ROBINHOOD TRADING APP IN SEC AND STATE REGULATOR CROSSHAIRS

Hodgson Russ Securities/Directors & Officers Litigation Alert
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Robinhood is an app-based stock trading platform marketed to younger investors, with approximately 13 million customer accounts. Robinhood's stated mission is to "democratize finance for all" and its website touts "investing for everyone." Its median customer age is 31, and its advertising features young people like a "broke college student" and others who profess they knew nothing about investments but learned as they went after joining Robinhood.

In response to an investigation by the Securities and Exchange Commission, Robinhood agreed to pay $65 million on December 17, 2020. The SEC claimed that Robinhood engaged in "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." The SEC's order details Robinhood's misconduct, including that Robinhood claimed its trading was "commission free" while its prices were inferior to other brokers. The SEC order found that the inferior trade prices deprived investors of $34.1 million. Robinhood did not admit or deny the findings but agreed to a cease-and-desist order and retention of an independent consultant to review and ensure compliance with its policies and procedures.

Robinhood is also the subject of a December 16, 2020 administrative complaint by the Massachusetts securities regulator. Robinhood is accused of "aggressively marketing itself to ... investors without regard for the best interests of its customers and failing to maintain the infrastructure and procedures necessary to meet the demands of its rapidly growing customer base" by the Massachusetts Securities Division of the Office of the Secretary of the Commonwealth.

In Massachusetts alone, the value of the accounts of state residents was almost $1.7 billion. According to the complaint, Robinhood targeted younger investors with little investment experience. Its exponential growth was met with inadequate internal controls to prevent and respond to outages on its trading platform, of which 70 instances occurred in 2020 through the end of November and during which investors could not access their accounts to purchase or sell securities. The most notable outage in March 2020 spawned a class action lawsuit.

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Massachusetts accuses Robinhood of "gamification" to the detriment of its customers. Gamification includes bombarding customers "with a number of strategies designed to encourage and incentivize continuous and repeated engagement with its application." These tactics include digital confetti congratulating customers on executed trades, promises of stock giveaways, and encouraging daily interactions with the platform to improve customer accessibility to premium features. Further, according to the complaint, Robinhood gave no consideration to customer suitability and published "Popular Lists" which provides categories of investments and a "100 Most Popular" list. Robinhood also improperly permitted inexperienced investors "to engage in very risky trading activity" including options trading and frequent trading. The complaint features 25 customers and their trading habits, including one who made 12,700 trades in a six-month period.

The relief being sought against Robinhood in Massachusetts is: (1) disgorgement of profits and compensation to investors for losses resulting from its wrongdoing; (2) review of compliance procedures, specifically with respect to options trading; (3) review of supervisory procedures; and (4) an administrative fine.

Please contact Jodyann Galvin (716.848.1520) or Catherine Cooley (716.848.1456) if you have any questions on how this SEC order and regulatory action could impact you or your organization.

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