RILING UP AS RECOMMENDATION: HOW COMMISSION-FREE BROKERAGES RECOMMEND ACTIVE INVESTING TO THE PUBLIC

ABSTRACT

TRAVIS C. STUDDARD*

Financial technology now rapidly changes the way retail investors interact with securities markets. Brokerages who once executed trades via pneumatic tubes for a fee now offer commission-free trades that can be completed at a finger tap from any smart phone. Robinhood and similar brokerages have removed barriers and expanded access to markets by offering commission-free trading. Commission-free trades drive profits because of payment for order flow, a practice where brokerages route customers' orders to market makers in exchange for a payment. This business model thrives on frequent trading – a practice known to be financially hazardous to inexperienced retail investors.

To increase customer trading, commission-free brokerages have focused less on financial innovation and more on behavioral manipulation. By presenting less information, Robinhood makes its application ("app") more attractive to investors who feel alienated by other, more-established brokerages. Investors already face their own internal biases that prevent them from making consistently rational investment decisions. Commission-free brokerages amplify this danger through gamification, a strategy that has regulators increasingly concerned, and biased "education" aimed at riling up customers and conditioning them to actively trade.

Unfortunately, the laws designed to protect investors have not kept pace with the technology. Before smart phones and apps, brokers had to speak with their customers on the phone or in person. Today, Robinhood and other commission-free brokerages remain in constant contact with their users through emoji-filled push notifications. This article demonstrates that retail investors need greater protection because the landscape surrounding how brokerages communicate with their customers has changed. In particular, regulators need to adopt a broader, more functional lens for the law to ensure that their definition of recommendation encompasses the kinds of stimuli brokerage firms use to induce ordinary humans to execute trades with increasing frequency. Brokerages now act as though they bear no responsibility for the consequences of their acts because the law has not yet recognized these innocuous communications as recommendations which push psychologically vulnerable customers toward risky investment decisions.

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* Student, University of Nevada, Las Vegas, William S. Boyd School of Law;

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I. INTRODUCTION

In June 2020, Alex Kearns took his own life to spare his family from financial ruin. He had been using Robinhood for almost two years, but only recently ventured into options trading. Shortly before Alex's suicide, the company demanded he deposit nearly two-hundred thousand dollars to meet a margin call. He had never enabled margin. Despite this, Robinhood told him he owed three quarters of a million dollars. His three emails to the company pleading for them to investigate went without reply.[1] Alex typed a suicide note, saved a screenshot of his account balance, and threw himself in front of an oncoming train.[2]

Kearns was a twenty-year-old business student and ROTC cadet at the University of Nebraska. His life had been upended by the COVID-19 pandemic. He was living at his parents' home. Alex exemplifies the typical Robinhood user: young, curious, and inexperienced with securities trading.[3] The app appeals to this group with simplistic design, inviting graphics, and offers of free stock.[4] This false simplicity may have led to Alex's death. The screen showing Alex's negative cash balance was only half of an incomplete trade – lacking critical details.[5] After Alex died the company emailed him stating that he did not owe any money because his positions were covered.[6] If Robinhood had presented information differently, he might be alive today.

Robinhood and other commission-free brokerages have successfully tapped into a new and robust market. They attract young investors by portraying securities trading as a fun, riskless game with frictionless design and lofty mission statements.[7] Through biased and one-sided "education," they guide users toward frequent, aggressive and overconfident trading.

Retail traders likely suffer from the aggressive trading strategies many commission-free brokerages encourage. Yet much of their profitability depends upon driving retail trading – communications that rile up a user base getting them to tap, tap, tap their way to transactions. The Securities and

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[1] *See* Tony Dokoupil, *et al., Alex Kearns died thinking he owed hundreds of thousands for stock market losses on Robinhood. His parents have sued over his suicide.*, CBS News (Feb. 8, 2021), https://www.cbsnews.com/news/alex-kearns-robinhood-trader-suicide-wrongful-death-suit/ (discussing Alex only received an automated reply assigning him a case number and warning that the company's response time may be delayed.) (last visited July 30, 2021).

[2] Hannah Levintova, *Robinhood Promises Free Trades. Did Alex Kearns Pay With His Life?*, Mother Jones (April 29, 2021), https://www.motherjones.com/politics/2021/04/robinhood-gamestop-free-trades-alex-kearns/ (last visited July 29, 2021).

[3] *See* Dokoupil, *et al.*, *supra* note 1 (Alex's suicide note read in part "I also have no clue what I was doing now in hindsight.").

[4] CNBC, *How Robinhood Captures Beginner Investors*, YouTube, (Oct. 7, 2020), https://www.youtube.com/watch?v=fjNtrraxLII&t=419s.

[5] Levintova, *supra* note 2.

[6] *See* Dokoupil, *et al.*, *supra* note 1.

[7] *See* Robinhood, About Us, https://robinhood.com/us/en/about-us/ (the company's mission is to "democratize finance for all.") (last visited July 29, 2021).

Exchange Commission (SEC)[8] and Congress[9] have both called for closer examination of these practices.

The existing regulatory regime overlooks the behavioral and psychological impacts of strategies relied upon by commission-free brokerages.[10] Robinhood and others like it use gamification and biased education to rile up investors inducing more active trading instead of making traditional recommendations. They avoid responsibility because the law does not yet clearly recognize these strategies as recommendations though they have the same effect. They remain in the law's (and often arbitrators') blind spot. To take a more realistic approach, regulators need to reconsider what qualifies as a recommendation and adopt a broader, more functional lens that includes the tactics and stimuli used to induce trading.

Robinhood and other commission-free brokerages dodge responsibility for their questionable practices because they avoid making what are considered "recommendations" to "reasonable" investors under the current law. Yet they put considerable effort into dubious "education" that pushes trading strategies that are not in the best interest of their customers. The abstract conception of how a reasonable investor acts may not hold up in light of reliable evidence about what actual humans do. If Robinhood researches what induces its customers to trade frequently, it is hard to say that they are not recommendations given that these prompts and similar stimuli are effective at inducing a desired behavior.

Due to forced arbitration clauses, courts lack opportunities to create binding precedent treating these tactics as de facto recommendations.[11] Arbitrators need to recognize that conditioning retail investors in this fashion should be deemed a recommendation for liability purposes. If arbitrators are unwilling to recognize these practices for what they are, a change in the law is urgently needed.

Section II describes Regulation Best Interest and how the law became what it is today. It also highlights how the law fails to protect investors by leaving terms such as "recommendation" and "best interest" undefined.

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[8] Staff of the U.S. Securities and Exchange Commission (SEC), *Request for Information and Comments on Broker-Dealer and Investment Adviser Digital Engagement Practices, Related Tools and Methods, and Regulatory Considerations and Potential Approaches; Information and Comments on Investment Adviser Use of Technology To Develop and Provide Investment Advice*, 86 Fed. Reg. 49067 (Sept. 1, 2021) ("Request for Information").

[9] Virtual Hearing before the House Committee on Financial Services, *Game Stopped? Who Wins and Loses When Short Sellers, Social Media, and Retail Investors Collide*, 117 Cong., (Feb. 18, 2021).

[10] Sarah O'Brien, *SEC adopts rule to protect ordinary investors, but critics say it's too lax*, CNBC, (June 5, 2019), https://www.cnbc.com/2019/06/05/sec-adopts-rule-to-protect-ordinary-investors-critics-say-its-too-lax html (last visited August 17, 2021).

[11] Benjamin P. Edwards, *Arbitration's Dark Shadow* (2018), Nevada Law Journal: Vol. 18 : Iss. 2 , Article 4.
Available at: https://scholars.law.unlv.edu/nlj/vol18/iss2/4.

[redacted]

Section III introduces biases and heuristics that impact both retail investors and financial professionals. The Section asserts that these factors already put rational financial decision-making at risk even without outside influence. Section IV describes various ways commission-free brokerages push customers toward active investing without triggering Regulation Best Interest. Section V concludes by summarizing the issues facing investors and advocating for increased investor protection through improvements in Regulation Best Interest.

II. REGULATION BEST INTEREST

Regulation Best Interest is the current standard that applies to brokerages "when making a recommendation of any securities transaction or investment strategy involving securities to a retail customer."[12] The Rule bars brokerages from placing their own interests "ahead…of the retail customer."[13] Brokerages must also have a "reasonable basis to believe that the recommendation is in the [customer's] best interest."[14] The Rule does not require brokerages to put customers first. Instead, it leaves "best interest" undefined allowing brokerages to argue a harmful recommendation was reasonable and within the Rule's ambiguous boundaries.

The securities laws were written for a different era when brokers would merely execute trades. Today, brokerages use well-known behavioral techniques to drive and influence trading activity. These techniques have the same effect as making recommendations, but brokerages evade responsibility for the economic consequences to their customers. If legal accountability for conditioning a retail customer to actively trade only occurs when a recommendation is made, then brokerages can use all sorts of tactics to drive that activity while dodging responsibility for the negative consequences impacting investors.

This part introduces Regulation Best Interest in greater detail. Below, section II.A. describes the legal gaps Regulation Best Interest was designed to address. Section II.B. describes how the new standard of care allows brokerages to benefit at the expense of their customers. Section II.C. argues Regulation Best Interest's threshold inquiry (i.e., Did the broker make a recommendation?) is insufficient in light of practices common across commission-free brokerages.

A. A Call for Harmony

Most new investors enlist the services of either registered investment advisers (RIAs) or broker-dealers (brokerages). However, many inexperienced

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[12] Regulation Best Interest, 17 C.F.R. § 240.15l-1 (2019).
[13] *Id.*
[14] *Id.*

retail investors do not understand the difference between the two.[15] Because they provide largely the same services, many investors incorrectly assume both RIAs and brokerages are obligated to act in the retail investor's best interest.[16] The divergent standards have been a significant source of confusion for retail investors.[17]

The difference has especially been evident when either financial professional made a recommendation for a transaction or strategy. RIAs are fiduciaries for their customers and must abide by the duties of loyalty and care.[18] In contrast, brokerages were held to a less stringent standard. They could provide securities recommendations so long as they had "a reasonable basis to believe" that the recommendation was "suitable" to their customers' individual investment profiles.[19] Retail investors were afforded less protection if they received the communication from a brokerage as opposed to an RIA. Regulators and industry participants called for harmonizing the standard for brokerages and RIAs.[20]

The Suitability Rule and the Know Your Customer Rule[21] required brokerages to have a reasonable basis for recommending a transaction or investment strategy.[22] This was a less rigorous standard compared to an RIA's fiduciary responsibilities. Further, retail investors were unaware that the standard of care differed depending on who the recommendation came from. Regulation Best Interest was intended not only to offer retail investors greater protection but to align law with customer expectations. Unfortunately, the Regulation seemingly just imposes the same standard of care as the Suitability Rule using different language and falls short of ensuring brokerages do not escape liability if they take advantage of their customers.[23]

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[15] *See* SEC, *Study on Investment Advisers and Broker-Dealers As Required by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act* (Jan. 2011) ("913 Study") at v.

[16] *See id.* ("Many expect that both investment advisers and broker-dealers are obligated to act in the investors' best interests.").

[17] *See id.* at viii (discussing that "harmonization of regulation…would offer several advantages, including that it would provide retail investors the same or substantially similar services from investment advisers and broker-dealers.").

[18] *See id.* at iii (describing the fiduciary standard RIAs are held to).

[19] FINRA, Rule 2111, https://www.finra.org/rules-guidance/rulebooks/finra-rules/2111.

[20] SEC, 913 Study, supra note 15, at v-vi.

[21] FINRA, Rule 2090, https://www.finra.org/rules-guidance/rulebooks/finra-rules/2090.

[22] FINRA, Office of General Counsel, Rules & Guidance, Suitability, https://www finra.org/rules-guidance/key-topics/suitability#overview (last visited July 23, 2021).

[23] *See* SEC Commissioner Kara M. Stein, *Statement on Proposals Relating to Regulation Best Interest, Form CRS, Restrictions on the Use of Certain Names or Titles, and Commission Interpretation Regarding the Standard of Conduct for Investment Advisers*, Public Statement, April 18, 2018, https://www.sec.gov/news/public-statement/stein-statement-open-meeting-041818 ("[T]he lack of a definition of best interest, the use of similar terms to mean different things, the use of different terms to mean the same things, and the possibility that the SEC and FINRA interpret the same language in their suitability

In practice, customers receive different advice from brokers and RIAs. A survey of the pre-Regulation Best Interest landscape found that brokerages offered more diverse and complex products that entailed higher commissions.[24] Under Regulation Best Interest, brokerages can continue to offer investments that generate third-party compensation, but investors are less likely to encounter them with RIAs.[25]

B. Permitting Questionable Practices

Despite the recommendation for harmonizing the standard of care, the SEC adopted Regulation Best Interest in June 2019.[26] Though the Regulation is "not intend[ed] to create a 'lower' or 'weaker' standard compared to" the SEC's recommendations, its nebulous language barely increased the standard of care above the prior Suitability Rule. [27]

Though Regulation Best Interest's care obligation has been described as "FINRA's Suitability Rule on steroids"[28] it falls short of a fiduciary standard. Regulation Best Interest simply leaves room for too many conflicts of interests.[29] It's "[s]pecific disclosure and additional mitigation requirements" were meant to address those conflicts. However, documents describing a brokerage's obligations may be useful to some, but many investors "do not read long formulaic documents" so their utility in practice is questionable.[30]

With its largely rhetorical protections, Regulation Best Interest allows the brokerage to consider its own interests when making a recommendation to a customer.[31] For example, brokers are allowed to recommend products and strategies that result in greater compensation to themselves even though it may be financially risky for the investor. But if the recommendation remains consistent with the customer's investment profile, the broker would not run

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standards differently. All of these concerns would make it difficult for the industry to discern a clear compliance path.") (last visited Aug. 17, 2021).

[24] *See* North American Securities Administrators Association (NASAA), *Regulation Best Interest: National Examination Initiative Phase One* at 3 (September 2020), https://www nasaa.org/wp-content/uploads/2020/09/Reg-BI-Phase-1-Report.pdf (last visited September 2, 2021).

[25] *Id* at 7

[26] Regulation Best Interest: The Broker-Dealer Standard of Conduct, 84 Fed. Reg. 33318 (July 12, 2019) (the "Final Rule").

[27] *See Id.* at 33331.

[28] FINRA, *Regulation Best Interest: Implementing a New Standard of Conduct*, Unscripted Podcast (2020), https://www finra.org/media-center/finra-unscripted/reg-best-interest-implementation (last visited July 23, 2021).

[29] Final Rule, *supra* note 26 at 33332.

[30] SEC releases, *Comments on Proposed Rule: Regulation Best Interest* Release No. 34-83062, (William F. Galvin - Secretary of the Commonwealth of Massachusetts, Comment Letter) at 5, (Aug. 7, 2018).

[31] Benjamin P. Edwards, *SEC rule merely pays lip service to investor protection*, The Hill, (June 18, 2019), https://thehill.com/opinion/finance/449094-sec-rule-merely-pays-lip-service-to-investor-protection (last visited July 23, 2021).

afoul of Regulation Best Interest.[32] Moreover, Regulation Best Interest allows brokerages to exclusively offer funds that pay kickbacks to the firm.[33] The brokerage could recommend any fund so long as its interest is not placed "ahead" of his customer's interest.[34] The tolerance of such practices undercuts the claim that Regulation Best Interest is a meaningfully heightened standard compared to the prior Suitability obligation.

Despite a legal challenge, the Regulation was upheld and persists as the current federal standard that applies when a broker makes a recommendation to a retail investor.[35] Many states believe retail investors deserve greater protection and crafted rules imposing a higher standard. For example, Massachusetts imposed a fiduciary obligation on brokers when they provide investment advice or recommend a strategy.[36] This new Rule was the basis for the Commonwealth's lawsuit against Robinhood.[37] Similarly, Nevada explicitly imposes a fiduciary duty on brokerages when they provide advice to their customers and must disclose if the brokerage stands to gain "if the advice is followed."[38] Without a strong federal standard, victims of conflicted advice must look within their own states' laws for protection and recourse.

C. Recommendation Remains Undefined

Regulation Best Interest applies when a brokerage makes "a recommendation of any securities transaction or investment strategy involving securities…to a retail customer."[39] However, the Regulation does not define "recommendation." Instead, it interprets whether a recommendation has been made through the lens of "precedent under the anti-fraud provisions of the federal securities laws…and how the term has been applied under the rules of self-regulatory organizations (such as FINRA)."[40] As a result, Regulation Best

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[32] *See* Final Rule, *supra* note 26 at 33334 ("Regulation Best Interest will not necessarily obligate a broker-dealer to recommend the 'least expensive' or the 'least remunerative' security or investment strategy, provided the broker-dealer complies with the specific component obligations. In other words, Regulation Best Interest will allow a broker-dealer to recommend products that entail higher costs or risks for the retail customer, or that result in greater compensation to the broker-dealer, or that are more expensive, than other products provided that the broker-dealer…does not place the broker-dealer's interest ahead of the retail customer's interest.").

[33] Edwards, *SEC rule merely pays lip service to investor protection*, *supra* note 31.

[34] *See id.* ("[Regulation Best Interest] also allows firms to set the menu of options their brokers can recommend to clients, meaning the best funds that pay the least in kickbacks might not be available…The new rules don't require brokerage firms to give investors the best options available.").

[35] *XY Planning Network, LLC v. SEC*, 963 F.3d 244, 253 (2nd Cir. 2020).

[36] 950 Mass. Code Regs. 12.207(1)(a) (2020).

[37] In the Matter of: Robinhood Financial, LLC, Respondent, 2020 WL 7711667

[38] Nev. Rev. Stat. Ann. § 628A.020 (West).

[39] Regulation Best Interest, *supra* note 12.

[40] SEC, *Regulation Best Interest: A Small Entity Compliance Guide*, (September 2019), https://www.sec.gov/info/smallbus/secg/regulation-best-interest (last accessed August 17, 2021).

Interest's application depends upon the interpretation of the prior Suitability Standard. This constricts the Regulation's application leaving retail investors vulnerable to conflicts of interest and biased "education" operating as a mass recommendation – an increasingly prevalent technique commission-free brokerages use.

Regulation Best Interest and the SEC's interpretative guidance do not provide a bright line definition of recommendation. Instead, the surrounding facts and circumstances determine whether a recommendation has been made.[41] The Rule asks whether a person would reasonably interpret a communication as a "call to action" or be "reasonably influenced to make a securities transaction."[42] It is unclear if this inquiry is based on some abstract reasonable person or on evidence about what causes actual humans to act. For example, a recommendation can easily be found where a broker hands a retail investor a list of "popular" stocks to a customer in-person after he tells his broker that he is having difficulty picking stocks.[43] However, the digital version of this interaction seems to have escaped the Rule's scope.

Consider retail investor behavior across platforms. Robinhood customers "traded nine times as many shares as E-Trade customers, and 40 times as many shares as Charles Schwab customers" in the first quarter of 2020.[44] Though this may be due to differences in customer-base, the disparity in trading behavior is also a result of conditioning customers to trade more through veiled recommendations. In a lawsuit challenging Robinhood, Massachusetts stressed its concern with inexperienced Robinhood customers engaging in an "astronomically higher" volume of transactions than retail investors have historically executed.[45]

Unfortunately, the literature is sparse on what facts and circumstances are necessary to determine if a broker's communication approaches "recommendation." Case law provides no guidance because most claimants are

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[41] *See* Final Rule, *supra* note 26 at 33335.

[42] *Id.*

[43] *See supra* note 37 at 5 ("In an effort to encourage trading, 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 is 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 recommendations to the customer.").

[44] Nathaniel Popper, *Robinhood Has Lured Young Traders, Sometimes With Devastating Results*, The New York Times (July 21, 2021), https://www.nytimes.com/2020/07/08/technology/robinhood-risky-trading.html (last visited Aug. 17, 2021).

[45] See Defendants' Opposition Memorandum to the Plaintiff's Motion for Preliminary Injunctive Relief, Robinhood Financial v. Galvin, Civil Action No. 2184 CV 00884 BLS (May 10, 2021), https://www.masscourts.org/eservices/search.page.3?x=OWxSoK9l0j0xQ3Ar*dLG8NbPCYo0lMb4t1lMmfgHt8auP6Hex0vgfqBaVPJtlWJxUQkEfkQwmkkRr8E-vtGLgpBP6K4fVmZatR75C65DUmXZIZN5iyDlMQ2Zh8eE2vda58aECDHXC*OQrPTkUElyysGq496D0FLvTZW1zXs8kfs.

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bound by arbitration clauses[46] forcing them into the shadowy arena of FINRA arbitration which notoriously lacks detailed information about claims and resolution reasoning in award decisions.[47]

Moreover, many arbitration claims against commission-free brokerages are brought by pro se litigants who lack the legal acumen necessary to test viable liability theories.[48] Notwithstanding litigants' absence of legal representation, different arbitrators facing the question of whether a communication was a recommendation will reach different conclusions depending upon what facts and circumstances they deem controlling. One arbitration panel may find a recommendation while another would reach an entirely different conclusion based on the same facts.

Though FINRA has never provided an exact definition of "recommendation" it emphasizes that the inquiry is objective and "based on the facts and circumstances of a particular case."[49] The likelihood a communication would be viewed as a recommendation increases proportionally to its personalization.[50] For example, "general financial and investment information," is excluded from the definition of "recommendation."[51] But if the communication is tailored to an individual or targeted group of individuals, the more likely the communication is a recommendation. FINRA is considering publishing a "Regulatory Notice" requesting information on new tactics brokerages employ that may eventually reshape its interpretation. [52]

It remains unclear when brokerages must abide by Regulation Best Interest because its threshold inquiry: "Has a recommendation been made?" is open to subjective interpretation. But biased education, gamification and behavioral prompts should not continue to escape regulatory scrutiny considering their objective effectiveness. These methods are not considered

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[46] *See* Robinhood Financial LLC & Robinhood Securities, LLC Customer Agreement, Page 29 #38 (describing the agreement's pre-dispute arbitration clause) (Revised June 22, 2020).

[47] Edwards, *Arbitration's Dark Shadow*, *supra* note 11.

[48] As of September 6, 2021, eleven (11) arbitration awards involving Robinhood Financial are available on FINRA's website; all but one resulted in a judgment in Robinhood's favor. https://www finra.org/arbitration-mediation/arbitration-awards-online?aao radios=all&field case id text=&search=robinhood&field forum tax=All&field special case type tax=All&field core official dt%5Bmin%5D=&field core official dt%5Bmax%5D=.

[49] *See* FINRA, *SEC Approves Consolidated FINRA Rules Governing Know-Your-Customer and Suitability Obligations*, Regulatory Notice 11-02 page 2 (October 7, 2011) ("[A] communication's content, context and presentation are important aspects of the inquiry.").

[50] *See id.* ("[T]he more individually tailored the communication is to a particular customer or customers about a specific security or investment strategy, the more likely the communication will be viewed as a recommendation.").

[51] *See* FINRA, Rule 2111, *supra* note 19.

[52] Robert W. Cook, President and Chief Executive Officer, FINRA, *Statement Before the Financial Services Committee U.S. House of Representatives* (May 6, 2021), https://www finra.org/media-center/speeches-testimony/statement-financial-services-committee-us-house-representatives.

recommendations under the Regulation, yet they have the same effect: they push the customer toward specific investing habits.

Commission-free brokerages rely on users' active investing habits to generate revenue from payment for order flow.[53] The more a customer actively trades, the more payment the brokerage receives. Consider Robinhood which derived 75% of its 2020 revenues from these payments.[54] The payment replaces transactions fees it would otherwise charge and the zero-transaction cost to the customer obscures the conflict created by this business-model.

Commission-free trades may seem beneficial to customers, but they create the illusion of a riskless playground leading customers to treat investing more like a game and less like a tool to build wealth. Less trading friction allows investors to trade more actively which increases revenue for the brokerage but is financially risky for investors.[55]

Regulation Best Interest requires brokerages to disclose if they earn revenue from payment for order flow. This does little to protect investors from a business-model that not only thrives on but encourages customers to make irrational investment decisions.[56] Most retail investors will not benefit from frequent trading, but commission-free brokerages continue to make a concerted effort to encourage aggressive strategies.

III. MISPLACED ASSUMPTIONS ABOUT INVESTORS

In crafting Regulation Best Interest, the SEC intended to protect the stringently rational, wealth-maximization-oriented investor.[57] Yet this consistently logical and "rational" investor is elusive. Already having to contend with his own innate biases and heuristics, he is constantly targeted by companies attempting to manipulate his behavior. These internal and external factors pull the investor away from rationally maximizing his wealth. No one is immune.

The first time investors enter securities markets they are inundated with noise (in contrast to information), encouraged to engage in herding behavior by social media, and risk succumbing to their own overconfidence. These factors, among others, make it difficult for the investor to make consistently rational investment choices. Moreover, most inexperienced retail investors have little understanding of their investment profile.[58] It becomes much easier for

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[53] *See* 17 C.F.R. § 240.10b-10 (defining payment for order flow as "any monetary payment, service, property, or other benefit that results in renumeration, compensation, or consideration to a broker-dealer in return for the routing of customer orders.").

[54] Robinhood Markets, Inc., Registration Statement (Form S-1) (July 1, 2021).

[55] Brad M. Barber & Terrance Odean, *Online Investors: Do the Slow Die First?* (December 1999). Available at SSRN: https://ssrn.com/abstract=219242.

[56] Brad M. Barber & Terrance Odean, *Trading Is Hazardous to Your Wealth: The Common Stock Investment Performance of Individual Investors*, 55 The Journal of Finance 2 (2000) (discussing that frequent trading tends to underperform passive investing strategies).

[57] Tiffany Heravi, *Regulation Best Interest: A Behavioral Analysis*, 28 PIABA B.J. 49 (2021).

[58] *See* Brad M. Barber, *et al., Attention-Induced Trading and Returns: Evidence from Robinhood Users* at 1 (July 2021) (discussing that 50% of Robinhood customers "are first-

Robinhood to push active investing strategies to customers who are "learning as they go along"[59] and lack a sense of their financial goals.

Commission-free brokerages thrive by enabling customers to treat securities markets more like casinos than a place to build personal wealth. Retail investors would benefit from a regulatory model that acts as a counterweight to commission-free brokerages who do their best to distract customers from questioning their own judgements.[60] Casinos do not want a customer tapping buttons on a slot machine to think twice. Similarly, Robinhood has designed its business to give its users a false sense of confidence – don't ask questions, just tap away, make trades and have fun.

Meanwhile, retail investors remain unprotected by Regulation Best Interest because it assumes all investors are rational. The Regulation protects idealized, theoretical traders with odd appetites for reading dull legal documents and does not realistically consider that retail investors are already at risk for irrational behavior even absent active measures by conflicted brokerages.

This section provides a brief overview of some factors inherent in decision-making that stand in the way of rational behavior. Section III.A. will contrast genuine information (i.e., signal) with distorted chatter (i.e., noise). Section III.B. will address herding behavior. Section III.C. will discuss the innate overconfidence investors have in themselves and how commission-free brokerages leverage that to their advantage.

A. Signal & Noise

Professional and retail investors alike encounter massive amounts of information with respect to securities markets. In this context, sophisticated financial literature separates information that holds predictive value, known as signal, with information that lacks this quality, known as noise.[61] Signal holds reliable prognostic value on the future worth of a security, while noise has little relevance to the stock's price.[62] Noise can manifest as a viral news story or a popular trend. Investors who base their trading decisions on noise are less likely to see their portfolios succeed over time.[63] Indeed, all investors have some reason for executing trades, but that reason is not always based on signal. Noise traders let emotion and hype drive their trades, rather than executing technical, process-based investing decisions.[64]

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time investors, who are unlikely to have developed their own clear criteria for buying a stock.") (internal citation omitted).

[59] *Supra* note 37 at 9.

[60] Joshua Rothman, *Why Is It So Hard To Be Rational?*, The New Yorker (August 16, 2021), https://www newyorker.com/magazine/2021/08/23/why-is-it-so-hard-to-be-rational (describing "meta-rationality" as "knowing when to let someone else do the thinking") (last visited August 19, 2021).

[61] Fisher Black, *Noise,* 41 The Journal of Finance 3, (1986).

[62] *Id.*

[63] *Id.*

[64] Will Kenton, *Noise,* Investopedia (June 24, 2021), https://www.investopedia.com/terms/n/noise.asp.

It remains difficult for rookie retail traders to consistently distinguish between signal and noise.[65] Moreover, they are competing with professionals who enjoy significant informational, analytical and capital advantages. Professional traders oftentimes have access to Bloomberg terminals, giving them superior access to company information and targeted research reports. Compared to retail investors, they are also more likely to have training in financial analysis and significant trading experience. Most professional traders experience comparatively faster and better execution, and more capital allows them to maintain positions longer than the typical retail investor.

By way of example, in late January 2021 GameStop (GME) and other "meme-stocks" rocketed to record highs, but these unprecedented gains were quickly followed by a significant corrective drop.[66] GameStop itself experienced changes in leadership and strategy which would explain some of the increase in their stocks' value,[67] but most observers attribute the stock's rise to it becoming a meme-stock via the Reddit discussion forum r/wallstreetbets.[68] Though the reasons the stock appeared on r/wallstreetbets were a combination of both signal and noise, a stock's popularity on the discussion board is a good signal that there is going to be some active short-term interest in the stock.

Whether trading speculatively or using shallow research, noise trading is dangerous to inexperienced retail investors. The resulting underperformance of noise traders' portfolios demonstrates the need to make retail traders aware of this mental pitfall.

B. Follow the Herd

The herd instinct refers to a psychological phenomenon where investors mimic the decisions of a larger, collective group.[69] Necessarily, they ignore their own investing plan and execute trades that could negatively impact their financial status. Those who succumb to the herd mentality find their rational calculations outweighed by the fear of losing money or embarrassment. The urge to avoid such outcomes is so strong that some investors will abandon their objectively sound financial plan and mimic the majority, possibly resulting in substantial losses especially if the herd was following noise rather than signal.

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[65] Black, *supra* note 61.

[66] Tyler Van Dyke, *Major brokers restrict trading on GameStop and AMC amid 'short squeeze'*, Washington Examiner (January 28, 2021), https://www.washingtonexaminer.com/news/major-brokers-restrict-trading-gamestop (last visited Aug. 18, 2021).

[67] Sergio Alberto Gramitto Ricci & Christina M. Sautter, *Corporate Governance Gaming: The Power of Retail Investors*, 22 Nev. L. J. (forthcoming 2021) at 7. Available at SSRN: https://ssrn.com/abstract=3815088 (discussing the co-founder of Chewy acquiring 9 percent of GameStop, the company's deal with Microsoft and 2020's gaming console cycle).

[68] *See* https://www.reddit.com/r/wallstreetbets/ which has become a popular discussion board for amateur investors to gather and talk investment strategy, meme-stocks and other financial topics.

[69] Adam Hayes, *Herd Instinct*, Investopedia (June 17, 2021), https://www.investopedia.com/terms/h/herdinstinct.asp (last visited Aug 18, 2021).

The events of late January 2021 are again illustrative. The retail investors who purchased GameStop (GME) and other meme-stocks likely did not sufficiently research the financials behind those companies. Instead, they bought the securities because many other similarly situated retail investors were doing the same thing. Keith Gill (aka "Roaring Kitty") posted numerous videos to YouTube and contributed to discussion forums on Reddit detailing why he thought GME was undervalued.[70] Many inexperienced retail investors followed his "buy recommendation" which caused the price of the stock to skyrocket.

These events were a near-perfect example of herd-mentality fueled by social-media. Though the urge to be a part of a group can be difficult to resist, it is dangerous to do so at the expense of individual financial plans. Following the herd can upend investment goals especially when retail investors put too much faith (or money) into plans others may not have thought through.[71]

C. Overconfidence & The Illusion of Knowledge

Overconfidence plagues investors of all types and skill level. Retail investors and professional fund managers are equally vulnerable to putting "unwarranted faith in one's intuitive reasoning, judgments, and cognitive abilities."[72] This can lead to irrational and risky decisions. For example, overconfident investors tend to have margin accounts and are more likely to have traded on margin.[73] They believe their ability to pick stocks will outperform the market and tend to buy and sell more often rather than passively invest. On average, those who engage in "more active, speculative trading…earn lower profits."[74]

Commission-free brokerages make education a key component of their business strategy. But even without education pushing a particular investing plan, a small amount of data can alter a retail investor who considers himself a novice to thinking that he has the abilities of a professional money manager leading to more active and speculative trading.[75]

Commission-free brokerages offer varying amounts of securities analytics. For example, TD-Ameritrade provides its users with four-hundred-

[70] Julia-Ambra Verlaine & Gunjun Banerji, *Keith Gill Drove the GameStop Reddit Mania. He Talked to the Journal.,* Wall Street Journal (Jan. 29, 2021) https://www.wsj.com/articles/keith-gill-drove-the-gamestop-reddit-mania-he-talked-to-the-journal-11611931696 (last visited Aug. 18, 2021).

[71] Supra note 4 (quoting a Robinhood user: "The first day I started trading I put 50 dollars in and then bought Coca-Cola and then put another 50 dollars in and bought Live Nation...because I saw Mark Cuban do it").

[72] Michael M. Pompian, *Behavioral Finance and Wealth Management* at 51, John Wiley and Sons, 2006.

[73] Brad M. Barber, *et al., Leveraging Overconfidence,* (November 30, 2020). Available at SSRN: https://ssrn.com/abstract=3445660.

[74] *Id.*

[75] *Id.*

eighty-nine (489) charting indicators while Robinhood only offers five (5).[76] In June 2020, Robinhood users averaged 4.3 million trades per day compared to TD-Ameritrade users who averaged 3.8 million trades.[77] Though different customer bases' habits may be some of the cause, the disparity in trading volume suggests that simplified information is partially to blame.

Robinhood provides its customers with enough data to make them feel confident in their trading decisions, but not so much that they feel alienated. However, information can only go so far. A typical user's forecast of expected return "tends to improve much more slowly than their confidence in the forecasts…lead[ing] to an illusion of knowledge and foster[ing] overconfidence."[78] Payment for order flow supported by overconfident and active trading subsidizes the commission-free business model which potentially opens retail investors to comparatively more financial harm.[79]

IV. ACTIVE MEASURES TO PUSH ACTIVE INVESTING

It is naturally difficult for rational investors to make wealth-maximizing investment decisions and commission-free brokerages understand that their customers are already on thin psychological ice. From there, they aim to rile up their customer-base and completely inhibit their ability to make rational investment choices. But they do not do so blatantly; they disguise the prodding in the form of education, gamified promotions and aggressive pushes for margin accounts.

Law makers and regulators have become increasingly concerned with the effects of these practices on retail investors. FINRA has recently established a group within the organization to measure the impacts of gamification and other customer-engagement methods on customers' trading behavior.[80] Further, FINRA called on member firms to evaluate whether their communications with customers constitute a recommendation that requires compliance with Regulation Best Interest.[81] Brokerages were also reminded that communications must be "fair and balanced" and should not make any "false, exaggerated or misleading" statements.[82] The SEC's Chairman sees these "digital engagement practices" as potentially harmful to investors and stresses that current rules will need to be reexamined to account for changes in

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[76] *See* Stockbrokers.com, *TD Ameritrade vs. Robinhood 2021,* (Aug 2, 2021) https://www.stockbrokers.com/compare/robinhood-vs-tdameritrade (last visited Aug 19, 2021).

[77] *See* Barber, *Attention-Induced Trading and Returns: Evidence from Robinhood Users, supra* note 58 at 4.

[78] *See id.* at 6.

[79] *Id* at 1-2.

[80] Cook, *supra* note 52.

[81] *See* FINRA, *2021 Report on FINRA's Examination and Risk Monitoring Program*, at 22 (Feb. 2021) https://www.finra.org/rules-guidance/guidance/reports/2021-finras-examination-and-risk-monitoring-program.

[82] *Id.*

[redacted]

brokerages' engagement practices.[83] In particular, the agency will be closely analyzing when a communication transforms from mere marketing into a recommendation subject to a heightened duty of care.[84]

This Section will describe practices common across commission-free brokerages that are used to increase customer engagement and trading. Section IV.A. will describe how brokerages use biased education to condition customers to actively trade. Section IV.B. will then introduce gamification and how it is used distract retail investors from reaching their own financial goals. Section IV.C. provides examples of how Robinhood uses gamification and psychological nudges to condition their customers to actively trade against their better judgment. Section IV.D. will describe how Robinhood aggressively pushes margin trading to increase its customers' trading activity.

A. Effects of Education

When providing financial education, commission-free brokerages act as if they are operating within the safe harbor of the prior Suitability Rule which excludes "general financial and investment information, including...basic investment concepts" from the definition of recommended strategies.[85] Robinhood, for example, has hundreds of jargon-free articles from simple to complex financial topics.[86] The articles themselves on an isolated individual basis would likely fall within the confines of the safe harbor. However, a text box sits at the end of every article with a link asking "Ready to start investing? Sign up for Robinhood and get your first stock on us." Considering its structure, Robinhood apparently thinks a potential customer who just learned a basic investing concept is ready to start buying and trading stocks. The lack of proximity between the article and the offer appears calculated to induce a person without experience to begin trading. This offer follows each of Robinhood's educational articles and exposes their push for active investing. Indeed, Robinhood likely has click-through metrics analyzing the effectiveness of its education at inducing trading.

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[83] *See* Katanga Johnson & Chris Prentice, *Exclusive: U.S. SEC to Scrutinize Firms' Digital-Engagement Practices as Investor Worries Grow,* Reuters (August 24, 2021), https://www reuters.com/technology/exclusive-us-sec-scrutinize-firms-digital-engagement-practices-investor-worries-2021-08-24/ (discussing Chairman Gensler's concern regarding "the data that's coming in to these data analytics, whether it be machine learning or deep learning, will represent the biases in society, as they exist already.") (last accessed August 26, 2021).

[84] *Id. See also* SEC, "Request for Information*" supra* note 8 at 49075 (citing the possibility that digital engagement practices "may, depending on the relevant facts and circumstances, constitute a recommendation for purposes of Regulation Best Interest.").

[85] FINRA, *supra* note 19.

[86] Robinhood, *What is a Portfolio?*, (2021) https://learn.robinhood.com/articles/4vaR9PkTzes8u3ibLAWrD1/what-is-a-portfolio/ (last visited Aug 19, 2021). *See also* Robinhood, *What is the Sharpe Ratio?*, (2021) https://learn.robinhood.com/articles/403DnmBe6ZeiQwhgDldXKn/what-is-the-sharpe-ratio/ (last visited Aug 19, 2021).

Robinhood also prominently displays articles on options trading. On the company's "Learn" page just below "Investing 101" is "Options trading Essentials."[87] The article readily reminds readers that options trading is not just for "adrenaline junkies" who enjoy "high-risk, short-term vices."[88] Again, the same tempting text box offering a free stock sits just below the article. It is difficult to imagine the justification for this offer unless the company is advocating for retail traders to adopt an active investing strategy. At the very least, it is a disguised recommendation outside the safe harbor.[89]

Robinhood is not the only commission-free brokerage promoting active investing under the guise of education and marketing. SoFi offers a self-directed brokerage service branded "Active Investing."[90] It touts this style of investing as superior to passive investing because it allows customers to "potentially beat average market returns...as opposed to waiting it out in the long run."[91] SoFi attempts to navigate into the safe harbor by stating they "won't be able to provide tips about which stocks you should buy or sell, or when."[92] In the aggregate, Sofi's biased "education" advocates for active investing while ignoring the advantages of passive investing.

Practices that emphasize customers can beat average market returns through active investing appear to be at odds with FINRA's prohibition on misleading statements.[93] By not informing customers that passive investing tends to outperform active investing, it becomes difficult to conclude that these communications are "fair and balanced."[94]

Education is essential to commission-free brokerages like Robinhood[95] and SoFi because it makes their customers more confident in their investment decisions. A small amount of information presented in bite-sized articles leaves readers thinking that they fully understand what are doing.[96] Overconfidence

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[87] Robinhood, https://learn.robinhood.com (last visited July 27, 2021).

[88] Robinhood, *Getting started with options*, (2021) https://learn.robinhood.com/articles/getting-started-with-options/ (last visited July 21, 2021).

[89] See Fred Reish, *Best Interest Standard of Care for Advisors #16* (Nov 7, 2019), https://fredreish.com/best-interest-standard-of-care-for-advisors-16/ (discussing how if educational conversations and materials are biased, they could be viewed as a disguised recommendation in the context of 401(k) plan rollovers) (last visited July 23, 2021).

[90] Sofi, https://www.sofi.com/invest/active/ (last visited Aug 19, 2021).

[91] *Id.*

[92] *Id.*

[93] FINRA, *supra* note 81.

[94] *Id.*

[95] *See* Robinhood Markets, Inc., *supra* note 54 at 162 ("Education is core to accomplishing our mission.").

[96] Carmen Sanchez and David Dunning, *Research: Learning a Little About Something Makes Us Overconfident*, Harvard Business Review (March 29, 2018) https://hbr.org/2018/03/research-learning-a-little-about-something-makes-us-overconfident (last visited Aug 19, 2021).

leads to more active trading which drives revenue for commission-free brokerages.[97]

The Dunning-Kruger effect suggests that people who possess a small amount of knowledge on a subject tend to overestimate their expertise in that area.[98] Thanks to this psychological phenomenon, an inexperienced investor may feel he is ready to buy stocks and trade options after spending just a few minutes reading Robinhood's articles. The articles explain the basics of securities markets, but they fall short of giving readers the knowledge and expertise needed to "beat average market returns."[99] However, many customers are led to believe that they can, in fact, beat the market. Educational articles do not appear to be recommendations on their face but when they are specifically targeted at inexperienced retail investors intending to make them "feel informed, confident, and knowledgeable"[100] they approach recommendation because they influence retail investors to trade more.

The articles Robinhood and SoFi offer lack personalization which removes them from under the umbrella of recommendation. However, their business-model does not require creating bespoke investment advice because retail investors can feel sufficiently overconfident from reading a couple of jargon-free articles. Robinhood and SoFi may avoid scrutiny under Regulation Best Interest because their educational materials are not personalized and each company explicitly states that it is not advocating or recommending any investment strategy.[101] But in the aggregate, these materials do advocate active trading as opposed to passive participation in the market – and the strategy is the same for all retail investors.

B. Gamification And Its Impacts

"Gamification" is the process of making activities in non-game contexts more game-like by using common game design elements such as points, badges,

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[97] *See* Brad M. Barber and Terrance Odean, *supra* note 56 at 774 ("Our most dramatic empirical evidence supports the view that overconfidence leads to excessive trading.").

[98] Jan Feld, *et al.*, *Estimating the Relationship Between Skill and Overconfidence*, IZA-Institute of Labor Economics (March 2017). Available at SSRN: https://ssrn.com/abstract=2940601.

[99] SoFi, *supra* note 90.

[100] Robinhood, *Meeting Our Responsibilities to Customers,* Under the Hood (2021), https://blog.robinhood.com/news/2021/6/30/meeting-our-responsibilities-to-customers (last visited July 27, 2021).

[101] *See* Robinhood, Form CRS (Aug 3, 2021) https://files.brokercheck.finra.org/crs_165998.pdf ("We buy and sell securities only at your direction and we do not offer recommendations of securities, or investment strategies involving securities…") and *see* SoFi, Form CRS (June 24, 2021) https://files.brokercheck.finra.org/crs_151717.pdf ("We do not currently make securities recommendations and do not monitor accounts for our customers.").

leaderboards, bonuses and competitions to increase user engagement.[102] Designers build "motivational affordances" into the non-game environment[103] to create game-like experiences and promote a psychological state that results in a desired behavioral outcome.[104] For example, the Boys Scouts of America use the possibility of obtaining a badge after demonstrating proficiency in a task as a motivational affordance to bring about a desired psychological and eventual behavioral outcome. Boy Scouts are motivated (psychological outcome) to learn a new skill (behavioral outcome) because of the possibility of obtaining a new badge (motivational affordance).

Until the end March 2021,[105] confetti would rain down from the top of the screen after a user placed their first trade on Robinhood.[106] The confetti has since been replaced with new digital designs to acknowledge "investing milestones,"[107] but this equates to swapping one gamification-feature with another because the digital designs fit the description and purpose of badges.[108]

Regulators are increasingly concerned about the effects that gamified retail investing apps may have on individual investors and markets.[109] Gamification manipulates targeted users' behavior to reach goals that may seem like their own but are actually the developer's goals.[110] A gamified app prods individuals to act against their own best interests and pulls people away from acting rationally simply because humans like games.[111] When a challenge is

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[102] *The Ultimate Definition of Gamification (With 6 Real World Examples),* Growth Engineering (March 10, 2021), https://www.growthengineering.co.uk/definition-of-gamification/ (last visited July 23, 2021).

[103] Michael Sailer, *et al., How gamification motivates: An experimental study of the effects of specific game design elements on psychological need satisfaction*, 69 Computers in Human Behavior 371, 372 (2016).

[104] Juho Hamari, *et al., Does Gamification Work? – A Literature Review of Empirical Studies on Gamification.* In proceedings of the 47th Hawaii International Conference on System Sciences (Hawaii, USA, Jan 6-9, 2014).

[105] Robinhood, *A New Way to Celebrate with Robinhood,* Under the Hood (2021) https://blog.robinhood.com/news/2021/3/31/a-new-way-to-celebrate-with-robinhood, (last visited Aug 19, 2021).

[106] Caitlin McCabe, *Robinhood to Remove Controversial Digital Confetti From Trading App*, The Wall Street Journal (March 31, 2021), https://www.wsj.com/articles/robinhood-to-remove-controversial-digital-confetti-from-trading-app-11617195612 (last visited July 27, 2021).

[107] *Id.*

[108] *See* Juho Hamari, *Do badges increase user activity? A field experiment on the effects of gamification*, Computers in Human Behavior 71 (April 2015).

[109] *See* Virtual Hearing before the House Committee on Financial Services, *Game Stopped? Who Wins and Loses When Short Sellers, Social Media, and Retail Investors Collide Part III*, 117 Cong., U.S. House Committee on Financial Services, 117th Cong. (May 6, 2021) (Testimony of Gary Gensler, Chair, Securities and Exchange Commission).

[110] *See supra* note 102.

[111] George Akerlof and Robert Shiller, *Phishing for Phools: The Economics of Manipulation and Deception*, Princeton University Press (2015).

overcome the brain releases dopamine which generates pleasant feelings.[112] Once we experience the rush of dopamine, we want to feel it again. This desire for more dopamine leads us to repeat our behaviors and continually participate in an activity that is not naturally attractive – such as retail investing.[113]

C. Gamification, Notifications & Information Within Robinhood

Much of Robinhood's success and a large source of its criticism is due to the simplicity of its app. The company took a "bare bones" approach chose not to include elements "designed for the 1%, with complicated, confusing and often intimidating user interfaces."[114] Instead, the app focuses on ease-of-use.[115]

An interface without a steep learning curve helps keep users engaged and placing trades on the app. But a simplified interface has its costs as well; it is difficult for the typical Robinhood user (even a "Gold" user)[116] to beat professional traders with "the biggest computers, the fastest data feeds, and the most sophisticated analytics."[117] The company makes no mention of this and instead bombards its users with gamified features and behavioral nudges to keep them engaged

1. Transforming Waitlists into Leaderboards

The promotional campaign for Robinhood's cash management service offers an example of how an innocuous feature can lead to addictive behavior. Prior to its release, interested customers were placed on a waitlist and could see their position relative to others. However, these positions were not static because their place depended upon how many times they tapped a fake debit card on the screen. Each customer could tap up to 1,000 times per day and were encouraged to continue tapping the next day. However, those who did not tap daily would watch their position fall.[118] Gamifying a waitlist has proven to be an effective way to train customers to interact with the app through mindless,

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[112] *Gamification and Dopamine: Why Games Motivate Us*, Playmotive (July 19, 2019), https://playmotiv.com/en/gamification-and-dopamine-why-games-motivate-us/ (last visited July 27, 2021).

[113] *Id.*

[114] Rich Bessel, *The Top Secret Robinhood Design Story,* (April 14, 2021), https://robinhood.engineering/the-top-secret-robinhood-design-story-a2b044812bae (last visited July 28, 2021).

[115] Chris Davis, *Robinhood Review 2021,* Nerd Wallet (July 23, 2021), https://www nerdwallet.com/reviews/investing/brokers/robinhood (last visited July 28, 2021).

[116] *See* Robinhood, *Upgrading to Gold*, https://robinhood.com/us/en/support/articles/upgrading-to-gold/ (discussing the benefits of its Gold Membership including access to Level II market data). (last visited August 6, 2021).

[117] Wall Street Journal, *How Robinhood Transformed Retail Trading Ahead of Its IPO,* YouTube (July 15, 2021), https://www.youtube.com/watch?v=qAuF4wlSQnk (quoting Larry Tabb - Head of Market Structure Research, Bloomberg Intelligence) (last visited August 6, 2021).

[118] *Supra* note 37.

constant and daily tapping. Though not illegal, the practice should be examined when it changes users' behavior through manipulation.

2. Cash and Stock Incentives

To encourage customers to join, Robinhood offers newly approved users a free share of stock that they reveal by scratching off a virtual lottery ticket.[119] This tactic offers another example of gamification.[120] Cash and stock incentives are a simple way to engage potential customers and give them a psychological nudge to produce a desired behavior.[121]

In March 2021, Robinhood offered cash to targeted users who deposited money into their trading account.[122] Selected users were offered $10 to $250 for making a deposit between $200 and $15,000.[123] This offer coincided with the release of $1,400 COVID-19 relief checks. Robinhood's campaign was designed to produce a substantial return through increased customer account balances leading to more trading. Such offers closely approach "recommendation" because they target distinctive groups of current and potential customers and extend different incentives.

Free money happens to be difficult to turn down. Robinhood uses this to their advantage and targets customers to encourage them to deposit more money. This is no different than a broker reaching out to its customers and offering them the same promotion. Regulators would likely view this as a recommendation because the brokerage firm is contacting targeted-customers and urging them to deposit more money so they can execute more trades. The only difference in Robinhood's case is that they sent mass emails to targeted customers. Psychological nudges like this are the kinds of practices that should concern regulators. Rather than using the relief money for necessities such as food and rent, Robinhood blatantly encouraged customers to use it for securities trading. But influencing customers to deposit a few hundred dollars into their account is only half the story; Robinhood still needs to stimulate trading to generate revenue for itself.

3. Push Notifications Push Influential Information

All smart phone users recognize the "ding" of a push notification. Each time an app demands our attention and we respond, notifications

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[119] Nathaniel Popper, *supra* note 44.

[120] *Id.*

[121] Richard H. Thaler and Cass R. Sunstein, *Nudge*, Yale University Press (April 2008).

[122] Anders Melin & Annie Massa, *Robinhood Offers Users Cash for New Deposits as $1,400 Checks Arrive,* Bloomberg Wealth (Mar 17, 2021), https://www.bloomberg.com/news/articles/2021-03-17/robinhood-offers-traders-cash-for-new-deposits-as-1-400-stimulus-checks-arrive (last visited July 28, 2021).

[123] *See id.* (Quoting Robinhood's promotional language "This promotion is not available to the general public. In order to be eligible to receive a cash reward, you must be a direct recipient of the original email from Robinhood.").

become increasingly difficult to ignore.[124] Similar to cash incentives, push notifications are used as a psychological prod to move a targeted user in a desired direction. Robinhood uses push notifications to capture its users' attention and draw them toward executing trades. It sends timely, personal and actionable notifications to various categories of its users.[125] For example, customers who have downloaded the app but have not executed any trades receive push notifications that read "Top Movers: Choosing stocks is hard [flexing bicep emoji] Get started by checking which stock prices are changing the most." The user who follows the notification is directed to a list displaying stocks whose prices are shifting the most at the time the notification is opened.[126]

The "Top Movers" list demonstrably influences customers' trading activity. A 2021 study found Robinhood customers "respond similarly to top gainers and losers, while other retail investors buy top gainers much more aggressively than top losers."[127] These findings suggest that Robinhood users' decisions are influenced by the information presented to them. Push notifications accompanied by the list of "Top Movers" approaches recommendation because it targets a specific group of customers and influences their investing decisions.[128] Even though the "Top Movers" list is available to all users, it still functions as a recommendation much like a broker "handing a list of securities to a customer."[129]

D. Aggressive Tactics to Push Margin Trading

To fill the vacuum left by a lack of sports betting during the COVID-19 pandemic, many bettors turned to the stock market because "investing has a ton of similarities."[130] Gamblers-turned-investors began trading stocks and some even went a step further into options trading without learning investing basics. Dave Portnoy, captured this attitude in a March 30, 2020 podcast episode

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[124] Dan Pontefract, *Push Notifications Have Become the Death of Thinking*, Forbes (Sep 26, 2017), https://www.forbes.com/sites/danpontefract/2017/09/26/push-notifications-have-become-the-death-of-thinking/?sh=1f7e679a3f6a (last visited July 28, 2021).
[125] KC Karnes, *Push Notification Best Practices: 35 Tips for Dramatically Better Messages*, Clever Tap (Nov 2, 2020), https://clevertap.com/blog/push-notification-best-practices/ (last visited August 7, 2021).
[126] *Supra* note 37 at 14.
[127] Brad M. Barber, *et al.*, *supra* note 58 at 15 (July 2021).
[128] *See* Hugh D. Berkson, *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/ (last visited September 5, 2021).
[129] *Supra* note 37 at 5.
[130] Kate Rooney, *Gamblers pivot to stock trading during lockdowns - Barstool's Portnoy revives old E-Trade account*, CNBC (May 22, 2020), https://www.cnbc.com/2020/05/22/gamblers-pivot-to-stock-trading-during-lockdowns---barstools-portnoy-revives-old-e-trade-account html (last visited July 28, 2021).

stating, "I have margin…I don't know what any of that means."[131] Most Americans cannot afford to make such a blind charge. However, commission-free brokerages like Robinhood aggressively pursued an opportunity with bored, stuck-at-home Millennials who had extra cash.[132]

Consider Robinhood's approval of inexperienced and risk averse customers for margin trading who did not meet the company's own criteria. Yet Robinhood approved them for options trading even though the company requires some trading experience and a medium to high tolerance for risk. These practices, among other systemic failures within the company, led FINRA to impose its largest fine ever ($70 million) on a member firm.[133] Robinhood's lack of an adequate review process shows that it is more concerned with generating order flow payments rather than their customers' financial well-being. Between December 31, 2019, and December 31, 2020, Robinhood's customer margin account balances increased nearly 450%.[134] The massive uptick can be partially attributed to the company's proliferation of "false and misleading information" and its "failure to exercise due diligence before approving options accounts."[135]

1. Demonstrably False Claims

Between January 2018 and March 2021, Robinhood significantly down-played the risk of potential losses related to options spread transactions. The company stated that "[y]ou'll never lose more than the premium you paid to enter the call debit spread."[136] This statement was simply not true because it did not account for circumstances in which it was possible for customers to suffer losses beyond the premium they paid.[137] Additionally, customers with expiring options who relied on Robinhood's statements lost money beyond what the company indicated.[138] Moreover, Robinhood represented that its default accounts were ineligible to trade on margin and that they could only "trade using unsettled funds up to the amount" in their account. However, the company failed to disclose that some trades "could and often did automatically trigger the use of margin" making them vulnerable to significant losses.[139]

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[131] Barstool Sports, *Barstool Rundown* Podcast (March 30, 2020), https://www.barstoolsports.com/video/2219389/barstool-rundown-march-30-2020 (last visited Aug 19, 2021).

[132] *See* Statista, *Tech Investors Rise During Pandemic,* (June 9, 2020), https://www-statista-com.ezproxy.library.unlv.edu/chart/21947/tech-investors-rise-covid/, (discussing new user positions on Robinhood tripling between March 2020 and June 2020) (last visited August 7, 2021).

[133] FINRA, *Letter of Acceptance, Waiver, and Consent* Re: Robinhood Financial LLC, (June 22, 2021).

[134] Robinhood Markets, Inc., *supra* note 54.

[135] FINRA, *supra* note 133.

[136] *Id* at 10.

[137] *Id.*

[138] *See id.* at 11.

[139] *Id* at 6-7.

[redacted]

These misrepresentations cost 630 customers over $5.73 million in losses.[140] Due to errors and delays in Robinhood's system, millions of customer accounts displayed inaccurate portfolio balances, buying power and total return.[141] Misrepresenting users' buying power and return is inapposite to empowering retail investors to make smart financial decisions.[142]

2. Due Diligence Failures

Robinhood users who want to trade options must upgrade to "Gold." For five dollars per month, customers can access at least $1,000 of margin and Level II market research reports.[143] Once a customer attests to their experience level and risk tolerance, Robinhood uses an automated process to expedite approval.[144] But this was not without its flaws. Robinhood allowed customers who were previously denied access to "Gold" membership to change their answers. In one case, a 19-year-old user applied for "Gold" access and initially stated he had "low risk tolerance" and "did not understand options."[145] The company denied his application because he did not meet the minimum criteria. Minutes later, he changed his risk tolerance to "high" and indicated he had "three or more years" of experience trading options. Robinhood immediately approved his application ignoring the red-flag that a 19-year-old had three years of options trading experience.[146] Investors with margin accounts tend to trade more actively.[147] Enabling users to easily access margin through careless practices demonstrates Robinhood's push to drive revenue through active trading.

V. CONCLUSION

As it stands, brokerage firms that profit by driving active trading should bear some responsibility for the behaviors they encourage. This may mean that arbitrators, regulators and other policy makers should take a more critical look at what constitutes a recommendation and adopt a broader conception of the term or otherwise revise their oversight. There exists a worrying trend that commission free brokerages are using their educational articles to drive active trading that harms both individuals and markets. To

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140 *Id* at 9.
141 *Id.*
142 *See* Robinhood, *Our Customers*, https://robinhood.com/us/en/our-customers/, (citing testimonials how information and education have "empowered" customers to make good financial decisions) (last visited Aug 19, 2021).
143 Robinhood, *supra* note 116.
144 *Supra* note 37 at 18.
145 FINRA, *supra* note 133 at 20.
146 *Id.*
147 *See* Emily Norris, *Cash Account vs. Margin Account: What Is the Difference?*, Investopedia (April 22, 2021), https://www.investopedia.com/ask/answers/100314/whats-difference-between-cash-account-and-margin-account.asp ("The borrowers of stocks held in margin accounts are generally active traders,") (last accessed August 7, 2021).

better protect investors the law must transform in-step with evolving digital engagement practices and data-driven business-models.