹¹³ *See, e.g.,* Mass. Complaint, *supra* note 60 at *8 (“During the Relevant Time Period, at least 241 Robinhood customers with no investment experience averaged at least 5 trades per day on Robinhood’s trading platform.”).

1. *Robinhood's Lists*

A number of key features of Robinhood's app raise questions about whether recommendations are being made. For example, Robinhood curates lists for the benefit of its userbase.¹¹⁴ Of note are the "Most Popular 100 List" and "Top Movers List." NASD selected guidelines, which came from the quick evolution of technology as means to communicate in 2001,¹¹⁵ are applicable for evaluating these lists as a possible form of recommendation.¹¹⁶ This article focuses on the selected guidelines below:

Regulators believe that members should consider, at a minimum, the following guidelines when evaluating their suitability obligations:

- Members should scrutinize any communication to a customer that suggests the purchase, sale, or exchange of a security—as opposed to simply providing objective data about a security—to determine whether a "recommendation" is being made.
- Members should be aware that the degree to which the communication reasonably would influence an investor to trade a particular security or group of securities—either through the context or manner of presentation or the language used in the communication—may be considered in determining whether a "recommendation" is being made to the customer?¹¹⁷

Additionally, NASD Regulations generally view the following communications as falling within the definition of "recommendation":

¹¹⁴ See *id* at *3 ("Robinhood provides lists of securities on its application, including lists of the most-traded securities on Robinhood's platform and the most popular securities traded by Robinhood customers. This no different from a broker-dealer agent handing a list of securities to a customer, pretending to be surprised when the customer purchases securities from that list, and then proclaiming that he made no recommendation to the customer.").

¹¹⁵ FINRA 2001 Notice, *supra* note 81.

¹¹⁶ After June 5, 2019, the SEC adopted 17 C.F.R. § 240.151-1 (2019), making such broker-dealer conduct is subject to Reg BI. See *Reg BI-Related Changes*, *supra* note 91 (noting that these guidelines are not binding, and a REG BI analysis would now apply in these situations).

¹¹⁷ FINRA 2001 Notice, *supra* note 81.

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- A member sends a customer specific electronic communication (e.g., an e-mail or pop-up screen) to a targeted customer or targeted group of customers encouraging the particular customer(s) to purchase a security.
 - A member sends its customers an e-mail stating that customers should be invested in stocks from a particular sector (such as technology) and urges customers to purchase one or more stocks from a list with “buy” recommendations.
 - A member uses data-mining technology (the electronic collection of information on Web Site users) to analyze a customer’s financial or online activity—whether or not known by the customer—and then, based on those observations, sends (or “pushes”) specific investment suggestions that the customer purchase or sell a security.¹¹⁸

Lists such as the “100 Most Popular List” went beyond providing objective data.¹¹⁹ Objective data is the financials of a company and its stock price.¹²⁰ Robinhood’s “Most Popular” list is a curated list based on the subjective decision making of its own userbase—comprised of amateur investors making investment decisions for the first time¹²¹—and its holdings,¹²² which then provides objective data on the companies its users hold in concentration.¹²³

Although a list such as the “Top Movers List” uses objective data about a stock’s price direction, it displays the information in a way that highlights both downward movement and upward movement without any delineation between the two. The comingling of sorting methods is described below:

¹¹⁸ *Id.* at 3.

¹¹⁹ Robinhood’s “100 Most Popular List” lists (i) the company name, (ii) the stock symbol, (iii) the stock price, (iv) the stock’s daily movement, and (v) the stock’s market cap. *See 100 Most Popular*, ROBINHOOD, <https://robinhood.com/lists/robinhood/e8ef4c1f-244f-4db5-a582-c4c37f3c8e8e> (last visited July 19, 2021).

¹²⁰ *See* Becky Hayman, *Subjective Versus Objective*, YOU CAN TRADE, <https://www.youcantrade.com/subjective-vs-objective/> (last visited July 20, 2021).

¹²¹ Mass. Complaint, *supra* note 60, at *4.

¹²² *Id.* at *15

¹²³ *Id.*

[T]he default sorting is based on the absolute returns and thus mixes top gainers and top losers. This feature differs from almost all other media accounts (e.g., Wall Street Journal, Yahoo! Finance, CNBC, etc.) that also report the top movers but separate the top gainers and top losers rather than mixing them together.¹²⁴

Using Robinhood's own published data, research suggests that the "unique way" Robinhood displays the "Top Movers List" influences "attention-induced trading" and herding events.¹²⁵

Nevertheless, whether the curation and publication of these two lists constitute a recommendation is not a certainty. In a notice regarding Reg BI, the SEC stated that "the more individually tailored the communication to a specific customer or targeted group of customers about a security or group of securities, the greater the likelihood that the communication may be viewed as a 'recommendation.'"¹²⁶ A list is a form of data that is not directed at individuals but all customers, viewable by a user logging in and, previously, the public at large.¹²⁷

However, as reported in the Massachusetts complaint, customers can "receive a push notification" that directs them to both the "Top Movers List" and "100 Most Popular List"¹²⁸ without any action or prior trading on the customer's part.¹²⁹ This interaction between Robinhood and its user is described in the Massachusetts complaint below.

[A] customer that has not yet traded in their account may receive a push notification that states: "Top Movers: Choosing stocks is hard. [flexing bicep emoji] Get started by checking which stock prices are changing the most." Upon clicking on the push notification, the customer redirects to the aforementioned Top Movers list. Customers may also receive a push notification that states, "Popular Stocks: Can't decide which stocks to buy? [thinking emoji] Check out the most popular stocks on Robinhood." Upon clicking on the push notification, the customer redirects to the

¹²⁴ Barber et al., *supra* note 98, at 13.

¹²⁵ *Id.* at 3 ("[E]vidence indicates the Robinhood app affects the intensity of this behavior because of the unique way Robinhood displays the "Top Mover" list.").

¹²⁶ *Regulation Best Interest: A Small Entity Compliance Guide*, *supra* note 90.

¹²⁷ See *Robinhood May Be Liable if You Lose Money Based on its Recommendations*, STOCK MARKET LOSS (Feb. 11, 2021), <https://www.stockmarketloss.com/securities-law/robinhood-may-be-liable-if-you-lose-money-based-on-its-recommendations/>.

¹²⁸ Mass. Complaint, *supra* note 60, at *18.

¹²⁹ *Id.* at 14.

aforementioned 100 Most Popular list.¹³⁰

If these allegations are true, they increase the chance that the communication becomes targeted at a specific customer, making the universality of the access to the list less important. Additionally, if Robinhood is using data mining to keep track of users' engagement within its mobile platform and then—using that data—pushes these notifications onto users who have not begun trading,¹³¹ the push notification comes very close to meeting the NASD “communications [that fall] within the definition of [a] recommendation.”¹³² The words such as “get started” and “check out” could “reasonably influence” an investor to trade the stocks directed towards them.

Furthermore, the factors laid out in the SEC's released opinion in the matter of *Siegel* point towards finding that a recommendation has been made.¹³³ Research suggests that Robinhood users are influenced by the lists within the app and more likely trade with reliance on these lists.¹³⁴ For a person with little to no investment experience opening an account for the first time, it is highly likely they would rely on Robinhood's subjective lists in making their investment decision, especially if those lists are pushed directly to their phone. Additionally, because a large part of Robinhood's userbase consists of new investors,¹³⁵ the list could serve as an initiation of the specific securities to the customer.¹³⁶ Therefore, these lists could serve as a “call to action” to specific stocks users own and trade within the platform, which, in light of Robinhood's own previously published data, suggests the lists are an “unusual factor” causing an increase in trades.¹³⁷ Although

¹³⁰ *Id.*

¹³¹ *See Robinhood May Be Liable, supra* note 127 (“Robinhood has allegedly been engaging in data mining and sending targeted communications to customers who aren't trading enough, in an effort to promote trading.”)

¹³² *See id.* (“Robinhood's push notifications are undoubtedly calls to action targeting select customers. As such, they are exactly the sorts of communications NASD said in 2001 would be considered recommendations.”)

¹³³ *In re Application of Michael Frederick Siegel*, Exchange Act Release No. 58737 (October 6, 2008).

¹³⁴ Barber et al., *supra* note 98.

¹³⁵ Robinhood IPO Filing, *supra* note 17, at 174.

¹³⁶ *In SEC's Opinion of the Commission*, the SEC noted the trader had “never heard of the security” and the broker was “the sole source of information of the company.” *Id.* at 10. It is very possible a brand-new user's sole source of information or awareness of a company could be from being alerted and directed to a Robinhood list by a “push notification.”

¹³⁷ Barber et al., *supra* note 98. “Using Robinhood trading as a proxy for attention-induced herding episodes, we find strong support for the return predictions of attention-based models of trading. Specifically, we link episodes of intense buying by Robinhood users to negative returns following the herding episodes.”

Robinhood discloses on its various lists that the lists are not “[i]ntended to serve as a recommendation to buy or sell any security[.]”¹³⁸ FINRA has stated that “[a] member cannot avoid or discharge its suitability obligation through a disclaimer.”¹³⁹

2. *Recommendation for Option Trading*

Under FINRA Rule 2360(b)(19)(B), a registered representative must have “a reasonable basis for believing” that a customer has requisite “knowledge and experience in financial matters that he may reasonably be expected to be capable of evaluating the risks of the recommended transaction and is financially able to bear the risks of the recommended position in the option contract.”¹⁴⁰ Robinhood admittedly advertises and encourages specific users to options trade within its platform.¹⁴¹ However, a legal gray area exists when Robinhood promotes options trading at the time users are putting stop, limit, and stop-limit orders on an individual stock.¹⁴² In Robinhood’s reply to Congress it articulated the timing of their promotion of option trades to customers, as described below.

[E]xisting customers also receive notices through the app concerning the possibility of trading options, subject to approval, when they access their account menu tab or when certain customers seek to change their order type (e.g., stop order, limit order, stop-limit order, etc.) from the default type for a stock order.¹⁴³

¹³⁸ *Web Disclosures*, ROBINHOOD, <https://cdn.robinhood.com/disclosures/WebDisclosures.pdf>, (last visited July 21, 2021).

¹³⁹ *Notice to Members 01-23*, RULES & GUIDANCE: FIN. INDUS. REGUL. AUTH., INC., <https://www.finra.org/rules-guidance/notices/01-23> (last visited Aug. 22, 2021).

¹⁴⁰ Rule 2360(b)(19)(B), 2360. *Options*, RULES & GUIDANCE: FIN. INDUS. REGUL. AUTH., INC., <https://www.finra.org/rules-guidance/rulebooks/finra-rules/2360> (last visited July 21, 2021).

¹⁴¹ Robinhood Reply, *supra* note 18, at 7 (“For example, at account opening, customers who indicate in the app that they have significant investment experience (e.g., by selecting “I’m an expert”) are asked if they are interested in commission-free options trading. Customers who indicate they are interested are invited to apply to trade options, subject to approval, if they tap the “Trade” button on a stock detail page.”).

¹⁴² *Id.* at 8.

¹⁴³ *Id.* at 7–8.

While recommendations do not usually cover a brokerage simply recommending a customer to engage in options trading,¹⁴⁴ the timing of the encouragement of a particular order type can raise red flags.¹⁴⁵

To determine if a recommendation exists, one would need to look at the circumstances of the order type to understand the nature of the “call to action.”¹⁴⁶ For example, if a customer is putting a limit order to buy a security at a certain price and Robinhood recommends options trading through some form of notification, that customer could view that as a recommendation to buy an option contract of that security. This series of events would initiate an array of requirements on the brokerage to determine if the security is in the best interest of the user.¹⁴⁷

3. *Gamification: Teenagers’ New Video Game*¹⁴⁸

“What does it mean when balloons and confetti are dropping, and you have behavioral prompts to get investors to do more transactions on what appears to be a free trading app, but there’s also this payment behind the scenes?”¹⁴⁹ SEC Chairman Gerry Gensler raised this question during his confirmation hearing in March 2021.¹⁵⁰ FINRA’s 2021 report on Examination and Risk Monitoring made it clear that Robinhood, and other similar trading platforms, were on its mind when it stated:

- If your firm offers an app to customers that includes an interactive element, does the information provided to customers constitute a “recommendation” that would be covered by Reg BI, which requires a broker-dealer to act in a retail customer’s “best interest,” or suitability obligations under FINRA Rule 2360 (Options)? If so, how does your firm comply with these obligations?

¹⁴⁴ *Regulatory Notice 21-15*, *supra* note 57 (stating communications about options “must be in conformance with the communications rules”).

¹⁴⁵ *Id.*

¹⁴⁶ *See generally id.*

¹⁴⁷ *See generally id.*

¹⁴⁸ Mass. Complaint, *supra* note 60, at *5 (“The use of these strategies is often referred to as gamification: the application of typical elements of game playing to other activities, typically as a marketing technique to boost engagement with a product or service . . . Robinhood’s gamification techniques have resulted in many customers with little or no investment experience making a large number of trades on Robinhood’s platform undefined.”); *see* Robinhood IPO Filing, *supra* note 17, at 47-48 (discussing possible regulatory action regarding gamification).

¹⁴⁹ SEC Chair and CFPB Director Confirmation Hearing, (statement of Garry Gensler at 1:34:29), C-SPAN (Mar. 2, 2021), <https://www.c-span.org/video/?509429-1/sec-chair-cfpb-director-confirmation-hearing>.

¹⁵⁰ *Id.*

- If your firm’s app platform design includes “game-like” aspects that are intended to influence customers to engage in certain trading or other activities, how does your firm address and disclose the associated potential risks to your customers?¹⁵¹

Research has developed over the years into what makes certain apps addictive,¹⁵² and the proliferation of Facebook and Instagram’s use of push notifications to keep customers engaged is well documented in academic literature.¹⁵³ Robinhood admits it makes most of its profit from payment for order flow,¹⁵⁴ and it is fundamentally designed different than other trading platforms.¹⁵⁵ Legal complaints against Robinhood argue the gamified techniques are meant to induce its users to trade more frequently,¹⁵⁶ which in turn creates profit for Robinhood (via payment for order flow).¹⁵⁷ Unlike social media platforms that want engagement for mere use to make money from advertisements,¹⁵⁸ Robinhood arguably seeks active engagement to drive trading volume. A former Facebook executive compares Facebook’s strategies to tobacco companies and stated: “[tobacco companies] added sugar and

¹⁵¹ FINRA, 2021 REPORT ON FINRA’S EXAMINATION AND RISK MONITORING PROGRAM 20 (2021), <https://www.finra.org/sites/default/files/2021-02/2021-report-finras-examination-risk-monitoring-program.pdf>.

¹⁵² See Chauncey Neyman, *A Survey of Addictive Software Design*, 1 CAL. POLYTECHNIC STATE UNIV. 1 (June 2017) (surveying design elements that make things addictive such as gamification, user investment, deception), <https://digitalcommons.calpoly.edu/cgi/viewcontent.cgi?article=1127&context=cscsp>.

¹⁵³ See *id.* (explaining mobile applications utilize “notifications and other processes by intensifying the dopamine surges received by their users, software designers are making their products addictive”).

¹⁵⁴ At the GameStop hearing, Vladimir Tenev stated that “payment for order flow is one of our largest revenue sources . . . it is the largest,” constituting “over 50%” of revenue. *GameStop Hearing Part 2*, *supra* note 53 at 1:00:49 & 1:58:00.

¹⁵⁵ See *Robinhood’s Tenev on the Road Ahead*, *supra* note 110 (“So Robinhood is from the very beginning looked a lot different than a typical financial services company. We hire mostly software engineers and product designers and product folks. In fact, over half the company is engineering and product, and we also have a large data science team. You know, double digit percentage of our company are Ph.D.’s. We have a lot of experts in things like machine learning, which is very rare for a brokerage or a financial company.”).

¹⁵⁶ See *e.g.*, Mass. Complaint, *supra* note 60, at *7 (“Robinhood uses these gamification techniques to increase revenue by stimulating customers to interact with the application more frequently and thereby execute more trades.”).

¹⁵⁷ See *id.*

¹⁵⁸ See Greg McFarlane, *How Facebook, Twitter, Social Media Make Money From You*, INVESTOPEDIA (Feb. 7, 2020), <https://www.investopedia.com/stock-analysis/032114/how-facebook-twitter-social-media-make-money-you-twtr-lnkdfb-goog.aspx>.

menthol to cigarettes so you could hold the smoke in your lungs for longer periods; at Facebook, we added status updates, photo tagging, and likes.”¹⁵⁹ By comparison, Robinhood employs gamified qualities such as confetti,¹⁶⁰ push notifications, and simplified designs that understate the complexities of investment strategy.¹⁶¹

Some design examples include Robinhood’s vivid color scheme, its choice of making the buy button brighter and larger than the sell button and making “Netflix-style recommendations for stocks to buy.”¹⁶² Its “simplicity is turning investing into a game and nudging inexperienced investors to take bigger risks.”¹⁶³

The Gamification in Robinhood was described aptly by a Wall Street Journal columnist:

[S]igning up was fun and easy. Three mystery cards emblazoned with question marks popped up. I scrubbed to reveal which free stock I had won, like in a scratch-off lottery game. Confetti showered my phone screen: I’d gotten one free share of Sirius XM Holdings Inc., at \$5.76. The next morning, my phone lit up: “Your free share of SIRI is up 1.05% today. Check on your portfolio now.” Two hours later, Robinhood nudged me again: “Start Trading Today.” An email from Robinhood proclaimed, “You’re Ready To Begin Trading!” ... Whenever a stock’s price changes, Robinhood updates it not just by showing an uptick in green and a downtick in red but also by spinning the

¹⁵⁹ Juan Flores, *Ex-Facebook Executive Says Company Made Its Product as Addictive as Cigarettes*, CBS NEWS (Oct. 2, 2020), <https://www.cbsnews.com/news/facebook-addictive-as-cigarettes-former-executive-says/>.

¹⁶⁰ Notably on March 31, 2021, Robinhood got rid of the confetti. *Compare A New Way to Celebrate with Robinhood — Under the Hood*, ROBINHOOD (March 31, 2021), <https://blog.robinhood.com/news/2021/3/31/a-new-way-to-celebrate-with-robinhood>, with Michael Wursthorn & Euirim Choi, *Does Robinhood Make It Too Easy to Trade? From Free Stocks to Confetti*, WALL ST. J. (Aug. 20, 2020, 2:53 PM), <https://www.wsj.com/articles/confetti-free-stocks-does-robinhoods-design-make-trading-too-easy-11597915801>.

¹⁶¹ Michael Wursthorn & Euirim Choi, *Does Robinhood Make It Too Easy to Trade? From Free Stocks to Confetti*, WALL ST. J. (Aug. 20, 2020, 2:53 PM), <https://www.wsj.com/articles/confetti-free-stocks-does-robinhoods-design-make-trading-too-easy-11597915801>.

¹⁶² *Id.*

¹⁶³ *Id.*

digits up and down like a slot machine. This flux of direction and color quickly becomes hypnotic.¹⁶⁴

A line must be drawn from inducement through activities like confetti, platform design, push notifications, and all other forms of engagement through the app to the user's mind thinking, "I want to trade." Finding that a recommendation is being made from gamification is hard because there is not a straight line from the form of gamification and the "call to action" to trade a specific security.¹⁶⁵ FINRA has outlined some issues a gamified platform raises for regulators:

[T]hese [gamified] features can appear in many aspects of how broker-dealers interact with customers, from initial advertisements through the opening of accounts and the presentation of different investment choices to communications following a trade. While some of these offerings may be designed to better enable the delivery of information to investors or to improve investor access to firm systems and investment products and services, they may also result in increased risks to customers if not designed with appropriate compliance considerations in mind, raising important regulatory questions, such as:

- **Advertising and marketing.** Are a member broker-dealer's communication to investors—regardless of format and technology— in compliance with FINRA's rules regarding communications with the public?
- **Recommendations to customers.** Depending on the facts and circumstances, do some of these interactions constitute "recommendations" that would be covered by the SEC's Reg BI, which requires a broker-dealer making recommendations of securities to act in a retail customer's "best interest"? If not, should they?
- **Other influences on customers.** Are there other game-like aspects of platform design

¹⁶⁴ Jason Zweig, *I Started Trading Hot Stocks on Robinhood. Then I Couldn't Stop.*, WALL ST. J. (Dec. 4, 2020, 1:03 PM), <https://www.wsj.com/articles/robinhood-day-trade-i-started-trading-hot-stocks-then-i-couldnt-stop-11607095765>.

¹⁶⁵ FINRA 2001 Notice, *supra* note 81.

that are intended to influence customers where the potential risks to investors and markets warrant attention beyond the application of existing rules?¹⁶⁶

Unsurprisingly, the Wall Street Journal columnist described above admitted the “Top Movers list” incited his engagement.¹⁶⁷ Therefore, the idea of gamification serving as a recommendation likely contributes to the “facts and circumstances” analysis when looking at other practices within Robinhood’s platform.

However, because Robinhood’s profit incentive from trading volume is linked to its success as a company,¹⁶⁸ it may be impossible not to see Robinhood’s gamified platform as a recommendation in and of itself. The facts and circumstances require the gamified design to be seen through the lens of profit motivation to induce frequent trades.¹⁶⁹ Robinhood argues that it should instead be viewed as a way to “make it feel like something that’s familiar to populations that historically have not been served.”¹⁷⁰ Importantly, Reg BI, under its “Care Obligation,”¹⁷¹ requires the broker-dealer to exercise:

[R]easonable diligence, care, and skill when making a recommendation to a retail customer to . . . have a reasonable basis to believe that a series of recommended

¹⁶⁶ Robert W. Cook, FINRA Response to Elizabeth Warren, FINRA 5 (Feb. 23, 2021), <https://www.warren.senate.gov/imo/media/doc/FINRA%20Response.pdf>.

¹⁶⁷ Zweig, *supra* note 164 (“Even so, with a few moments of exposure, the ever-changing numbers and colors put me into a kind of trance. Robinhood showed me a list of ‘Top Movers.’ They were bright lime green. They were beautiful. I had no idea what most of them were. My plan flew out the window and I bought a fistful of Top Movers instead.”).

¹⁶⁸ See Nathaniel Popper, *Robinhood Has Lured Young Traders, Sometimes with Devastating Results*, N.Y. TIMES (July 19, 2021, 7:24 AM), <https://www.nytimes.com/2020/07/08/technology/robinhood-risky-trading.html> (showing Robinhood made \$18,955 per dollar in the average account compared to its peers; TD Ameritrade (\$18,991); E-Trade (\$1,326); Charles Schwab (\$195)); Kate Rooney & Maggie Fitzgerald, *Here’s How Robinhood Is Raking in Record Cash on Customer Trades — Despite Making It Free*, CNBC (Aug. 14, 2020, 10:17 AM), <https://www.cnbc.com/2020/08/13/how-robinhood-makes-money-on-customer-trades-despite-making-it-free.html>.

¹⁶⁹ See, e.g., Mass. Complaint, *supra* note 60, at *19 (“Robinhood uses these gamification techniques to increase revenue by stimulating customers to interact with the application more frequently and thereby execute more trades.”); see also Ann Lipton, *Robinhood’s Interface*, LPB NETWORK (Feb. 5, 2021), https://lawprofessors.typepad.com/business_law/2021/02/robinhoods-interface.html.

¹⁷⁰ Zweig, *supra* note 164 (quoting Madhu Muthukumar, senior director of product management at Robinhood).

¹⁷¹ Regulation Best Interest: A Small Entity Compliance Guide, *supra* note 90.

transactions, even if in the retail customer's best interest when viewed in isolation, is not excessive and is in the retail customer's best interest when taken together in light of the retail customer's investment profile.¹⁷²

If Robinhood's use of gamification constitutes a recommendation or tips other activities over the recommendation line, then an analysis may look to "excessive" trading within a retail account in light of its "investment profile."¹⁷³ For example, the Massachusetts's complaint broadcasted the frequency of inexperienced traders using Robinhood, explaining "Robinhood gave hundreds of customers with limited to no investment experience the ability to make thousands of trades in the matter of months. At least 670 Robinhood customers with limited or no investment experience averaged at least five trades per day, with two customers averaging close to 100 trades per day. As an example, Robinhood allowed a customer with no investment experience to make more than 12,700 trades in just over six months."¹⁷⁴ The inquiry then becomes what part of the frequency is due to the gamified components of the app, rather than the customer's desire to trade independent of the game-like design.

IV. THE LEGAL FUTURE

Robinhood is a place where a CEO acknowledges that its userbase is made of "new investors making investments for the first time," and at the same time, also employs a mobile application that actively promotes margin and options trading within a platform resembling a highly addictive video game.¹⁷⁵ Furthermore, Robinhood's formulation

¹⁷² *Frequently Asked Questions on Regulation Best Interest*, SEC, <https://www.sec.gov/tm/faq-regulation-best-interest> (last visited July 21, 2021) ("A 'series' of recommended transactions is an established term under the federal securities laws and SRO rules that is evaluated in concert with existing guideposts, such as turnover rate, cost-to-equity ratio, and use of in-and-out trading, which have been developed over time and which serve as indicators of excessive trading. The staff notes that Regulation Best Interest does not change this well-established approach. The Commission stated that what would constitute a 'series' of recommended transactions would depend on the facts and circumstances and would need to be evaluated with respect to a particular retail customer.").

¹⁷³ Potential examples of this are evident for Robinhood users with little to no investment experience in Massachusetts, as detailed in its complaint. See Mass. Complaint, *supra* note 60, at *19-24.

¹⁷⁴ Mass. Complaint, *supra* note 60, at 5.

¹⁷⁵ Tim Levin, *Robinhood Has Filed for an IPO. Read Its Cofounders' Letter to Future Investors.*, BUS. INSIDER (July 1, 2021, 2:29 PM), <https://www.businessinsider.com/robinhood-ipo-public-stock-founder-letter-to-investors-2021-7>.

of social investing and listing stocks based on its own users' holdings potentially "recommends" demonstrably poor investment decisions to its userbase disguised as giving the customer a "familiar" design.

The legal future of this regulatory framework is a balancing act. On the one hand, Retail investors do not want a regulatory scheme that acts as a gatekeeper to the availability of complex investment strategies and opportunities afforded to institutions.¹⁷⁶ On the other hand, the SEC's mission is to "protect investors," like those caught in attention-induced, momentum-based trading, based on gamified designs within a trading platform,¹⁷⁷ and are often left "holding the bag" for institutional investors.¹⁷⁸ By erasing the typical entry barriers to securities purchasing—the impulsiveness of decision-making heightens—users receive the same thrill from playing a video game blends into trading stock. Reddit users often joke that if a user is down money on Robinhood, all the mobile user must do is delete the app;¹⁷⁹ however, losing the "game" of stocks is not easily forgotten nor avoided by its player. Even small losses can have significant financial impacts over an extended period and affect an investor's ability to generate wealth through a long-term investing strategy.¹⁸⁰

¹⁷⁶ See John Berlau, *Respect, Don't Restrict, Retail Investors*, COMPETITIVE ENTER. INST. BLOG (Jan. 29, 2021), <https://cei.org/blog/respect-dont-restrict-retail-investors/>.

¹⁷⁷ Barber et al., *supra* note 98 at 1, 12.

¹⁷⁸ See Matthew Gault, *Reddit's 'GMEBagHoldersClub' Is Where GameStop Stock Buyers Admit They Messed Up*, VICE (Feb. 5, 2021, 9:17 AM), <https://www.vice.com/en/article/k7ayga/reddits-gmebagholdersclub-is-where-gamestock-stock-buyers-admit-they-messed-up> ("The issue, of course, is that for many people it was about the money, and needed to be about the money, considering that many large hedge funds can sustain billions in losses while the average person sinking tons of their own money into a stock cannot necessarily do the same There are people who say that they have truly ruined their lives, or missed out on a potential life-changing opportunity, or who have tons of regret. It has become in some sense a support board for people who are really struggling.").

¹⁷⁹ See e.g., r/wallstreetbets & u/andyb6789 ("I emptied my life savings into some SPY calls on Friday. Obviously with futures being down more than 5%, I'll lose money when the market opens. Luckily, I just deleted the Robin Hood app so none of its real (trust me guys you have to actually have the app on your phone for trades to go [] up) REDDIT (March 23, 2020, 2:04 AM), https://www.reddit.com/r/wallstreetbets/comments/fnf1a7/i_deleted_the_robin_hood_app_so_my_friday_calls/; r/wallstreetbets & u/[deleted] ("Y'all said to delete the app so I wouldn't have to worry about a margin call, but now they're emailing me") REDDIT (July 06, 2018, 11:34 AM), https://www.reddit.com/r/wallstreetbets/comments/8wl0vh/yall_said_to_delete_the_app_so_i_wouldnt_have_to/.

¹⁸⁰ Alicia Adamczyk, *Trading Apps like Robinhood are Having a Moment. But Users Should be Careful*, CNBC (Aug. 24, 2020, 3:49 PM), <https://www.cnbc.com/2020/08/21/robinhood-is-having-a-moment-users-should-be-careful.html>.

It is difficult to determine whether recommendations are being made via Robinhood's platform. Critics argue that imposing such broad recommendation determinations, such as a through a broker-generated list, would open the door to massive liability and limit the educational resources brokerages offer to their customers out of fear that such resources could be interpreted as a "call to action."¹⁸¹ However, this article argues the analysis itself is a more subtle one that deserves regulatory attention and reaction.¹⁸² The FINRA 2001 Notice¹⁸³ and 2021 Risk Monitoring Program¹⁸⁴ attempt to capture this broad array of interaction and design as a form of recommendation,¹⁸⁵ but technology has progressed to the point where the regulations themselves likely need to expand to properly regulate Robinhood. For these reasons, three changes are needed to expand the rules and regulations to address the inherent risks in Robinhood's platform, without drastically limiting an investor's ability to access the market.

A. FINRA Rule 2360

For the most part, FINRA sets the bare minimum requirements in the options approval process and a brokerage's each adopt their own eligibility analyses.¹⁸⁶ This lack of uniform guidance on the option approval process allows some brokerages to operate within their own discretionary bare minimum.¹⁸⁷ Robinhood has demonstrated options account approval should not be an application with instant approval—a setting one can simply turn on¹⁸⁸—but based on a heightened, drawn-

¹⁸¹ Robinhood IPO Filing, *supra* note 17, at 70. Robinhood stated as a risk in its IPO that "[p]roviding investment education tools could subject us to additional risks if such tools are construed to be investment advice or recommendations."

¹⁸² See Jeanna Smialek & Deborah B. Solomon, *Yellen and Regulators Met Amid GameStop Frenzy to Discuss Market Volatility*, N.Y. TIMES (Feb. 4, 2021), <https://www.nytimes.com/2021/02/04/business/economy/yellen-gamestop.html> ("The entire [Gamestop] episode has caused Washington's financial overseers to examine whether markets—in becoming both more democratized by technology and more subject to the whims of social media—have changed in ways that require new attention and potentially different regulation.").

¹⁸³ FINRA 2001 Notice, *supra* note 81, at 18.

¹⁸⁴ REPORT ON FINRA'S EXAMINATION AND RISK MONITORING PROGRAM, *supra* note 151.

¹⁸⁵ See *id.*; see also FINRA 2001 Notice, *supra* note 82, at 18.

¹⁸⁶ Cf. *Regulatory Notice 21-15*, *supra* note 57 (FINRA "reminds" its members about option approval, including guidance that pushes towards broker-dealers to apply an "appropriate" standard in analyzing a customer's eligibility for approval).

¹⁸⁷ See FINRA AWR, *supra* note 63.

¹⁸⁸ See [r/wallstreetbets & u/WSByolobaggins](https://www.reddit.com/user/WSByolobaggins/comments/) ("It used to literally be a toggle in settings. I keep hearing they've upped it a bit in recent days following all the glitches rofl so now idk") REDDIT (Dec. 29, 2019, 2:54 PM), <https://www.reddit.com/user/WSByolobaggins/comments/>.

out process. When the tragic suicide of a young adult is the only way to force a company to reevaluate its internal eligibility standards,¹⁸⁹ it is time for regulators to make those standards clear.

Therefore, as an extension of the due diligence process, FINRA Rule 2360(b)(19)(B) should require brokerages to make more informed decisions in approving options accounts. There should be levels of sophistication encouraged and outlined for varying levels of options trading set by regulators—not the brokerage—including a best practices manual to ensure compliance. Similar to past notices, the compliance manual should give examples on what meets the standard of due diligence under the Rule 2360 and what does not.¹⁹⁰ As the SEC stated in its March 10, 2015, Investor Bulletin: Opening an Options Account,¹⁹¹ there is an inference of a form of a “suitability” analysis at the point of opening, but there is no current requirement or clear guidance. Some brokerages already perform a thorough, sophisticated analysis; however, without clear guidelines, companies like Robinhood can continue to legally choose between profit, open access, and investor safety.

Additionally, there should be new guidance to close the gray area existing within the option recommendation space.¹⁹² A brokerage should not be able to actively encourage a customer—upon opening an account for the first time—to start trading options without any repercussions or actual knowledge of the user’s investment knowledge beyond a user’s self-reported click of “I am an expert.” Regulators must set defined boundaries between how a brokerage can advertise its options and margin platform. These boundaries should minimize the use of uninterrupted alerts through push notifications which can potentially persuade customers to open these accounts and make trades.

B. SEC Reg BI

Certainly, Reg BI has expanded the protections of retail customers. However, the SEC should use Reg BI to broaden the scope of what it means to recommend a security, since it still relies on a recommendation to trigger the best interest analysis—which possibly leaves self-directed

¹⁸⁹ *GameStop Hearing Part 1*, *supra* note 19 (statement of Vladimir Tenev at 2:06:00) (“The passing of Mr. Kearns was deeply troubling to me and the entire company. We vowed to take a series of aggressive steps to make our options products safer for our customers...strengthening the requirements for people getting options and adding a live support line. We went to immediate action to not just make the accessible options products for our customer but safer as well.”).

¹⁹⁰ See e.g., FINRA 2001 Notice, *supra* note 81.

¹⁹¹ See e.g., *Investor Bulletin: Opening an Options Account*, *supra* note 49.

¹⁹² See *id.*

accounts without protection. A broader recommendation standard should account for factors such as gamification, curated lists, and promoting investing strategies via app interaction.

The idea of a human making a recommendation needs to be replaced with a new norm of sophisticated platforms encouraging security purchases. Brokerages should not be able to avoid liability by allowing their application to replace what a professional would have said, done, or induced. Technology is rapidly changing, and regulations must keep pace to protect investors.

C. Protections for Self-Directed Brokerages Accounts Without a Recommendation

In October of 2020, the SEC began drawing attention to the expanding role of self-directed accounts for retail investors.¹⁹³ The SEC acknowledged the lack of protections for this new generation of retail investors in a “dynamic, expanding, and ever-changing marketplace,”¹⁹⁴ which hints at the possibility of new regulations, as the SEC stated:

[W]e believe that these leveraged/inverse products and other complex products may present investor protection issues—particularly for retail investors who may not fully appreciate the particular characteristics or risks of such investments, including the risks that holding such products may pose to their investment goals Speaking more specifically, we are concerned that retail investors are independently selecting complex products for which they may not fully appreciate the unique characteristics and risks. In light of these concerns, the staff [] will review the effectiveness of the existing regulatory requirements in protecting investors—particularly those with self-directed accounts—who invest in leveraged/inverse products and other complex products. Based on this review, the staff will make recommendations to the Commission for potential new rulemakings, guidance, or other policy actions, if appropriate.¹⁹⁵

¹⁹³ *Joint Statement Regarding Complex Financial Products and Retail Investors*, *supra* note 32 (“Advances in technology have not only driven an increase in investment options for retail investors, they also have driven changes in the channels through which retail investors purchase and sell securities, including complex products.”).

¹⁹⁴ *Id.*

¹⁹⁵ *Id.*

This statement infers that in the context of complex products, such as options trading and high margin trading, new regulations to protect retail investors may be on the horizon and market players should be ready to comment on them.¹⁹⁶

However, the SEC may be selling the problem short by overlooking the possible recommendations being made via technological communications to investors within self-directed brokerage accounts, which Reg BI would be able to enforce.¹⁹⁷ FINRA is also keying in on the issues identified by the SEC. On February 23, 2021, FINRA's president discussed the issues raised by the SEC, stating:

FINRA agrees with the SEC that “this is a dynamic, expanding, and ever-changing marketplace, and that it is our responsibility to consider whether existing protections can be improved.” Accordingly, we are committed to supporting the SEC staff's review (announced in October 2020) of the increase in self-directed trading by retail investors that is not covered by Reg BI, and the effectiveness of existing regulatory requirements in protecting investors in those circumstances. FINRA is also committed to supporting the SEC as it continues to oversee the implementation of Reg BI and considers further refinements in Reg BI's application. At the same time, FINRA is also considering the effectiveness of its own rules in addressing these developments.¹⁹⁸

FINRA also published a request for comment on Effective Methods to Educate Newer Investors stating, the “time is ripe to rethink how best to engage and educate investors with a diverse array of needs and priorities, especially those who opt not to work with an intermediary

¹⁹⁶ *See id.* (“If you would like to let the staff know your views regarding these issues, we are providing an email box as a convenient method for you to communicate with the staff.”).

¹⁹⁷ *Contra id.* (“[I]t should be recognized that self-directed retail investors are typically making investment decisions on their own accord via online trading platforms and without the assistance of a financial professional. In other words, these self-directed investors do not have the required protections that apply when they receive recommendations or advice from a broker or investment adviser, who must understand, and may explain if necessary, the characteristics and potential risks and rewards of the investment, and determine that it is in the best interest of the retail investor.”).

¹⁹⁸ Cook, *supra* note 166, at 5–6.

such as an individual registered investment professional.”¹⁹⁹ The role of education in the marketplace, specifically for younger investors choosing self-directed brokerages, will continue to grow, develop, and serve in parallel with enforcement action.

V. CONCLUSION

Robinhood has been under regulatory scrutiny for some time for controversies like best execution and improper disclosure of revenue sources.²⁰⁰ With FINRA’s recent, increased focus on brokerages such as Robinhood, examinations under SEC’s Reg BI will likely increase.²⁰¹ FINRA and the SEC are aware of the surge of retail investors and the limited protections these investors are offered within self-directed brokerage accounts.²⁰² However, it is unclear how Reg BI will impact the possible recommendation analysis, and if it is adaptable enough to apply to situations like Robinhood’s communications with customers via their mobile application.²⁰³

Although this article does not address the numerous other controversies surrounding Robinhood,²⁰⁴ these issues can arguably be traced back to the nature of Robinhood’s business, which

¹⁹⁹ FINRA Requests Comment on Effective Methods to Educate Newer Investors: Special Notice – 6/30/21 FINRA, available at <https://www.finra.org/rules-guidance/notices/special-notice-063021> [hereinafter FINRA Effective Methods to Educate Notice].

²⁰⁰ See *SEC Charges Robinhood Financial With Misleading Customers About Revenue Sources and Failing to Satisfy Duty of Best Execution*, SEC (Dec. 17, 2020), <https://www.sec.gov/news/press-release/2020-321> (“The Securities and Exchange Commission today charged Robinhood Financial LLC for repeated misstatements that failed to disclose the firm’s receipt of payments from trading firms for routing customer orders to them, and with failing to satisfy its duty to seek the best reasonably available terms to execute customer orders.”); Michelle Ong & Mike Rote, *FINRA Fines Robinhood Financial, LLC \$1.25 Million for Best Execution Violations*, FINRA MEDIA CENTER (Dec. 19, 2019), <https://www.finra.org/media-center/newsreleases/2019/finra-fines-robinhood-financial-llc-125-million-best-execution>.

²⁰¹ See Melanie Waddell, *SEC to Ramp up Reg BI Exams in January*, THINKADVISOR (Dec. 22, 2020, 11:26 AM), <https://www.thinkadvisor.com/2020/12/22/sec-to-ramp-up-reg-bi-exams-in-january/>.

²⁰² See *Joint Statement Regarding Complex Financial Products and Retail Investors*, *supra* note 32; Cook, *supra* note 166.

²⁰³ See *infra*. (

²⁰⁴ These controversies include payment for order flow, market manipulation within the GameStop controversy, and other parallel conflicts. See Matt Levine, *People Are Worried About Payment for Order Flow*, BLOOMBERG OP. (Feb. 5, 2021, 12:09 PM), <https://www.bloomberg.com/opinion/articles/2021-02-05/robinhood-gamestop-saga-pressures-payment-for-order-flow>; Frank Chaparro, *Robinhood Made More Than \$600 Million from Payment for Order Flow Revenue in 2020*, BLOCK (Feb. 1, 2021, 5:15 PM), <https://www.theblockcrypto.com/post/93321/robinhood-payment-for-order-flow-2020>.

disproportionately supplies, recommends, and advertises to its userbase with margin and the ability to options trade. These controversies are a byproduct of the lack of effective current rules or enforcement actions implicating liability for recommending or approving inexperienced users' access to these complex investment strategies.²⁰⁵

However, Alexander Kearns was a young man who got caught up in a game he barely understood. There are likely several retail traders like him among Robinhood's rapidly growing base of new retail investors who are captured by the noise of a platform that makes everything seem simple and praises its customers for engagement. How to properly protect these new traders is a significant challenge.²⁰⁶ However, a regulatory framework must—at a minimum—find ways to safeguard investors from the inducement and approval to trade complex investment products they may not yet understand.

²⁰⁵ *But see* FINRA AWR, *supra* note 63 (representing the beginning of FINRA action on brokerages' options approval process).

²⁰⁶ *See* FINRA Effective Methods to Educate Notice, *supra* note 199 (exploring a possible way to protect new investors is to find better ways to educate them on complex market strategies in a way that adapts to their current learning methods).