

VIII. Robinhood IPO: Continued Regulatory Issues After Going Public

A. Introduction

Since April 2013, Robinhood has served as an online investing platform offering commission-free trading on several U.S.-listed investment types.¹ The company declares that the mission of Robinhood is to “democratize finance for all.”² As of July 29, 2021, Robinhood is a publicly traded company under the stock symbol \$HOOD.³ Despite the many successes that must have been achieved in order to become a publicly traded company, Robinhood has also faced many problems throughout its eight years of operation.⁴ The company has been penalized by multiple regulatory bodies for a variety of offenses.⁵ Most notably, the largest Financial Industry Regulatory Authority (“FINRA”) penalty ever ordered was against Robinhood.⁶ In response to the penalties, Robinhood has made hopeful additions to the board of directors and made many improvements within the platform.⁷ However, regardless of efforts to improve, it is likely that Robinhood will face more regulatory challenges in the future. First, this article will provide a brief history of Robinhood and its initial public offering (“IPO”). Second, this article will examine notable regulatory penalties that Robinhood has faced in the past. Third, this article will analyze expected future developments. Finally, this article will discuss proposed reform efforts and their effect on the future of Robinhood.

¹ Letter of Acceptance, Waiver, and Consent, Robinhood Financial LLC, to Financial Industry Regulatory Authority, (June 22, 2021) (on file with author).

² *Welcome to the New Wall Street*, ROBINHOOD BLOG (July 29, 2021), <https://perma.cc/TZ96-GMJU>.

³ *Id.*

⁴ Dean Seal, *Robinhood to Pay Record \$70M FINRA Penalty*, Law360 (June 30, 2021), <https://www-law360-com.ezproxy.bu.edu/articles/1399110>.

⁵ *Id.*

⁶ *Id.*

⁷ *Robinhood Markets Welcomes Three New Directors to Board*, ROBINHOOD BLOG (June 1, 2021), <https://perma.cc/NPM8-L6HM>.

1. *A Brief History of the Robinhood IPO*

Robinhood became a publicly traded company on July 29, 2021.⁸ On that day, Robinhood sold 55 million shares at \$38 each.⁹ Robinhood sold the bulk of the shares on offer, while the company's co-founders and Chief Financial Officer sold a combined 2.6 million shares in the offering.¹⁰ According to filings with the Securities and Exchange Commission ("SEC"), proceeds from the IPO will be used to repay approximately \$342 million in debt that Robinhood expects to borrow in order to fund certain tax withholdings and remittance obligations.¹¹ Additional proceeds will be allocated "toward working capital, meeting regulatory capital requirements, and corporate initiatives such as expanding the Robinhood team."¹²

2. *Notable Regulatory Penalties*

(a) SEC Findings

Amongst the various penalties that Robinhood has faced in previous years are massive fines from the SEC and FINRA.¹³ On December 17, 2020, the SEC charged Robinhood with "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."¹⁴ The SEC found that between 2015 and 2018, Robinhood made misleading statements and omissions in customer communications regarding its largest revenue source when describing how it created revenue.¹⁵ The company failed to disclose that it receives most of its revenue from "payments from trading firms in exchange for

⁸ Elise Hansen, *Robinhood Hits the Markets After \$2.1B Cravath-Led IPO*, Law360 (July 29, 2021), <https://www-law360-com.ezproxy.bu.edu/articles/1407788/robinhood-hits-the-markets-after-2-1b-cravath-led-ipo>.

⁹ *Id.*

¹⁰ *Id.*

¹¹ *Id.*

¹² *Id.*

¹³ Press Release, Sec. and Exch. Comm'n, SEC Charges Robinhood Financial with Misleading Customers About Revenue Sources and Failing to Satisfy Duty of Best Execution (Mar. 21, 2020) (on file with author).

¹⁴ *Id.*

¹⁵ *Id.*

Robinhood sending its customer orders to those firms for execution, also known as ‘payment for order flow.’”¹⁶ One of the marketed attractions of Robinhood is that it offers “commission free” trading to users.¹⁷ However, due in part to unusually high payment for order flow rates, Robinhood executed user orders at prices that were inferior to those of other brokers.¹⁸ In aggregate, Robinhood provided inferior trade prices that deprived customers of \$34.1 million, even after accounting for the savings derived from not paying a commission.¹⁹ The SEC further found that between October 2018 and June 2019, Robinhood falsely claimed on the company website “that its execution quality matched or beat that of competitors.”²⁰ “Without admitting or denying the SEC’s findings, Robinhood agreed to a cease-and-desist order prohibiting it from violating the antifraud provisions of the Securities Act of 1933 and the recordkeeping provisions of the Securities Exchange Act of 1934...”²¹ Robinhood agreed to pay \$65 million in order to settle the charges.²²

(b) FINRA Penalties

On June 30, 2021, FINRA announced that it had fined Robinhood \$57 million and ordered the company to pay approximately \$12.6 million in restitution, plus interest, to harmed customers.²³ This is the largest financial penalty ever ordered by FINRA in order to “reflect the scope and seriousness of the violations.”²⁴ First, FINRA found that during certain periods after September 2016, Robinhood negligently communicated false and misleading information to its customers despite its mission to “de-mystify finance for all.”²⁵ The false and misleading statements made by Robinhood concerned whether users could place trades on margin, how much cash was in users’ accounts, how much buying power users had, the risk of loss users faced in certain

¹⁶ *Id.*

¹⁷ *Id.*

¹⁸ *Id.*

¹⁹ *Id.*

²⁰ *Id.*

²¹ *Id.*

²² *Id.*

²³ Press Release, Financial Industry Regulatory Authority, FINRA Orders Record Financial Penalties Against Robinhood Financial LLC (June 30, 2021) (on file with author).

²⁴ *Id.*

²⁵ *Id.*

transactions, and whether users faced margin calls.²⁶ “Second, FINRA found that since Robinhood began offering options trading to customers in December 2017,” Robinhood had “failed to exercise due diligence before approving customers to place options trades.”²⁷ In order to approve customers for trading, Robinhood had implemented “option account approval bots” that relied upon inconsistent or illogical information.²⁸ Consequently, Robinhood approved thousands of users for options trading who either did not satisfy eligibility criteria or whose accounts contained concerns indicating that options trading may not have been appropriate for them.²⁹ “Third, FINRA found that from January 2018 to February 2021 Robinhood failed to reasonably supervise the technology that it relied upon to provide core broker-dealer services, such as accepting and executing customer orders.”³⁰ As a result of this failure, Robinhood experienced a series of outages and critical systems failures.³¹ The most severe of the outages occurred on March 2 and 3, 2020, when Robinhood’s website and mobile applications stopped, preventing customers from accessing their accounts during a time of “historic market volatility.”³² Fourth, FINRA found that between 2018 and 2020 Robinhood failed to report tens of thousands of written customer complaints that it was required to report to FINRA.³³ Such complaints included that customers had been provided with false and misleading information from Robinhood and that customers had suffered monetary losses as a result of Robinhood’s outages and system failures.³⁴ The reporting failures were caused primarily by a company policy that exempted certain categories of complaints from being reported, despite the fact that those categories fell within the scope of FINRA’s reporting requirements.³⁵ Robinhood accepted and consented to the fines, without admitting or denying the findings.³⁶

Legal experts speculate that these FINRA allegations could lead to further penalties from other regulators or enforcement authorities for

²⁶ *Id.*

²⁷ *Id.*

²⁸ *Id.*

²⁹ *Id.*

³⁰ *Id.*

³¹ *Id.*

³² *Id.*

³³ *Id.*

³⁴ *Id.*

³⁵ *Id.*

³⁶ *Id.*

related matters.³⁷ In late 2019, Robinhood was fined by FINRA for allegedly failing to provide “best execution” for users.³⁸ The fine stated that between October 2016 and November 2017 Robinhood failed to properly ensure that it was complying with FINRA’s best execution rule, which requires FINRA-registered companies such as Robinhood to analyze various factors to ensure that trades executed on behalf of clients are the best deals available to the market.³⁹ One year later, Robinhood was then fined a substantially larger penalty by the SEC over similar claims.⁴⁰ Such a situation could occur again.⁴¹ Robert Fisher, former FINRA senior litigation counsel, has stated that he could “imagine that [the U.S. Department of Justice], the SEC and a few of the state attorneys general might take a look at the FINRA allegations” and pursue further.⁴² According to Robinhood IPO documents, the SEC has conducted examinations regarding the most serious of the system outages cited in the FINRA penalty.⁴³ Further, state regulators have also opened investigations into these matters.⁴⁴

B. Expected Future Developments

Most importantly, the penalties that Robinhood has faced are likely not the last.⁴⁵ Robinhood’s IPO documents show that the company has reserved millions of dollars for a potential settlement with the New York Department of Financial Services (“DFS”) over “anti-money laundering and cybersecurity-related issues.”⁴⁶ According to the Robinhood registration statement, the DFS opened an examination of

³⁷ Dean Seal, *Robinhood Fine a Harbinger of Looming Regulatory Clashes*, LAW 360 (July 2, 2021), <https://www-law360-com.ez-proxy.bu.edu/articles/1399732/robinhood-fine-a-harbinger-of-looming-regulatory-clashes>.

³⁸ *Id.*

³⁹ Emilie Ruscoe, *Robinhood to Pay \$1.25M for Violating FINRA Trade Rule*, LAW 360 (Dec. 19, 2019), <https://www-law360-com.ez-proxy.bu.edu/articles/1229840/robinhood-to-pay-1-25m-for-violating-finra-trade-rule>.

⁴⁰ Seal, *supra* note 37.

⁴¹ *Id.*

⁴² *Id.*

⁴³ *Id.*

⁴⁴ *Id.*

⁴⁵ Registration Statement, File No. 333-258474 (July 1, 2021) [hereinafter Registration].

⁴⁶ Seal, *supra* note 37.

Robinhood's cryptocurrency operation that was later referred to the department's Consumer Protection and Financial Enforcement Division.⁴⁷ The department then informed Robinhood of alleged violations of anti-money laundering and New York Banking Law requirements as well as "certain alleged violations of, among other things, cybersecurity and virtual currency requirements, including certain deficiencies in [Robinhood] policies and procedures regarding risk assessment, lack of an adequate incident response and business continuity plan, and deficiencies in [Robinhood] application development security."⁴⁸ The registration statement explains that "in connection with these allegations, NYDFS has indicated that it plans to seek a monetary penalty, as well as the appointment of an independent consultant."⁴⁹ Robinhood has announced that it is cooperating with the department's investigation and has reached a settlement in principle, "subject to final documentation," that would result in an estimated \$15 million penalty.⁵⁰

Robinhood's registration statement also notes the outstanding investigations that are not resolved by the FINRA order, including issues with Robinhood's customer support procedures and customer arbitration agreements.⁵¹ In November 2020, FINRA opened an investigation into "account takeovers," which are instances in which an "unauthorized actor" gains access to a user's account.⁵² The SEC and state regulators, such as New York's Attorney General and DFS, have also opened investigations into the unauthorized access.⁵³ Relatedly, on January 8, 2021, a class action was filed against Robinhood on behalf of approximately 2,000 customers who experienced account takeovers.⁵⁴ Plaintiffs of the class action alleged that Robinhood "breached commitments made and duties owed to customers to safeguard customer data and assets."⁵⁵ Robinhood filed a motion to dismiss the complaint, which was granted in part and denied in part.⁵⁶

⁴⁷ Registration, *supra* note 45.

⁴⁸ *Id.*

⁴⁹ *Id.*

⁵⁰ *Id.*

⁵¹ *Id.*

⁵² *Id.*

⁵³ *Id.*

⁵⁴ *Id.*

⁵⁵ *Id.*

⁵⁶ *Id.*

A second amended complaint was filed by the plaintiffs, which Robinhood again moved to dismiss.⁵⁷ The litigation is ongoing.⁵⁸

Additionally, Robinhood made the decision to stop trading activity in the middle of trading madness for GameStop and AMC.⁵⁹ This stoppage purportedly cost users hundreds of millions, if not billions, in value.⁶⁰ Robinhood maintains that its user agreements provide the company with the right to restrict trading when necessary and that the buying blackouts were a consequence of a dramatic increase in the deposit requirements imposed by clearinghouses in response to the extreme volatility.⁶¹ However, that explanation proved insufficient for users, as Robinhood customers filed dozens of lawsuits against the company.⁶² “For example, beginning on March 4, 2020, 15 putative class actions and one individual action were filed against [Robinhood] in state and federal district courts relating to the March 2020 Outages.”⁶³ Most of the class actions were consolidated as *In re Robinhood Outage Litigation* in the United States District Court for the Northern District of California.⁶⁴ Generally, all of the lawsuits allege that the Robinhood platform design was inadequate to handle customer demand and that Robinhood failed to implement necessary backup systems.⁶⁵ “The lawsuits include ... claims for breach of contract, negligence, gross negligence, breach of fiduciary duty,” and unjust enrichment, as well as additional claims.⁶⁶ Robinhood also was notified that approximately “1,600 jointly represented customers may pursue arbitration of individual claims” arising out of the March 2020 outages, in addition to other alleged system outages.⁶⁷

Further, Robinhood and its Chief Executive Officer, Vladimir Tenev, received inquiries, subpoenas and requests for testimony from the U.S. Attorney’s Office for the Northern District of California, the Department of Justice’s Antitrust Division, the SEC, FINRA, New York’s Attorney General, other state Attorneys General and a number

⁵⁷ *Id.*

⁵⁸ *Id.*

⁵⁹ Seal, *supra* note 37.

⁶⁰ *Id.*

⁶¹ *Id.*

⁶² *Id.*

⁶³ Registration, *supra* note 45.

⁶⁴ *Id.*

⁶⁵ *Id.*

⁶⁶ *Id.*

⁶⁷ *Id.*

of state securities regulators regarding the outages.⁶⁸ Regarding the Gamestop volatility, the SEC has stated that “[t]he Commission will closely review actions taken by regulated entities that may disadvantage investors or otherwise unduly inhibit their ability to trade certain securities.”⁶⁹ In response to such requests for information, Robinhood has responded by explaining that “due to the preliminary nature of all of these proceedings, we are unable at this time to estimate the likelihood or magnitude of any possible losses related to these matters.”⁷⁰

Interestingly, Robinhood’s IPO documents emphasize the current legal battle between Robinhood and the Massachusetts Secretary of the Commonwealth.⁷¹ Massachusetts is seeking to ban Robinhood from conducting business within the state.⁷² The ban would be part of an enforcement action accusing Robinhood of failing to supervise users and violating Massachusetts’ fiduciary rule for broker-dealers.⁷³ Massachusetts asserts that most Robinhood users are young and inexperienced at investing and that the application has implemented “gamification” features to entice such users to interact with the platform inappropriately.⁷⁴ In response, Robinhood’s registration statement provides that “recent statements by lawmakers, regulators and other public officials have signaled an increased focus on new or additional regulations that could impact our business and require us to make significant changes to our business model and practices.”⁷⁵ The statement section makes reference to SEC Chairman Gary Gensler’s appearance at a hearing before Congress “about meme stock trading, in which he said that ‘embedding game-like features’ into trading apps could negatively affect users’ long-term financial health.”⁷⁶ Robinhood is aware of the SEC’s subsequent announcement that it would seek public commentary on potential rules related to gamification, as well as FINRA’s indication at a public conference that it intended to solicit

⁶⁸ *Id.*

⁶⁹ Public Statement, Sec. and Exch. Comm’n, Statement of Acting Chair Lee and Commissioners Peirce, Roisman, and Crenshaw Regarding Recent Market Volatility.

⁷⁰ Seal, *supra* note 37.

⁷¹ *Id.*

⁷² *Id.*

⁷³ *Id.*

⁷⁴ *Id.*

⁷⁵ Registration, *supra* note 45.

⁷⁶ Seal, *supra* note 37.

public feedback on whether to address gamification through rulemaking.⁷⁷

1. Proposed Reform Efforts

On May 13, 2021, while facing regulatory controversy, Robinhood announced improvements to Robinhood Options.⁷⁸ First, Options support has expanded to 24-hour coverage and now offers help from a live support team over the phone.⁷⁹ Second, a new profits and loss chart allows users to gain insight into options strategy before entering into a position.⁸⁰ Third, new prompting warnings have been added to make users aware of implications of certain trading strategies.⁸¹ Fourth, an options trading essentials hub provides regularly updated educational resources and helps users to learn the “ins and outs of options trading, risk management, and plenty more.”⁸² Finally, Robinhood has begun implementing additional eligibility criteria for certain options trading.⁸³ Level 3 on Robinhood makes additional options strategies available to customers.⁸⁴ These strategies include call credit spreads, put credit spreads, call debit spreads, iron condors, calendar spreads, and iron butterflies.⁸⁵ It is possible for a customer to lose the principal that was invested, as well as potentially more.⁸⁶ As a result, Robinhood has implemented new financial requirements and revised experience requirements in order to gain access to Level 3.⁸⁷ Robinhood also notes that box spreads are not allowed, because of great hidden dividend risk that could cause customers to lose much more money than expected.⁸⁸

⁷⁷ *Id.*

⁷⁸ *Updates to Robinhood Options*, ROBINHOOD BLOG (May 13, 2021), <https://perma.cc/NL9J-RV7L>.

⁷⁹ *Id.*

⁸⁰ *Id.*

⁸¹ *Id.*

⁸² *Id.*

⁸³ *Id.*

⁸⁴ *Advanced Options Strategies (Level 3)*, ROBINHOOD, <https://perma.cc/SN36-D5JK>.

⁸⁵ *Id.*

⁸⁶ *Id.*

⁸⁷ *Id.*

⁸⁸ *Id.*

On June 1, 2021, Robinhood announced three new members of the Robinhood Markets Board of Directors.⁸⁹ The new members “bring tremendous experience across finance, technology, accounting, governance, international markets and public policy.”⁹⁰ Notably, Paula Loop, one of the new directors, provides considerable experience in governance, technical accounting and SEC and finance reporting matters.⁹¹

C. Conclusion

Robinhood acknowledges that it is “subject to claims and lawsuits in the ordinary course of business, including arbitrations, class actions and other litigation ...”⁹² The company continues by noting that it “operate[s] in a highly regulated industry and many aspects of [its] business involve substantial risk of liability, and [it is] regularly the subject of actions, inquiries, investigations, examinations and proceedings by regulatory and other governmental agencies.”⁹³ From speculation from industry experts, as well as Robinhood itself, it is probable that there are many more penalties in the company’s future.

Aspen Schneider⁹⁴

⁸⁹ *Robinhood Markets Welcomes Three New Directors to Board*, *supra* note 7.

⁹⁰ *Id.*

⁹¹ *Id.*

⁹² Registration, *supra* note 45.

⁹³ *Id.*

⁹⁴ Student, Boston University School of Law (J.D. 2023).