

FIDUCIARY DUTIES—Massachusetts charges Robinhood with manipulation in first state fiduciary duty action,(Dec. 16, 2020)

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The Massachusetts securities regulator accuses the pioneer no-commission brokerage of using "gamification" and aggressive tactics to entice the use of its mobile trading app.

The Massachusetts Securities Division has charged Robinhood Financial, LLC with violating the state's fiduciary duty rule by aggressively marketing itself to investors without regard for the best interests of its customers. In an administrative complaint, the Division accuses the no-commission broker-dealer of using aggressive tactics to attract new and inexperienced investors while also using strategies such as "gamification" to entice them to make continuous use of Robinhood's mobile trading application. The complaint also alleges that Robinhood failed to implement policies and procedures to prevent response to system outages and disruptions and failed to follow procedures regarding the approval of options trading ([In re Robinhood Financial, LLC](#), December 16, 2020).

The enforcement action is the first brought by Massachusetts under the fiduciary duty rule [adopted](#) by the state earlier this year. Under the rule, which became effective March 6, 2020, for enforcement starting September 1, 2020, broker-dealers and agents owe a fiduciary duty to their customers when they: (1) provide investment advice; (2) recommend an investment strategy; (3) open or transfer assets to any account type; or (4) buy, sell or exchange any security. The rule imposes both a fiduciary duty of care and a fiduciary duty of loyalty and requires, among other things, that brokers use the attention, caution, and prudence of a reasonable person in the same circumstances while disclosing all material conflicts of interest and prioritizing the customer's interests.

Financial democracy. Founded in 2013 in Palo Alto by Stanford University graduates Vladimir Tenev and Baiju Bhatt, Robinhood has described itself as a "pioneer" of no-commission investing. Robinhood provides commission-free trading to retail customers when using the firm's online mobile trading application or website to submit orders to trade in U.S. listed and over-the-counter securities. "We're on a mission to democratize our financial system," states language on the ["About Us" page](#) on Robinhood's website.

According to the Massachusetts complaint, Robinhood experienced a dramatic increase in its customer base beginning in 2016, growing from one million to 13 million accounts nationwide by May 2020. By early December 2020, Robinhood had approximately 486,000 accounts in Massachusetts alone, representing a total value of over \$1.6 billion. The complaint claims that in achieving this growth, Robinhood's marketing has targeted youthful, inexperienced investors, with the firm having a reported median customer age of just 31 years old.

Expansion outpaces controls. Despite Robinhood's rapid expansion in business, however, the Division alleges that the firm's internal controls have failed to keep pace with the growth. For example, on March 2, 2020, a day on which the Dow Jones Industrial Average achieved the largest daily gain in history up to that point,

Robinhood's platform collapsed and remained inoperative until the following day, leaving customers unable to benefit from the historic gains.

Moreover, the Division claims, Robinhood encourages more and more customers to open accounts, and then relentlessly bombards them with aggressive strategies such as "gamification" to use its trading platform constantly. As described by the Division, gamification in this context refers to the application of typical elements of game playing to marketing efforts in order to boost engagement with the company's services. For example, Robinhood rewards customers by raining colorful digital confetti on their screens after executing trades. Robinhood also used gamification to reward customers who interacted daily on the app by boosting their ranking on a waitlist for the brokerage's new cash management feature, while less frequent users saw their position on the waitlist plummet.

The Division also claims that Robinhood violated its own policies by failing to screen customer profiles and by allowing thousands of inexperienced investors to engage in options trading or other risky trading activity. For example, the firm allegedly approved 340 customers for options trading who had no investment experience and who had not placed a single trade with Robinhood, despite having policies requiring that a customer either self-report investment experience or have four filled orders with the broker-dealer.

According to the Division, Robinhood's conduct in targeting young, inexperienced investors and exposing its customers to unnecessary trading risks falls far short of the fiduciary standard required of broker-dealers in Massachusetts. Among other sanctions, the Division's complaint seeks the disgorgement of all Robinhood's profits from the alleged wrongful conduct as well as restitution to fairly compensate investors for losses attributable to the wrongdoing. The Division also seeks an administrative censure and the engagement of an independent compliance consultant to review Robinhood's trading infrastructure and the firm's policies and procedures related to options trading.

The proceeding is [No. E-2020-0047](#).

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