

Why Robinhood Is Not a Fiduciary

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This Note examines the theoretical and practical limitations of regulating broker-dealers under a fiduciary-duty paradigm. Drawing on a recent example of fiduciary regulation of broker-dealers in Massachusetts, as well as recent literature on the theoretical underpinnings of fiduciary relationships, this Note argues that fintech broker-dealers like Robinhood lack the elements of “discretion” and “best interest” necessary to establish a fiduciary relationship. Beyond theoretical coherence, there are also practical reasons to seek an alternative to a fiduciary standard. These include the need to preserve the distinct market-making functions of broker-dealers and to address infrastructural problems beyond the scope of a recommendation. This Note proposes an alternative to fiduciary regulation: expanding Regulation Systems Compliance and Integrity to include brokers like Robinhood.

Introduction	1447
I. The Current State of Regulation	1450
A. Distinguishing Between Investment Advisers and Broker-Dealers	1450
B. Problems Posed by Robinhood and Other Fintech Platforms ..	1452
C. Regulation Best Interest	1454
II. Imposing Fiduciary Duties on Robinhood?.....	1456
A. The Massachusetts Regulation	1457
1. The Complaint Against Robinhood	1459
2. Robinhood’s Response.....	1462
B. A Fiduciary Relationship Does Not Exist Between Robinhood and Its Users	1464
1. The Analytical Priority of Fiduciary Relationships	1464
2. Three Theories of Fiduciary Relationships	1465
3. What Constitutes “Discretion”?	1468
4. What Is in a User’s “Best Interest”?	1472

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- C. A Critique of the Massachusetts Regulation and Its Application1474
 - 1. The Function of Broker-Dealers1475
 - 2. The Recommendation Trigger1478
- III. A Better Case for Regulation1480
 - A. The Suitability Standard and Its Limits.....1480
 - B. Expanding “Regulation Systems Compliance and Infrastructure”1482
- Conclusion1486

Introduction

It would be an understatement to say that Robinhood has had a tumultuous relationship with its users and the press over the last few years. In December of 2018, Robinhood experienced outages with its options trading service that prevented its users from closing out their open positions, causing many to incur substantial losses.¹ In response, users took to Twitter to express their frustration and demand compensation. In early March 2020, Robinhood suffered three separate outages within a week that prevented its users from trading during one of the best weeks for U.S. equities markets since the recession.² Just a few months later, Alex Kearns, a 20-year-old college sophomore and Robinhood user, took his own life thinking he had amassed nearly \$730,000 in options-related trading losses when he in fact had a balance of nearly \$16,000.³ In January 2021, Robinhood sparked widespread consternation from both retail investors and lawmakers⁴ when it restricted the trading of GameStop shares in response to the now-infamous retail-buying frenzy fueled by posts on various Reddit forums.⁵

These stories are just a few of the numerous recent headlines about the inadequacies of Robinhood's platform infrastructure and business model that have caught the nation's attention. While alarming stories like these can galvanize the public into putting greater pressure on companies like Robinhood to adopt necessary changes that protect inexperienced investors, they can also

1. Dan DeFrancesco, *Robinhood's Options Trading Stopped Working, and Customers Are Furious Over the Money They Lost*, BUS. INSIDER (Dec. 13, 2021), <https://www.businessinsider.com/robinhoods-options-trading-shutdown-and-customers-are-furious-2018-12> [<https://perma.cc/FLT9-F43P>].

2. The three outages took place on March 2, 3, and 9 of 2020. *See, e.g.*, Richard Henderson, *Robinhood Shutdown Leaves Users Feeling Robbed*, FIN. TIMES (Mar. 3, 2020), <https://www.ft.com/content/b4751b3c-5d1c-11ea-8033-fa40a0d65a98> [<https://perma.cc/MWY8-62V5>]; Jay Peters, *Robinhood Experienced Its Third Outage in a Week as US Stocks Have Plummeted*, THE VERGE (Mar. 9, 2020), <https://www.theverge.com/2020/3/9/21171584/robinhood-outage-week-us-stocks-third-market> [<https://perma.cc/F5BU-DM9N>] (noting that Robinhood's platform was down for a third time in a week due to infrastructural issues).

3. Antonia Noori Farzan, *A 20-Year-Old Died by Suicide, Thinking He'd Lost More Than \$730,000 on Robinhood. Now His Family Is Suing*, WASH. POST. (Feb. 9, 2021), <https://www.washingtonpost.com/nation/2021/02/09/robinhood-wrongful-death-lawsuit> [<https://perma.cc/F6U8-FTPU>] (noting that the massive losses were displayed because the application had processed only one side of Kearns's complex options trade); Robin Wigglesworth, Richard Henderson & Eric Platt, *The Lockdown Death of a 20-Year-Old Day Trader*, FIN. TIMES (July 2, 2020), <https://www.ft.com/content/45d0a047-360f-4abf-86ee-108f436015a1> [<https://perma.cc/Y7UZ-MXQ7>] ("In fact, his account had a balance of \$16,000.").

4. Members of Congress who called for a hearing on Robinhood's conduct included Representative Alexandria Ocasio-Cortez, Representative Rashida Tlaib, and Senator Ted Cruz. *See* Oscar Gonzalez, *AOC and Lawmakers Call for Hearings on Robinhood For Freezing Trades on GameStop Stock*, CNET (Jan. 29, 2021), <https://www.cnet.com/personal-finance/investing/aoc-and-lawmakers-call-for-hearings-on-robinhood-for-freezing-trades-on-gamestop-stock> [<https://perma.cc/DPQ6-H3EK>].

5. *See* Yun Li, *GameStop, Reddit and Robinhood: A Full Recap of the Historic Retail Trading Mania on Wall Street*, CNBC MARKETS (Jan. 30, 2021), <https://www.cnbc.com/2021/01/30/gamestop-reddit-and-robinhood-a-full-recap-of-the-historic-retail-trading-mania-on-wall-street.html> [<https://perma.cc/9EF3-6JG4>] (offering an overview of events leading to Robinhood's decision to temporarily block its users from purchasing shares in GameStop).

incite knee-jerk reactions from federal and state legislators that threaten to sanction and regulate an entire industry out of existence. Recent developments in the regulation of broker-dealers, which include Robinhood, signal a troubling trend towards the latter.

After a 2009 attempt by the Obama Administration to subject broker-dealers to fiduciary duties⁶ failed to gain traction in Congress and was later rendered ineffectual by the Trump Administration,⁷ the state of Massachusetts responded by issuing regulation Section 12.207 in 2019. The rule attempts to harmonize the regulation of broker-dealers and investment advisers by imposing fiduciary duties on both groups.⁸ Although not the first attempt by a state to impose fiduciary duties on broker-dealers, the Massachusetts regulation represents the most robust and aggressive attempt by any state in recent history to fundamentally alter the long-standing regulation of broker-dealers in the United States.

What makes the Massachusetts regulation special is not simply the boldness of its design, which leaves no doubt that all broker-dealers are subject to strict fiduciary duties, but also the aggressiveness with which the Massachusetts Securities Division (MSD) has pursued enforcement actions against broker-dealers like Robinhood.⁹ On December 16, 2020, the MSD enforced the rule for the first time and filed an administrative complaint against Robinhood alleging that the platform had violated its fiduciary duties of care and loyalty to its users. The requested remedies included, but were not limited to, requiring Robinhood to “permanently cease and desist” conduct in violation of the regulation, to “disgorge all profits and other direct or indirect remuneration” from the alleged wrongdoing, to “provide restitution to . . . compensate investors for losses attributable to the alleged wrongdoing,” to pay an administrative fine, and to engage in an independent compliance consultation and review.¹⁰

6. U.S. DEP’T OF TREASURY, A NEW FOUNDATION: REBUILDING FINANCIAL SUPERVISION AND REGULATION 71 (2009), https://www.treasury.gov/initiatives/wsr/Documents/FinalReport_web.pdf [<https://perma.cc/Q4NL-94CJ>].

7. U.S. DEP’T OF LAB., Bulletin No. 2017-02, *Temporary Enforcement Policy on Fiduciary Duty Rule* (May 22, 2017), <https://www.dol.gov/sites/dolgov/files/ebsa/employers-and-advisers/guidance/field-assistance-bulletins/2017-02.pdf> [<https://perma.cc/HAS6-MJ8G>].

8. 950 MASS. CODE REGS. 12.207 (effective on Mar. 6, 2020 and enforced starting Sept. 1, 2020).

9. The state of Massachusetts recently fined Massachusetts Mutual Life Insurance Co. (MML) \$4 million for failing to supervise the activities of Keith Gill, a registered broker at MML Investors Services LLC who had made various posts on social media platforms regarding GameStop Corp., notwithstanding the fact he had not made the posts under his real name or in his official capacity as an MML employee. *See, e.g.*, Matt Levine, *Be Careful with Your Financial Influence*, BLOOMBERG: MONEY STUFF (Sept. 17, 2021), <https://www.bloomberg.com/opinion/articles/2021-09-17/be-careful-with-your-financial-influence> [<https://perma.cc/FE82-4935>]; Caitlin McCabe, *MassMutual Fined for Failing to Oversee Gamestop Trader Keith Gill, Others*, WALL ST. J. (Sept. 16, 2021), <https://www.wsj.com/articles/massmutual-fined-over-social-media-trading-activity-of-employees-including-gamestop-trader-keith-gill-11631814212> [<https://perma.cc/Q4WT-TH7H>].

10. Administrative Complaint at 1-2, Robinhood Financial, LLC, No. E-2020-0047 (Mass. Sec. Div. Dec. 16, 2020), <https://www.sec.state.ma.us/sct/current/sctrobinhood/MSD-Robinhood-Financial-LLC-Complaint-E-2020-0047.pdf> [<https://perma.cc/QL9F-X27M>] (“The Enforcement Section seeks an order: 1) finding as fact the allegations set forth below; 2) finding that all the sanctions and remedies

Why Robinhood Is Not a Fiduciary

As I shall discuss further in Section II.A, this alarming development in Massachusetts should not be viewed as an isolated case of extreme regulatory activism against a single broker-dealer. Instead, it should be viewed as indicative of a future where heavy-handed and blunt regulation of financial technology (fintech) companies is the norm and not the exception.¹¹ Should the MSD prevail in this action, it would not only threaten Robinhood's operations in the state of Massachusetts but also embolden other state regulators to pursue similar actions of their own, thereby jeopardizing the ability of millions of Americans to obtain commission-free access to the public markets. In the face of this growing regulatory response, now is a critical time to question whether imposing fiduciary duties on brokers like Robinhood makes sense, given the potential impact of such regulation on the democratization of investing and its inconsistency with the spirit of fiduciary law.

Intervening in this debate, I advance three propositions in this Note. First, in Section II.B, I argue that imposing fiduciary duties makes little sense as a theoretical matter because Robinhood's relationship to its users lacks both the elements of "discretion" and "best interest" that typically characterize a fiduciary relationship. Second, the imposition of fiduciary duties on Robinhood (or any broker for that matter) would have significant unintended consequences for the democratization of investing and would threaten the market-making function of broker-dealers. Third, in Part III, I argue that expanding Regulation Systems Compliance and Integrity (Reg SCI) to include large FINRA-registered¹² brokers offers a much better regulatory alternative to the fiduciary standard. By expanding Reg SCI, regulators could more effectively target shortcomings beyond the scope of a recommendation, such as failures to prevent platform outages and disruptions or to provide an adequate customer service department. For these reasons, current attempts to expand the sphere of fiduciary duties onto broker-dealers like Robinhood are misguided.

detailed herein are in the public interest and necessary for the protection of Massachusetts investors; 3) requiring Respondent to permanently cease and desist from further conduct in violation of the Act and Regulations in the Commonwealth; 4) censuring Respondent; 5) requiring Respondent to provide restitution to fairly compensate investors for those losses attributable to the alleged wrongdoing; 6) requiring Respondent to disgorge all profits and other direct or indirect remuneration received from the alleged wrongdoing; 7) requiring Respondent to engage an independent compliance consultant to review Respondent's platform, the underlying infrastructure, and its customer service system related to trading platform outages and disruptions; 8) requiring Respondent to engage an independent compliance consultant to review and enhance its policies and procedures related to the approval of options trading; 9) requiring Respondent to review its supervisory procedures to ensure compliance with applicable state and federal laws; 10) imposing an administrative fine on Respondent in such amount and upon such terms and conditions as the Director or Presiding Officer may determine; and 11) taking any such further action which may be in the public interest and necessary and appropriate for the protection of Massachusetts investors.").

11. Financial technology (fintech) companies are businesses that utilize technology to "improve and automate the delivery and use of financial services." Julia Kagan, *Financial Technology – Fintech*, INVESTOPEDIA (Aug. 27, 2020), <https://www.investopedia.com/terms/f/fintech.asp> [<https://perma.cc/3B24-DNVT>].

12. Financial Industry Regulatory Authority (FINRA) is a private U.S. corporation that acts as an independent regulator of all securities firms, including brokerage firms and exchange markets, doing business in the United States. *See* FINRA, <https://www.finra.org> [<https://perma.cc/VC9C-BJHL>].

Ultimately, I argue that the lesson to be learned from Robinhood's repeated missteps is not that fintech companies should be regulated out of existence in the interest of protecting young and inexperienced investors. Such a response is exactly the type of state-mandated paternalism that has historically limited the means of wealth accumulation to the affluent and well-connected. What is needed instead is an approach to the regulation of retail investing that prioritizes infrastructural resilience, investor education, and customer support.

I. The Current State of Regulation

Before delving into the argument against the imposition of fiduciary duties on Robinhood, I offer some context on the salient differences between investment advisers and broker-dealers. In doing so, I explain why the United States employs a bifurcated system of regulation and what questions the current system raises about how investment companies should be regulated in an increasingly digital and retail-focused financial market.

A. Distinguishing Between Investment Advisers and Broker-Dealers

The distinction between investment advisers and broker-dealers is a matter of utmost importance for financial-services providers because it impacts how they are regulated under federal and state laws.¹³ As a general matter, investment advisers are considered fiduciaries and subject to strict fiduciary duties.¹⁴ Broker-dealers, on the other hand, are not considered fiduciaries, and are subject to a much less onerous "suitability" standard.¹⁵ Under the Investment Advisers Act of 1940, "investment advisers" are characterized as "any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities."¹⁶ The definition explicitly excludes brokers and dealers, among other entities, from the definition of investment advisers insofar

13. Investment advisers may not operate at the national level unless they are registered with the SEC as Registered Investment Advisers. *See* Investment Advisers Act, 15 U.S.C. § 80b-3(a) (2018).

14. Commission Interpretation Regarding Standard of Conduct for Investment Advisers, 84 Fed. Reg. 33,669, 33,669 (July 12, 2019) ("Under federal law, an investment adviser is a fiduciary."); *see also* SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 194 (1963) ("Courts have imposed on a fiduciary an affirmative duty of 'utmost good faith, and full and fair disclosure of all material facts,' as well as an affirmative obligation 'to employ reasonable care to avoid misleading' his clients.").

15. Investment Advisers Act of 1940, 15 U.S.C. § 80b-2(a)(11)(C) (2018) (excluding from the definition of an investment adviser, "any broker or dealer whose performance of such services is solely incidental to the conduct of his business as a broker or dealer and who receives no special compensation therefor").

16. 15 U.S.C. § 80b-2(a)(11) (2018).

as their advice is “solely incidental” to their brokerage services and they do not receive “special compensation” for providing the advice.¹⁷

An investment adviser’s fiduciary duties consist of two general obligations: a duty of loyalty and a duty of care. The duty of loyalty requires an investment adviser to act in the client’s best interest by not subordinating the client’s interest to those of the adviser and to disclose and/or eliminate any conflicts of interests.¹⁸ The duty of care, on the other hand, requires advisers to make reasonable determinations that any investment advice provided “is suitable for the client based on the client’s financial situation and investment objectives,”¹⁹ and to “make a reasonable investigation to determine that it is not basing its recommendations on materially inaccurate or incomplete information.”²⁰ Not only do the fiduciary duties of loyalty and care impose significant compliance costs on investment advisers, but the failure to meet either of these duties may result in monetary and non-monetary penalties from the SEC, such as censures, suspensions, injunctions, and limitations on business activities. By contrast, under the “suitability” standard, any recommendation a broker-dealer makes to its customers need only be “suitable” to the goals and interests of the customer.²¹ Broker-dealers are also required to disclose material conflicts of interest like their adviser counterparts, but only in limited circumstances, such as when a recommendation is being made.²²

The fact that broker-dealers are not subject to fiduciary duties is what allows them to engage in key market-making functions like principal trading²³ and to employ transaction-based compensation models.²⁴ The former is critical to the maintenance of market liquidity and depth,²⁵ but is explicitly prohibited

17. 15 U.S.C. § 80b-2(a)(11)(C) (2018) (“[A]ny broker or dealer whose performance of such services is solely incidental to the conduct of his business as a broker or dealer and who receives no special compensation therefor.”).

18. STAFF OF THE U.S. SEC & EXCH. COMM’N, STUDY ON INVESTMENT ADVISERS AND BROKER-DEALERS AS REQUIRED BY SECTION 913 OF THE DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT iii-iv (Jan. 2011) [hereinafter SEC STUDY], <https://www.sec.gov/news/studies/2011/913studyfinal.pdf> [<https://perma.cc/TE4V-CUQ4>].

19. *Id.* at 27-28.

20. *Id.* at 22 (citing Concept Release on the U.S. Proxy System, Investment Advisers Act Release No. 3052, at 119 (July 14, 2010)).

21. *Id.* at iv (“An important aspect of a broker-dealer’s duty of fair dealing is the suitability obligation, which generally requires a broker-dealer to make recommendations that are consistent with the interests of its customer.”); see also Arthur B. Laby, *Fiduciary Principles in Investment Advice*, in THE OXFORD HANDBOOK OF FIDUCIARY LAW 145, 147 (Evan J. Criddle, Paul B. Miller & Robert H. Sitkoff eds., 2019).

22. See SEC STUDY, *supra* note 18, at iv.

23. Will Kenton, *Principal Order*, INVESTOPEDIA (June 17, 2020), <https://www.investopedia.com/terms/p/principalorders.asp> [<https://perma.cc/P3HP-7UXB>] (defining principal order as “an order in which a broker-dealer buys or sells for its own account as opposed to carrying out trades for the brokerage’s clients”).

24. Broker-dealers are usually paid a fee per transaction effectuated.

25. See Andrew Bloomenthal, *Market Maker*, INVESTOPEDIA (Aug. 31, 2021), <https://www.investopedia.com/terms/m/marketmaker.asp> [<https://perma.cc/T44A-WS8N>] (“[A] firm or individual who actively quotes two-sided markets in a particular security, providing bids and offers (known as asks) along with the market size of each. Market makers provide liquidity and depth to markets and profit from the difference in the bid-ask spread.”).

for investment advisers.²⁶ The latter is beneficial for many retail investors unable to afford to pay for investment advisers, who often charge a fee as a percentage of the amount of assets under management.²⁷ I shall return to both of these activities in Section II.C, where I critique the Massachusetts regulation and explain why the push to expand fiduciary duties would prevent broker-dealers from engaging in principal trading and employing a transaction-based compensation model—both to the detriment of retail investors.

B. Problems Posed by Robinhood and Other Fintech Platforms

In theory, the distinction between investment advisers and broker-dealers is straightforward. In practice, these two regimes are much more difficult to disentangle because individuals and firms often provide investment advice without being subject to fiduciary obligations.²⁸ This is partly attributable to the lack of clear guidance from the Securities and Exchange Commission (SEC) and Congress about what is and is not “investment advice.” Changes in the financial sector over the past few decades have also caused the activities of broker-dealers and investment advisers to converge, calling into question the appropriateness of our historically bifurcated system of regulation.²⁹

The convergence of brokerage and advisory services occurs through two mechanisms. The first is dual-registration (also known as “hat-switching”), which occurs when a financial services company registers as both an investment adviser as well as a broker-dealer.³⁰ In doing so, the company may offer both advisory and brokerage services to customers as long as it provides advance notice of when the “hat-switching” takes place.³¹ The second occurs when a

26. Investment Advisers Act of 1940, 15 U.S.C. § 80b-6(3) (2018) (prohibiting investment advisers from “acting as principal for his own account”). The restriction on principal trading is both explicit in the statute and implicit in the fiduciary duties borne by investment advisers. For a deeper discussion of this latter point, see *infra* Section II.C.1.

27. See Roger Wohlner, *What You Need to Know About Fee-Only Financial Advisors*, INVESTOPEDIA (Sept. 14, 2021), <https://www.investopedia.com/articles/investing/102014/feeonly-financial-advisers-what-you-need-know.asp> [<https://perma.cc/CM24-NLH8>] (“Some advisors may only deal with clients with a minimum level of assets to invest, or charge a minimum fee that equates to that asset level. In other words, they may be too rich for the investment blood of those with smaller portfolios who need advice.”).

28. Laby, *supra* note 21, at 145 (noting that this state of affairs is the result of “a Depression-era statutory scheme administered by regulators who have not interpreted the law to keep pace with market developments”).

29. Broker-dealers are regulated under the Securities Exchange Act of 1934, whereas financial advisers are regulated under the Investment Advisers Act of 1940.

30. See, for example, Charles Schwab & Co., Inc. (CRD#: 5393) on Investment Adviser Public Disclosure (IAPD). Also consider the emergence of “robo-advisers,” which automate the process of providing financial advice. It remains unclear how “financial advice” from robo-advisers should be construed.

31. Lawrence M. LaBine, Initial Decision Release No. 973, SEC Administrative Proceeding File No. 3-15967, 2016 SEC Lexis 795, at *31 (Mar. 2, 2016), <https://www.sec.gov/alj/aljdec/2016/id973bpm.pdf> [<https://perma.cc/6ZHD-USSQ>] (“It would be inconsistent with the remedial purposes of the Advisers Act to hold that LaBine could have ‘switched hats’ and disclaimed the fiduciary duties of an adviser without giving notice to his clients.”); see also Matthias Rieker, *Fiduciary or Broker? Many Financial Advisers Wear Both Hats*, WALL ST. J. (Feb. 25, 2015), <https://www.wsj.com/articles/BL->

company that is only registered as a broker-dealer offers products beyond those associated with traditional brokerage services. Historically, these have included services like providing research reports on industry trends or news alerts but now also include activities like displaying lists of trending stocks and/or distributing rewards for trading on the platform. The controversy surrounding Robinhood's business practices and infrastructural issues falls into this second category.³² Robinhood is a FINRA-regulated and SEC-registered, commission-free brokerage-services provider. Neither Robinhood Markets, Inc., nor any of its subsidiaries (Robinhood Financial, LLC and Robinhood Securities, LLC), however, are registered with the SEC as investment advisers.³³ This means that brokerages like Robinhood currently do not owe fiduciary duties to their users. Yet Robinhood's (and other similar fintech platforms') popularity among retail investors has led regulators, such as the MSD, to question whether this ought to continue to be the case.³⁴

The potential for widespread abuse, infrastructure failure, and consumer confusion caused by broker-dealers operating in this nebulous territory has prompted many scholars to advocate for the extension of fiduciary duties to cover broker-dealers. The calls for greater regulation fall on a spectrum that includes reforms such as the imposition of a limited duty of care,³⁵ the adoption of a fiduciary standard based on an investor's reasonable expectations,³⁶ the enactment of a uniform fiduciary duty for both advisers and broker-dealers,³⁷ and

TOTALB-2886 [<https://perma.cc/G682-HUDJ>] (noting the confusion surrounding the SEC's allowance of firms registered as both financial advisers as well as financial brokers).

32. Referring to Robinhood Markets, Inc., and its wholly owned subsidiaries, which include Robinhood Financial, Robinhood Securities, and Robinhood Crypto.

33. See SEC, Investment Adviser Public Disclosure (IAPD), <https://adviserinfo.sec.gov> [<https://perma.cc/M27T-3Z72>]; see also *BrokerCheck*, FINRA, <https://brokercheck.finra.org> [<https://perma.cc/4JCW-TE7A>] (Robinhood Financials, LLC (CRD#: 165998) and Robinhood Securities, LLC (CRD#: 287900) are both registered as FINRA regulated brokerage firms).

34. Consider the example of Coinbase, the most popular platform for cryptocurrency trading, which provides services to over 73 million verified users, has over \$255 billion of assets under custody, and facilitates over \$327 billion in trades each quarter. See *About Coinbase*, COINBASE, <https://www.coinbase.com/about> [<https://perma.cc/TNP5-V6YQ>].

35. William A. Nelson II, *Broker-Dealer: A Fiduciary By Any Other Name?*, 20 FORDHAM J. CORP. & FIN. L. 637, 639 (2015) (arguing that "under common law, brokers have historically been held to a fiduciary standard of care when providing personalized investment advice to retail customers or when holding themselves out to the public as trusted financial advisors who provide unbiased investment advice").

36. Arthur B. Laby, *Selling Advice and Creating Expectations: Why Brokers Should Be Fiduciaries*, 87 WASH. L. REV. 707, 713 (2012) (arguing that "a fiduciary obligation should be imposed on brokers that give advice based on investors' reasonable expectation").

37. See, e.g., Ryan K. Bakhtiari, Katrina Boice & Jeffrey S. Majors, *The Time for Uniform Fiduciary Duty Is Now*, 87 ST. JOHN'S L. REV. 313, 334-35 (2013) ("[A]doption of a uniform fiduciary duty requiring all broker-dealers to act in the best interests of their clients and make full and fair disclosures would be a step in the right direction. A single broad-based uniform fiduciary standard would better serve investors by enhancing transparency and protecting the integrity of the marketplace. The time for a uniform fiduciary duty is now."); Bonnie M. Treichel, Note, *The Quest for Financial Regulatory Reform: Will a Uniform Fiduciary Standard Guide the Way?*, 4 J. BUS. ENTREPRENEURSHIP & L. 151, 171-74 (2010) ("[A] uniform fiduciary standard will provide a more understandable system in which investors who seek to impose liability on their financial providers will not be confused as to the applicable standard [of care].").

the preservation of an investor's private right of action against a broker-dealer.³⁸ Opponents to the expansion of fiduciary duties emphasize the barriers to affordable investment services for consumers,³⁹ the additional costs of such regulations on the industry,⁴⁰ and the unworkability of such proposals.⁴¹

This debate has also been taken up by various branches of the federal government. In 2015, the Obama Administration and the Department of Labor (DOL) put the financial industry on notice that brokers providing retirement services would be subject to traditional fiduciary standards just like their adviser counterparts.⁴² This was termed the “fiduciary duty rule” and was met with swift backlash from the brokerage community.⁴³ Almost immediately after its announcement, a series of lawsuits ensued. In 2017, President Trump issued a memo delaying the rule's implementation.⁴⁴ By 2018, the Fifth Circuit had vacated the fiduciary duty rule in its entirety.⁴⁵

C. Regulation Best Interest

On June 5, 2019, the SEC introduced Regulation Best Interest (Reg BI), which borrows heavily from the “key principles underlying fiduciary obligations” and elevates the standard of conduct applicable to broker-dealers to

38. See Gary A. Varnavides, *The Flawed State of Broker-Dealer Regulation and the Case for an Authentic Federal Fiduciary Standard for Broker-Dealers*, 16 *FORDHAM J. CORP. & FIN. L.* 203, 204 (2011) (proposing “the adoption of an authentic, federal fiduciary standard for broker-dealers that preserves a private right of action for investors”).

39. See Paul R. Walsh & David W. Johns, *Can the Retail Investor Survive the Fiduciary Standard?*, 87 *ST. JOHN'S L. REV.* 437, 449 (2013) (noting that the imposition of fiduciary duty onto a broker would create a barrier to investment advice for small investors who cannot afford an investment adviser—thereby limiting access to financial services to the wealthy).

40. See Lin Bai, *Broker-Dealers, Institutional Investors, and Fiduciary Duty: Much Ado About Nothing*, 56 *WM. & MARY BUS. L. REV.* 55 (2014) (noting that the negligible benefit but indeterminate cost of the fiduciary duty to the financial industry renders it an unviable means of enhancing institutional investor protection).

41. See Thomas Moloney, Paul R. St. Lawrence, III & Angela F Hamarich, *Fiduciary Duties, Broker-Dealers and Sophisticated Clients: A Mismatch that Could Only Be Made in Washington*, 4 *J. SEC. L. REG. & COMPLIANCE* 336, 337 (2010) (arguing that proposals to impose fiduciary duties on broker-dealer interactions with institutional investors would be “unworkable, [be] unnecessary[,] and result in an economically undesirable paradigm shift from the existing disclosure-based regulation system”).

42. U.S. DEP'T OF LAB., *U.S. Labor Department Seeks Public Comment on Proposal to Protect Consumers from Conflicts of Interest in Retirement Advice*, (Apr. 14, 2015), <https://www.dol.gov/newsroom/releases/ebsa/ebsa20150655> [<https://perma.cc/LE7H-BY6T>]; see also JOHN J. TOPOLESKI & GARY SHORTER, CONG. RES. SERV. REP. 44884, DEPARTMENT OF LABOR'S 2016 FIDUCIARY RULE: BACKGROUND AND ISSUES, Summary (July 3, 2017), <https://sgp.fas.org/crs/misc/R44884.pdf> [<https://perma.cc/H2GW-KBY3>] (“Under DOL's 2016 regulation, brokers and dealers are generally considered to be fiduciaries when they provide recommendations to participants in retirement plans.”).

43. Katelyn Peters, *Everything You Need to Know About the DOL Fiduciary Rule*, *INVESTOPEDIA* (July 14, 2021), <https://www.investopedia.com/updates/dol-fiduciary-rule> [<https://perma.cc/5YS3-U57S>] (noting that “the regulation [was] met with staunch opposition from other professionals, including brokers and planners”).

44. U.S. DEP'T OF LAB., Bulletin No. 2017-02, *Temporary Enforcement Policy on Fiduciary Duty Rule* (May 22, 2017), <https://www.dol.gov/sites/dolgov/files/ebsa/employers-and-advisers/guidance/field-assistance-bulletins/2017-02.pdf> [<https://perma.cc/6D2D-GS3M>].

45. *Chamber of Com. v. U.S. Dep't of Lab.*, 885 F.3d 360 (5th Cir. 2018) (vacating the DOL Fiduciary Duty Rule in its entirety, including the Best Interest Contract Exemption (BICE) and the amendments to Prohibited Transaction Exemption (PTE) 84-24).

something akin, in many respects, to the fiduciary duties of loyalty and care.⁴⁶ Reg BI requires brokers, in the course of making a recommendation, to

[a]ct in the best interest of the retail customer at the time the recommendation is made, without placing the financial or other interest of the broker-dealer ahead of the interests of the retail customer; and address conflicts of interest by establishing, maintaining, and enforcing policies and procedures reasonably designed to identify and fully and fairly disclose material facts about conflicts of interest, and in instances where we have determined that disclosure is insufficient to reasonably address the conflict, to mitigate or, in certain instances, eliminate the conflict. The standard of conduct established by Regulation Best Interest cannot be satisfied through disclosure alone. . . . Importantly, regardless of whether a retail investor chooses a broker-dealer or an investment adviser (or both), the retail investor will be entitled to a recommendation (from a broker-dealer) or advice (from an investment adviser) that is in the best interest of the retail investor and that does not place the interests of the firm or the financial professional ahead of the interests of the retail investor.⁴⁷

One of the peculiarities of Reg BI is that despite not being a bona fide fiduciary regime, it has the effect of imposing duties on brokers that are more onerous than the traditional fiduciary regime applicable to investment advisers. Under prior common law doctrines and regulations regarding fiduciary duties, advisers could eliminate presumptive conflicts of interest through timely disclosure to and explicit approval from their clients.⁴⁸ According to Reg BI, however, such disclosures alone would no longer be sufficient since a broker also has a duty to mitigate and eliminate the conflict under certain circumstances. It is for this reason that some brokers have asserted that Reg BI makes it less onerous to be an adviser than a broker, which is a rather counterintuitive conclusion.⁴⁹ Others have noted that, due to the self-regulatory nature of its mitigation requirement, Reg BI may in fact be less strict than it might appear at first glance.⁵⁰ The SEC has yet to clarify which of these two interpretations is correct.

46. Regulation Best Interest: The Broker-Dealer Standard of Conduct, Exchange Act Release No. 34-86031, 84 Fed. Reg. 33,318 (July 12, 2019) (codified at 17 C.F.R. pt. 240).

47. *Id.* at 33,318.

48. In the seminal case of *SEC v. Capital Gains Research Bureau*, 375 U.S. 180, 191 (1963), the Supreme Court held advisers to a higher duty of loyalty than broker-dealers by noting that the Investor Advisers Act of 1940 reflected “congressional intent to eliminate, or at least to expose, all conflicts of interest which might incline an investment adviser.” Advisers are now expected to disclose these conflicts on their Form ADVs, the uniform document used to register with the SEC.

49. See John Taft, *Reg BI the Best We Could Have Hoped For*, INVESTMENT NEWS (June 12, 2019), <https://www.investmentnews.com/john-taft-reg-bi-the-best-we-could-have-hoped-for-79919> [https://perma.cc/3FA8-DXU8] (“Under Reg BI, broker-dealers must mitigate and in certain cases eliminate financial conflicts of interest. Disclosure of a financial conflict alone is not considered adequate under the rule, effectively holding broker-dealers to a higher standard than the one applicable to investment advisers today, where conflicts can be disclosed and waived by investors. Not so in Reg BI. This is truly a best-interest standard with real teeth.” (emphasis omitted)).

50. See Knut Rostad, *Does Reg BI Really Hold Brokers to a Higher Standard than Investment Advisers?*, INVESTMENT NEWS (June 14, 2019), <https://www.investmentnews.com/does-reg-bi-really-hold-brokers-to-a-higher-standard-than-investment-advisers-79967> [https://perma.cc/SP36-YRZQ] (“Mr. Taft says conflict mitigation is required by the rule. Yet, the rule and release reveal a different picture. It’s that policies to identify if conflicts merit mitigation are required. Yet, actual mitigation is only called for if, and only if, the B-D itself finds it is so.”).

Depending on who you ask, Reg BI simultaneously goes too far and not far enough. From a fiduciary purist's point of view, such a standard is fundamentally incompatible with the core activities of broker-dealers and should be rejected.⁵¹ Yet from the perspective of consumer protection advocates, Reg BI is insufficient because it fails, first, to deem Robinhood a fiduciary outright and, second, to impose an ongoing duty of care and loyalty on brokers like Robinhood, even when not providing advice or recommendations.⁵² Both sides can probably agree that deciphering what constitutes a "recommendation" or "advice" will present additional challenges of their own.

What the foregoing discussion illustrates is that our current system of bifurcated regulation has undergone a series of developments that seem to raise more questions than answers. Previous attempts by regulators to offer clarity on the duties owed by advisers and broker-dealers to their clients have not only made things more complicated but have also produced some rather counter-intuitive results.

II. Imposing Fiduciary Duties on Robinhood?

In this Part, I introduce readers to the recent administrative complaint filed by the Massachusetts Securities Division (MSD) against Robinhood and connect it to the growing fiduciary movement across the United States. From there, I argue that the relationship between Robinhood and its users fails to meet the necessary elements of a fiduciary relationship as defined within the theoretical frameworks advanced by contemporary scholars. On this ground alone, Robinhood should not be constrained by the duties of loyalty and care. This is not to say that Robinhood should escape regulation entirely. But regulating Robinhood through the lens of a fiduciary relationship, in particular, is an inappropriate extension of these duties, which should not be implemented if we wish to maintain a coherent conception of fiduciary law. Finally, I present a critique of the Massachusetts regulation and explain how subjecting Robinhood to the duties of loyalty and care runs counter to the spirit of "democratizing" investing and may prevent brokers from engaging in key market-making activities.

51. I explore this point further in Section II.C.1.

52. See, e.g., Bob Pisani, *Brokers Will Have to Tell You a Lot More About What They Are Advising You to Buy Starting Next Week*, CNBC (June 25, 2020), <https://www.cnbc.com/2020/06/25/brokers-will-have-to-tell-you-a-lot-more-about-what-they-are-advising-you-to-buy-starting-next-week.html> [<https://perma.cc/D9GC-UAS9>] ("Critics contend that the measure does not go far enough and that regulators have missed an opportunity to require broker-dealers to adhere to the same fiduciary standards that financial advisors are required to adhere to already."); Mariam Robin, *Consumer Advocated Not Satisfied by Regulation BI*, INTELLIGIZE (June 11, 2019), <https://www.intelligize.com/consumer-advocates-not-satisfied-by-regulation-bi> [<https://perma.cc/NRW2-ULSN>] ("Regulation BI imposes new duties on brokers but stops short of the fiduciary standard that applies to registered investment advisors.").

A. The Massachusetts Regulation

In response to the failure of the Obama-era fiduciary rule to gain traction in the federal arena, Massachusetts took matters into its own hands. On February 21, 2020, the MSD adopted amendments to the standard of conduct applicable to broker-dealers under Section 12.207 of the Code of Massachusetts Regulations,⁵³ which took effect on March 6, 2020.⁵⁴ The adopted amendments apply a fiduciary-conduct standard to broker-dealers like Robinhood when dealing with customers. Failure to adhere to the fiduciary duties of loyalty and care constitutes a dishonest or unethical business practice in violation of Section 204(a)(2)(G) of the Massachusetts General Laws.⁵⁵ The amendments also make clear that the existing suitability standards would still be applicable to any relationships and transactions expressly excluded from the fiduciary standard.

Massachusetts is part of a growing movement of states, including New Jersey,⁵⁶ Nevada,⁵⁷ and Maryland,⁵⁸ that are considering enacting or have already enacted similar laws that impose fiduciary duties on broker-dealers. The implementation of these other regulations, however, has either been stalled by the effects of the pandemic or remains in rulemaking limbo.⁵⁹ As of the writing of this Note, Massachusetts remains the only state that has successfully enacted and applied the fiduciary standard to broker-dealers.⁶⁰ I therefore look to the Massachusetts case for what it reveals about a potential future where broker-

53. 950 MASS. CODE REGS. 12.207 (2020).

54. *Adopting Release*, MASS. SEC. DIV. (Feb. 21, 2020), <https://www.sec.state.ma.us/sct/sectfiduciaryconductstandard/Adopting-Release.pdf> [<https://perma.cc/TA9P-TYJ7>].

55. MASS. GEN. LAWS ch. 110A, § 204(a)(2)(G) (2002) (“The secretary may by order impose an administrative fine or censure or deny, suspend, or revoke any registration or take any other appropriate action if he finds . . . (2) that the applicant or registrant or, in the case of a broker-dealer or investment adviser, any partner, officer, or director, any person occupying a similar status or performing similar functions, or any person directly or indirectly controlling the broker-dealer or investment adviser: . . . (G) has engaged in any unethical or dishonest conduct or practices in the securities, commodities or insurance business[.]”). 950 MASS. CODE REGS. 12.207 (2020) defines “unethical or dishonest conduct” for the purpose of this statute.

56. See Press Release, N.J. Div. of Consumer Aff., New Jersey Bureau of Securities Proposes New Rule Requiring NJ Financial Industry to Put Investors’ Interests First: Proposed Rule Establishes Uniform Fiduciary Standard, Eliminates Investor Confusion (Apr. 15, 2019), <https://www.njconsumeraffairs.gov/News/Pages/04152019.aspx> [<https://perma.cc/4ZS2-4RGL>].

57. See Notice of Draft Regulations and Request for Comment, *Fiduciary Rule – SB 383*, OFF. OF THE SEC’Y OF STATE FOR NEV. (Jan. 18, 2019), <https://www.nvsos.gov/sos/home/showdocument?id=6156> [<https://perma.cc/UR48-PG9T>].

58. See S.B. 786, 2019 Gen. Assemb., 440th Sess. (Md. 2019), <https://legiscan.com/MD/bill/SB786/2019> [<https://perma.cc/W2VR-SP3N>] (introduced on Feb. 4, 2019 but later died in chamber); see also H.B. 1127, 2019 Gen. Assemb., 440th Sess. (Md. 2019), <https://legiscan.com/MD/bill/HB1127/2019> [<https://perma.cc/J4EB-PG7Z>] (introduced on Feb. 8, 2019 but later died in committee).

59. The New Jersey regulation, which was proposed in April 2019, had an initial deadline of April 2020 at which point it would expire. The deadline was extended until 90 days after the pandemic. The Nevada regulation remains in legislative limbo. See Mark Schoeff Jr., *State Fiduciary Rules Slow Down Amid Pandemic, Political Transition*, INVESTMENT NEWS (Dec. 21, 2020), <https://www.investmentnews.com/state-fiduciary-rules-pandemic-political-change-200356> [<https://perma.cc/D8WS-3VT7>].

60. For updates on the latest federal and state developments in fiduciary regulation, see *Fiduciary Source: Tracking the Latest Fiduciary Updates*, INST. FOR PORTFOLIO ALTERNATIVES, <https://www.ipa.com/fiduciary> [<https://perma.cc/R2XJ-MU8R>].

dealers are subjected—either by a substantial number of states or by federal law—to standards previously applicable only to investment advisers. Such an analysis is useful for understanding whether the government’s purported reasons for greater regulation and proposed amendments actually align with the needs of everyday users of brokerage services like Robinhood.

The scope of the recent Massachusetts amendment is nuanced and demands further examination. Section 12.207, which is centrally implicated in the new amendment, governs broker-dealers and agents but excludes from regulation investment advisers and their representatives on the grounds that the latter are already held to ongoing fiduciary duties of loyalty and care under federal securities law.⁶¹ In contrast to the ongoing fiduciary regulation of investment advisers and representatives, the MSD clarified that the fiduciary duties referenced in Section 12.207(1)(a) “run[] during the period in which incidental advice is made in connection with the recommendation of a security to the customer.”⁶² The duty is not deemed to be ongoing “except as set out in § 12.207(1)(b)” of the final regulation.⁶³ Section 12.207(1)(b) extends the duty beyond the recommendation period in certain circumstances that are “based upon ancillary factors that occur outside the traditional broker-dealer customer relationship.”⁶⁴ This language sets out the limited circumstances in which fiduciary duties are applicable to broker-dealers and agents.

Three scenarios merit the imposition of ongoing duties. Section 12.207(1)(b)(1) requires broker-dealers and agents to act in accordance with fiduciary duties during any period in which he or she “[h]as or exercises discretion in a customer’s account, unless the discretion relates solely to the time and/or price for the execution of the order.”⁶⁵ The adopting release clarifies that fiduciary duties are expanded in these circumstances because “the broker-dealer or agent, by taking control of the account, has assumed a position of trust and confidence.”⁶⁶ Section 12.207(1)(b)(2) extends the broker-dealer or agent’s duties in circumstances where there is a “contractual fiduciary duty” imposed.⁶⁷

61. An earlier draft contained language referencing investment advisers and investment adviser representatives as well. These references were removed in response to commenters’ concerns that including federally registered investment advisers and their representatives, who were already held to a fiduciary standard, could lead to unintended consequences. *See Adopting Release, supra* note 54, at 2; *see also* Investment Advisers Act of 1940, 15 U.S.C. § 80b-1 (2018).

62. *Adopting Release, supra* note 54, at 3; *see also* 950 MASS. CODE REGS. 12.207(1)(a) (2020) (“Failing to act in accordance with a fiduciary duty to a customer when providing investment advice or recommending an investment strategy, the opening of or transferring of assets to any type of account, or the purchase, sale, or exchange of any security.”).

63. *Adopting Release, supra* note 54, at 3; *see also* 950 MASS. CODE REGS. 12.207(1)(b) (2020) (“Failing to act in accordance with a fiduciary duty to a customer during any period in which the broker-dealer or agent: 1. Has or exercises discretion in a customer’s account, unless the discretion relates solely to the time and/or price for the execution of the order; 2. Has a contractual fiduciary duty; or 3. Has a contractual obligation to monitor a customer’s account on a regular or periodic basis, as such regular or periodic basis is determined by agreement with the customer.”).

64. *Adopting Release, supra* note 54, at 3.

65. 950 MASS. CODE REGS. 12.207(1)(b)(1) (2020).

66. *Adopting Release, supra* note 54, at 3.

67. 950 MASS. CODE REGS. 12.207(1)(b)(2) (2020).

Under these circumstances, fiduciary duties are understood to be established by contract and recognized by statute. Finally, Section 12.207(1)(b)(3) extends fiduciary duties when broker-dealers or agents have “contractual obligation[s] to monitor a customer’s account on a regular or period basis, as such regular or periodic basis is determined by agreement with the customer.”⁶⁸ Unlike Section 12.207(1)(b)(2), which establishes fiduciary duties by way of contract, Section 12.207(1)(b)(3)’s fiduciary duties are established by statute, and it is only the duration that is established by contract.

One of the purported rationales behind expanding fiduciary duties to encompass broker-dealers and agents is the need to address the ease with which broker-dealers and agents can engage in investment-adviser-like activities. As the MSD noted, “[b]roker-dealers advertise themselves today as financial advisers and consultants rather than stockbrokers.” These advisory titles imply that they provide much more than “incidental advice.”⁶⁹ Citing a 2007 study, the MSD argued that customers did not understand the key distinctions between the titles of investment advisers and broker-dealers. The study attributed part of customer confusion to the dozens of titles used in the field, including generic titles, such as financial adviser and financial consultant.⁷⁰

In summary, the Massachusetts regulation subjects any broker-dealer with operations in the state to the fiduciary duties of loyalty and care when providing recommendations to users. These fiduciary duties are not ongoing except in the three circumstances outlined above. The general suitability standard applicable to all broker-dealers remains in effect. This represents a major departure from the previous status quo along at least two fronts. First, since the enactment of the Investment Advisers Act of 1940, broker-dealers have always been held to a standard of conduct that is distinct from that of advisers because of their differing functions within the financial industry. Second, states have generally been deferential to federal regulations concerning broker-dealers and advisers and seldom conflict in such a dramatic manner thanks in part to the principles of preemption.⁷¹ These two departures from the status quo offer compelling reasons to examine the regulatory developments in Massachusetts.

1. The Complaint Against Robinhood

Amended regulation Section 12.200 immediately opened the door to significant enforcement liability for fintech brokers like Robinhood. Only nine months after the amended regulation took effect, the Secretary of the

68. 950 MASS. CODE REGS. 12.207(1)(b)(3) (2020).

69. *Adopting Release*, *supra* note 54, at 4.

70. *Id.*

71. Some scholars maintain that a broker’s fiduciary duties are not necessarily preempted by federal securities law. However, the issue of preemption that is raised by the Massachusetts regulation has yet to be litigated in the courts. *See, e.g.*, Tamar Frankle, *Which Laws Apply to Broker-Dealers? Federal Laws? State Laws? Both? General Principles Leading to an Answer*, VERDICT JUSTIA (Mar. 6, 2020), <https://verdict.justia.com/2020/03/06/which-laws-apply-to-broker-dealers-federal-laws-state-laws-both> [<https://perma.cc/7L58-X49J>].

Commonwealth of Massachusetts filed an administrative complaint against Robinhood, alleging that Robinhood had “engaged in acts and practices in violation of the [aforementioned Act⁷² and Regulation⁷³] by aggressively marketing itself to Massachusetts investors without regard for the best interests of its customers and by failing to maintain the infrastructure and procedures necessary to meet the demands of its rapidly growing customer base.”⁷⁴ This marked the first enforcement action brought by any state agency under a regulation or law subjecting broker-dealers to fiduciary duties of care and loyalty to their customers.⁷⁵

Massachusetts took advantage of Robinhood’s increased liability to target numerous facets of the company’s operations. According to the complaint, Robinhood failed to maintain an adequate trading platform that could accommodate not only the increases to its customer base but also the frequency of its use. Robinhood experienced as many as seventy outages between January 1, 2020 and November 30, 2020, many of which deprived its users of the benefit of historic gains in the stock market.⁷⁶ Robinhood’s servers were down on March 2, 2020, the day when the Dow Jones Industrial Average surged by 1,290 points, the largest one-day gain in the index’s history.⁷⁷ Days later, on March 9, 2020, amid a dramatic stock market decline, Robinhood experienced yet another outage that prevented customers from making trades for the day.⁷⁸ These infrastructural issues, according to the complaint, were entirely “foreseeable and preventable” and arose directly from Robinhood’s failure to maintain and update its platform infrastructure to support its growth.⁷⁹

The complaint further alleged that in its quest to democratize investing, Robinhood deliberately targeted younger users with little to no investing experience by proffering lists of securities without regard for their suitability.⁸⁰ These lists, according to the complaint, “have the potential to influence the

72. Massachusetts Uniform Securities Act, MASS. GEN. LAWS ch. 110A, § 204(a) (2020).

73. 950 MASS. CODE REGS. 10.00-14.413 (2020).

74. Administrative Complaint at 1, Robinhood Fin., No. E-2020-0047 (Mass. Sec. Div. Dec. 16, 2020), <https://www.sec.state.ma.us/sct/current/sctrobinhood/MSD-Robinhood-Financial-LLC-Complaint-E-2020-0047.pdf> [<https://perma.cc/E39Y-627U>].

75. See Caitlin McCabe, *Massachusetts Regulators File Complaint Against Robinhood*, WALL ST. J. (Dec. 16, 2020), <https://www.wsj.com/articles/massachusetts-regulators-to-file-complaint-against-robinhood-11608120003> [<https://perma.cc/99AQ-ZCXE>] (“The complaint marks Mr. Galvin’s first enforcement action of the rule.”). The Massachusetts Securities Division was the first state regulator to finalize and enforce a fiduciary rule of this kind on February 21, 2020. See *Massachusetts Promulgates Broker-Dealer Fiduciary Rule*, SIDLEY AUSTIN (Mar. 4, 2020), <https://www.sidley.com/en/insights/newsupdates/2020/03/massachusetts-promulgates-broker-dealer-fiduciary-rule> [<https://perma.cc/BHP4-QCPG>].

76. Administrative Complaint, *supra* note 74, at 10, ¶¶ 24-27.

77. *Id.* ¶ 26; see also Donna Fuscaldo, *Robinhood App Down as Dow Surges Back Up*, FORBES (Mar. 2, 2020), <https://www.forbes.com/sites/donnafuscaldo/2020/03/02/robinhood-app-down-as-dow-surges-back-up/> [<https://perma.cc/MGA4-ZTQE>].

78. Administrative Complaint, *supra* note 74, ¶ 28.

79. *Id.* ¶ 33.

80. The Robinhood app homepage used to display a list of stocks ranked in order of popularity. The app also provided a multitude of “Popular Lists” that ranked stocks in different investment categories such as “Top Movers,” “Technology,” and “Crypto.” See *id.* ¶ 38.

securities that new, unsophisticated consumers with no investment experience purchase.”⁸¹ Robinhood’s own disclosures reveal that the median customer age is 31 years old.⁸² The complaint listed twenty-five customers who engaged in over 15 trades per day despite having no investment experience prior to trading with Robinhood.⁸³

The complaint proceeded to allege that Robinhood engages in “gamification,” which refers to the use of game-like strategies and techniques to incentivize repeated and continuous use of an application.⁸⁴ Robinhood gifts new users a free stock upon joining, which makes them an instant investor,⁸⁵ and promises additional free stocks to users who refer other users to the app.⁸⁶ These gamification techniques stimulated greater interaction with the application and increased the frequency of risky and unsuitable trading.⁸⁷ It is worth noting that Robinhood has since made various changes to its trading platform in response to these “gamification” charges.⁸⁸

Finally, the complaint alleged that Robinhood failed to meet its own policies and procedures for the approval of options trading by its customers. Here, some background is necessary. Brokerages typically employ various option-approval levels to prevent traders from accidentally running up enormous debts that they cannot afford.⁸⁹ Because debts must be settled by the brokerages regardless of whether the individual trader is able to pay, there is a strong incentive to make sure traders know what they are doing when dealing with options.⁹⁰ Customers seeking approval for level-two options trading, the lowest

81. *Id.* ¶ 36.

82. *Id.* ¶ 18.

83. *See, e.g., id.* ¶¶ 57, 61. In the most extreme case, Customer One averaged 92 trades per day and amassed over 12,000 trades since February 1, 2020. Customer Six made over 18,000 trades with Robinhood over a period of three years.

84. *Id.* ¶ 40.

85. *Id.* ¶ 22.

86. The promotions for referral initiatives often mentioned the possibility of receiving attractive stocks such as those of Microsoft, Visa, or Apple, despite the low probability that any user would actually receive those particular ones. *See Invite Friends, Get Stock: Our Referral Program*, ROBINHOOD, <https://robinhood.com/us/en/support/articles/invite-friends-get-free-stock> [https://perma.cc/Q3QX-MSFA].

87. Administrative Complaint, *supra* note 74, ¶ 53.

88. For example, Robinhood recently replaced its signature confetti animation, which displayed when a user made a trade for the first time, with an animation composed of various geometric shapes, which “cheer[s] on customers through the milestones in their financial journey.” *See A New Way to Celebrate with Robinhood*, ROBINHOOD (Mar. 31, 2021), <https://blog.robinhood.com/news/2021/3/31/a-new-way-to-celebrate-with-robinhood> [https://perma.cc/6AF2-VWKQ]. In a February congressional hearing, Robinhood’s CEO, Vlad Tenev, emphasized that “we [Robinhood] don’t believe in gamification” and “we know investing is serious.” Annie Massa, *Robinhood Ditches Its Confetti Animation Following Criticism*, BLOOMBERG (Mar. 31, 2021), <https://www.bloomberg.com/news/articles/2021-03-31/robinhood-ditches-its-confetti-animation-following-criticism> [https://perma.cc/4NTR-JXDE].

89. SEC Investor Alerts and Bulletin, *Opening an Options Account* (Mar. 18, 2015), https://www.sec.gov/oiea/investor-alerts-bulletins/ib_openingoptionsaccount.html [https://perma.cc/DQ52-BM3X] (“Broker-dealers generally offer 5 levels of option trading representing varying degrees of risk.”).

90. *See* Lucas Downey, *Unlimited Risk*, INVESTOPEDIA (Aug. 18, 2021), <https://www.investopedia.com/terms/u/unlimitedrisk.asp> [https://perma.cc/J26N-925K] (noting that if an options-related loss exceeds the initial amount invested or even the entirety of an investor’s trading account, a “broker

level of trading that Robinhood offers, must have (1) at least four filled orders or a self-reported investment experience greater than none, (2) a self-reported medium or high-risk tolerance, and (3) a margin account.⁹¹ Massachusetts's complaint asserted that Robinhood had approved at least 680 Massachusetts customers for options trading despite their failure to meet these criteria.⁹² Massachusetts charged that, together, these actions by Robinhood demonstrated a failure by the company to meet its new fiduciary duties of care and loyalty to its customers.⁹³

The two most meritorious elements of the complaint against Robinhood include its repeated failures to maintain its platform against outages and disruptions and to adhere to its own internal policies for the approval of options trading by its customers. Neither of these issues, however, require the imposition of fiduciary duties. The charge of gamifying investing is harder to substantiate for two reasons: first, it must withstand charges of excessive paternalism by the state, and second, it must distinguish itself from other risky state-sanctioned activities such as online sports gambling⁹⁴ and the borrowing of thousands of dollars of non-dischargeable⁹⁵ student loans.⁹⁶ Finally, to the extent that the practice of proffering lists of securities to inexperienced investors may be construed as a recommendation, it would be captured by the existing suitability standard and does not require a separate fiduciary standard. As I explore in Part III, a better case for regulation involves expanding an existing SEC regulation, Regulation Systems Compliance and Integrity (Reg SCI), to cover large broker-dealers, which would resolve both the platform infrastructure and options trading issues.

2. Robinhood's Response

On April 15, 2021, in response to the MSD's attempt to revoke Robinhood's registration as a broker-dealer, Robinhood filed a lawsuit in state

will ask the trader to deposit funds in order for them to maintain their position (if still open) or bring their account balance up to zero," otherwise, the trader is indebted to the broker).

91. Administrative Complaint, *supra* note 74, ¶ 83.

92. *Id.* ¶ 84.

93. *Id.* at 2.

94. Online sports betting is legal in 17 states. See Ryan Butler, *Where is Sports Betting Legal? Projections for All 50 States*, ACTION (Jan. 6, 2022), <https://www.actionnetwork.com/news/legal-sports-betting-united-states-projections> [<https://perma.cc/WW4G-F3T2>]. In 2018, the Supreme Court, in a 6-3 vote, struck down a quarter-century old federal law that prohibited states from amending their laws to allow sports betting. See *Murphy v. NCAA*, 138 S. Ct. 1461 (2018).

95. 11 U.S.C. § 523(a)(8)(A) (2018) (excluding from discharge "an educational benefit overpayment or loan made, insured, or guaranteed by a governmental unit, or made under any program funded in whole or in part by a governmental unit or nonprofit institution," unless such "such debt from discharge under this paragraph would impose an undue hardship on the debtor and the debtor's dependents").

96. The average size of federal loan debt is \$28,950 among holders of bachelor's degrees and \$71,000 among holders of graduate degrees. The total amount of federally backed student loans outstanding is \$1.61 trillion. See Anna Helhoski & Ryan Lane, *Student Loan Debt Statistics: 2021*, NERDWALLET (Jan. 2, 2022), <https://www.nerdwallet.com/article/loans/student-loans/student-loan-debt#average-student-loan-debt> [<https://perma.cc/J7HZ-ZGPN>].

court against Secretary William Galvin and the Commonwealth of Massachusetts.⁹⁷ In its complaint and motion for preliminary injunctive relief, Robinhood sought to invalidate the Massachusetts regulation on the grounds that Galvin and the MSD lacked the authority to override the state's highest court's longstanding holding that brokerage firms are not fiduciaries.⁹⁸ Robinhood also alleged that the Massachusetts regulation created a conflict with Reg BI, a federal regulation that preempts the standard that the MSD sought to enforce.⁹⁹ On May 27, 2021, a Massachusetts judge denied Robinhood's request for a preliminary injunction against the MSD action on the grounds that it would not be in the public's best interest to block the administrative hearing.¹⁰⁰ Litigation is currently ongoing.

Should the Massachusetts regulation be upheld in court, there is little doubt among industry professionals that other state regulators across the United States would be inspired to enact similar regulations and lodge similar complaints against broker-dealers like Robinhood. New Jersey, for example, was on course to impose a fiduciary rule of its own on broker-dealers before it delayed final rulemaking on April 16, 2020 due to the pandemic.¹⁰¹ In 2017, Nevada amended its securities laws to provide that broker-dealers owe their customers fiduciary duties, but failed to clarify what these duties entailed.¹⁰² Nevada began seeking comments from the public in 2019 regarding draft regulations that sought to clarify these fiduciary obligations.¹⁰³ In its recent S-1 filing with the SEC, Robinhood also revealed that the California Attorney General's Office recently issued an investigative subpoena "seeking documents and answers to

97. Motion for Preliminary Injunctive Relief, *Robinhood Fin. v. Galvin*, No. 2084CV00884BLS2, 2021 WL 5626410, (Mass. Super. Ct. Apr. 15, 2021), <https://cdn.robinhood.com/assets/robinhood/legal/motion-for-preliminary-injunctive-relief.pdf> [<https://perma.cc/JZP6-AUZY>].

98. Nate Raymond, *Massachusetts Regulators Seek to Revoke Robinhood's License; Brokerage Sues*, REUTERS (Apr. 15, 2021), <https://www.reuters.com/technology/robinhood-sues-invalidate-massachusetts-fiduciary-rule-2021-04-15> [<https://perma.cc/B5NQ-Q67N>]; see also Caitlin McCabe, *Massachusetts Seeks Revocation of Robinhood's Registration*, WALL ST. J. (Apr. 15, 2021), <https://www.wsj.com/articles/massachusetts-seeks-revocation-of-robinhoods-registration-11618521362> [<https://perma.cc/U464-UA95>].

99. Raymond, *supra* note 98.

100. Caitlin McCabe, *Judge Allows Robinhood Consumer-Protection Case to Proceed*, WALL ST. J. (May 27, 2021), <https://www.wsj.com/articles/judge-allows-robinhood-customer-protection-case-to-proceed-11622146018> [<https://perma.cc/NZ6B-YSQJ>].

101. See Bernice Napach, *New Jersey Delays Final Fiduciary Rulemaking*, THINKADVISOR (Apr. 16, 2021), <https://www.thinkadvisor.com/2020/04/16/new-jersey-delays-final-fiduciary-rulemaking> [<https://perma.cc/FH8C-6AQC>]. For a comprehensive tracker of state fiduciary law developments, see *State Fiduciary and Best Interest Developments*, Best Interest Compliance Team, FAEGRE DRINKER LLP (July 1, 2021), <https://www.brokerdealerlawblog.com/wp-content/uploads/2021/07/Recent-State-Fiduciary-Duty-Developments-06-28-2021.pdf> [<https://perma.cc/L3C3-6CNB>].

102. See Mark Schoeff Jr., *New Nevada Law Imposes Fiduciary Duty on Brokers*, INVESTMENTNEWS (June 16, 2017), <https://www.investmentnews.com/new-nevada-law-imposes-fiduciary-duty-on-brokers-71584> [<https://perma.cc/6UBU-M6ZL>].

103. *Notice of Draft Regulations and Request for Comment*, OFF. SEC'Y STATE NEV. (Jan. 18, 2019), <https://www.nvsos.gov/sos/home/showdocument?id=6156> [<https://perma.cc/DP5C-PWXT>] (final rulemaking was delayed due to the pandemic); see also Fred Reish & Burce Ashton, *Nevada Proposed Fiduciary Regulations*, BROKER-DEALER L. BLOG (Feb. 6, 2019), <https://www.brokerdealerlawblog.com/2019/nevada-proposes-fiduciary-regulations> [<https://perma.cc/2ZAA-5R5S>].

interrogatories about [Robinhood’s] trading platform, business and operations, [and] application of California’s commodities regulations” to the company.¹⁰⁴ These actions all pose existential threats to the business model of broker-dealers like Robinhood, which offer commission-free trading to the public.

What all of these developments suggest is that the time is ripe for a critical reassessment of whether the regulation of broker-dealers through the lens of fiduciary law is an adequate response to calls for greater consumer protection. In the following sections, I maintain that higher barriers to entry for retail investors, increased compliance costs to financial-services providers, and greater incoherence to our fiduciary laws are significant considerations that weigh against the imposition of a fiduciary duty on broker-dealers.

B. A Fiduciary Relationship Does Not Exist Between Robinhood and Its Users

In order to assess whether the imposition of fiduciary duties on Robinhood makes any sense as a theoretical matter, we must first determine what a fiduciary relationship entails. As will become clear in the subsequent discussion, there exists no consensus among fiduciary scholars about what elements are sufficient to establish a fiduciary relationship. With that being said, I demonstrate that the three most recent and compelling frameworks in fiduciary scholarship all point to (1) the existence of “discretionary power” by the agent and (2) the expectation that the agent will look after the “best interests” of its principal as necessary conditions for the existence of a fiduciary relationship.

1. The Analytical Priority of Fiduciary Relationships

Scholars have noted that the conventional wisdom of judges and plaintiffs alike, as evidenced by their opinions and briefs, implies “the analytical priority of relationship over duty in the structure of fiduciary liability.”¹⁰⁵ That is, there must be a fiduciary relationship before there can be a fiduciary duty. For example, in pleading their cases, plaintiffs often do not merely allege the existence of a breach of loyalty or care, but often premise their claims on the existence of a fiduciary relationship.¹⁰⁶ Moreover, judges are often called to preside over fact-intensive discovery to determine whether a relationship was in fact fiduciary in nature before rendering a judgment on whether a fiduciary duty has been breached.¹⁰⁷

104. Robinhood Markets, Inc., Registration Statement (Form S-1) (July 1, 2021), <https://www.sec.gov/Archives/edgar/data/1783879/000162828021013318/robinhoods-1.htm> [<https://perma.cc/W6MY-7XP2>].

105. Paul B. Miller, *The Fiduciary Relationship*, in PHILOSOPHICAL FOUNDATIONS OF FIDUCIARY LAW 63, 67 (Andrew S. Gold & Paul B. Miller eds., 2014).

106. *Id.* at 67.

107. *Id.* at 68 (citing, as a notable example, the case of *United States v. Chestman*, 947 F.2d 551, 569 (2d Cir. 1991), which held that “[b]ecause the fiduciary obtains access to this property to serve the ends of the fiduciary relationship, he becomes duty-bound not to appropriate the property for his own use”).

On a conceptual level, it makes little sense to speak of imposing fiduciary duties without reference to a fiduciary relationship. While it is true that the law does on occasion impose fiduciary obligations on parties without reference to a preexisting status or relationship, this phenomenon is the byproduct of flawed analogical reasoning and should be avoided if we wish to limit legal incoherence. To determine the features of a fiduciary relationship, most scholars employ a definitional approach, which is concerned with the general description of fiduciary relationships.¹⁰⁸ This can be contrasted with an analogical approach, which attempts to identify common characteristics among parties that are conceptually relevant for the extension of fiduciary duties. In analogical reasoning, “the focus is on likenesses, with conditions governing the materiality of likeness being derived independently of analogical reasoning itself.”¹⁰⁹

For example, some scholars have asserted that trustees and directors are both subject to fiduciary duties because they both have privileged access to the property of others. But while it may be correct to impose these duties on trustees and directors, it is unclear why having access to the property of others is the appropriate criterion. A separate explanation of the relevance of the criteria which ground the analogy in the first place is required. The only plausible answer is that the criteria serve to distinguish between what is *fiduciary* and what is *not fiduciary* at some fundamental level and is therefore definitional. For this reason, only definitional reasoning can articulate the contours of a fiduciary relationship in general terms.

2. Three Theories of Fiduciary Relationships

In recent years, several scholars have attempted to establish the contours of fiduciary relationships. Three attempts—D. Gordon Smith’s “Critical Resource Theory,” Paul B. Miller’s “Fiduciary Power Theory,” and Evan Criddle’s “Republican Theory”—are noteworthy for (1) their insistence that the problem of epistemic incoherence in fiduciary law can be resolved, (2) their commitment to utilizing definitional reasoning rather than analogical reasoning, and (3) the simplicity of their definitions of fiduciary relationships. It is for these reasons that I look to these theoretical frameworks for guidance on what a fiduciary relationship entails. My analysis will show that while these scholars are not in agreement about what elements are sufficient to establish a fiduciary relationship, there does exist a consensus among the scholars about what

108. See Paul B. Miller, *The Identification of Fiduciary Law*, in OXFORD HANDBOOK OF FIDUCIARY LAW 367, 375 (Evan Criddle, Paul Miller & Robert Sitkoff eds., 2019) (“First, analogical reasoning may be contrasted with definitional reasoning and direct characterization in that it does not imply a concern with general description of fiduciary relationships. Instead, analogical reasoning aims to identify common characteristics and to suggest that these are conceptually relevant (to conceptual framing of particular phenomena) and normatively relevant (in supporting a common legal response to phenomena analogized).” (emphasis omitted)).

109. *Id.* at 377 (emphasis omitted).

elements are necessary for a fiduciary relationship to exist—namely those of “best interest” and “discretion.”¹¹⁰

Let us first consider D. Gordon Smith’s “Critical Resource Theory,” which defines fiduciary relationships in the following manner:

[F]iduciary relationships form when one party (the “fiduciary”) acts *on behalf of* another party (the “beneficiary”) while exercising *discretion* with respect to a *critical resource* belonging to the beneficiary.¹¹¹

In Smith’s definition, the “on behalf” requirement is designed to capture the actions by the fiduciary which are for the benefit of the beneficiary, even when such actions may be detrimental to the fiduciary’s own interest.¹¹² The “discretion” requirement refers to the fact that fiduciaries have the freedom to make choices about how to perform their obligations. The exercise of this discretion, however, is limited to the critical resource of the beneficiary rather than one’s own performance—the latter of which is characteristic of discretionary performance in contractual arrangements.¹¹³ Finally, and most importantly, “critical resource” may refer to (1) something that is widely considered to be property—for example, land or money, or (2) something that is valued by the beneficiary but is not generally considered to be property—for example, confidential information. Crucially, “something” must lie at the core of the relationship, and this “something” cannot simply be the expectation of loyalty.¹¹⁴

Paul B. Miller offers a slightly different take in his “Fiduciary Power Theory” when he argues that:

A fiduciary relationship is one in which one party (the fiduciary) exercises discretionary power over the significant practical interests of another (the beneficiary).¹¹⁵

Miller terms this the “power” theory of fiduciary relationships because the exercise of discretionary power is the most significant characteristic of the relationship.¹¹⁶ Fiduciary power is distinguishable from other varieties of power “by virtue of the fact that it is a form of *authority* ordinarily derived from the *legal personality* of another (natural or artificial) person.”¹¹⁷ In other words, it

110. It should be noted that Smith, Miller, and Criddle created their definitions of fiduciary relationship without any reference to Robinhood, or any fintechs for that matter. One could, however, also envisage a scholar developing a definition of fiduciary relationships that is specifically designed to capture the likes of Robinhood. This latter approach, however, would be problematic because it entails artificially creating a path to a result that one is looking for rather than questioning whether that result is appropriate in the first place. The goal, as I see it, should be to conceive a more coherent theory of fiduciary relationships that is universally applicable rather than one that achieves the narrow result of subjecting Robinhood to the duties of loyalty and care.

111. D. Gordon Smith, *The Critical Resource Theory of Fiduciary Duty*, 55 VAND. L. REV. 1399, 1402 (2002) (“The italicized typeface highlights the three core requirements of a fiduciary relationship.”).

112. *Id.*

113. *Id.* at 1403.

114. *Id.* at 1404.

115. Miller, *supra* note 105, at 69.

116. *Id.* at 69.

117. *Id.* at 70.

must be a preexisting power conferred by one entity onto another. Miller highlights three principal modes of authorization: (1) mutual consent, whereby fiduciary and beneficiary intentions are evidenced in writing or some other form of communication, (2) unilateral undertaking, whereby one party voluntarily assumes fiduciary status, and (3) legal decree, where fiduciary duties are imposed on a party by the court or legislature.¹¹⁸

The most recent attempt to define fiduciary relationships comes from Evan J. Criddle, who maintains that the nature of fiduciary relationships “comes into clearest focus when viewed through the lens of republican legal theory.”¹¹⁹ For Criddle, republicanism offers a deceptively simple test for the identification of fiduciary relationships:

Fiduciary duties apply whenever a party has been entrusted with power over another’s legal or practical interests.¹²⁰

This definition has three components that merit further examination. “Power” refers to a form of authority over the exercise of another’s legal rights.¹²¹ “Entrustment” occurs when power, which does not belong to a party by right, is nonetheless committed to him/her by voluntary assignment of a principal or the independent operation of law.¹²² Finally, “another’s legal or practical interest” captures the idea that it is the fiduciary’s empowered position relative to a principal/beneficiary which gives rise to the threat of “alien control.”¹²³ The exercise of fiduciary power is considered “dominating” if the fiduciary is able to act “without reference to the interest, or the opinions, of” the principal and beneficiary.¹²⁴ Importantly, the fiduciary duty of loyalty exists to ensure that the powers entrusted to a fiduciary track “the terms of her mandate and the interests of her beneficiaries.”¹²⁵

All three frameworks note that one of the defining characteristics of a fiduciary relationship is the existence of “discretion.” For Smith, the “discretion” that is characteristic of fiduciaries refers to the freedom to make choices about how obligations are to be performed.¹²⁶ Miller elaborates further when he notes the discretionary power of fiduciaries is derived from the legal personality of the beneficiary.¹²⁷ Criddle maintains that a fiduciary violates his/her discretionary power when he/she acts without reference to the interests or opinions of the

118. *Id.* at 74-75.

119. Evan J. Criddle, *Liberty in Loyalty: A Republican Theory of Fiduciary Law*, 95 TEX. L. REV. 993, 995 (2017).

120. *Id.* at 1000.

121. *Id.* at 1038.

122. *Id.* at 1036-37.

123. *Id.* at 1037.

124. *Id.* at 995 (citing PHILIP PETTIT, REPUBLICANISM: A THEORY OF FREEDOM AND GOVERNMENT 55 (1997)).

125. *Id.* at 995.

126. Smith, *supra* note 111, at 1402.

127. Miller, *supra* note 105, at 70.

beneficiary, thereby placing the latter in a condition of domination.¹²⁸ The second defining characteristic of a fiduciary relationship is the existence of an obligation and expectation on the part of the fiduciary to promote the best interests of the beneficiary. Smith utilizes the term acting “on behalf of” the beneficiary, whereas Miller and Criddle refer to wielding power or control over the “practical interests” of the beneficiary.¹²⁹

In the sections below, I argue that Robinhood’s relationship with its users confounds these essential elements of a fiduciary relationship, challenging on a fundamental level any attempt to impose a fiduciary duty on Robinhood or broker-dealers like it.

3. What Constitutes “Discretion”?

The first defining feature of a fiduciary relationship is the existence of “discretion,” a characteristic that is particularly difficult to locate in the relationship between Robinhood and its users. Can Robinhood be said to wield any discretionary power over its users? I maintain that it cannot. To the extent that discretion does exist, it is not the type of discretion that would warrant the imposition of fiduciary duties.

Robinhood, like all brokerage firms, takes buy and sell orders and executes them.¹³⁰ It does not wield discretion, at least not in any obvious sense, over how users’ funds may be allocated to various securities. Robinhood may not, for example, take money from a user’s account and use it to purchase shares in Apple without the user’s consent, even if it has reason to believe that Apple shares will rise over time and produce gains for the user. Congress, in 1940, explicitly excluded brokers from the definition of investment advisers because brokers are not in the business of controlling the substance of their clients’ investments.¹³¹ Miller has taken this argument one step further to argue that, notwithstanding the current federal regulatory regime, “advisers are not fiduciaries by virtue of giving advice. Instead, they are fiduciaries only where they exercise discretionary power over the practical interests of their clients.”¹³² Outside of the United States, courts have held that advisory relationships are not inherently fiduciary. Justice Le

128. Criddle, *supra* note 119, at 995 (explaining that “the central message of republican legal theory is that legal norms and institutions are necessary to safeguard individuals from ‘domination,’ understood as subjection to another’s alien control (*arbitrium*)”).

129. Miller, *supra* note 105, at 69; Criddle, *supra* note 119, at 1000.

130. In reality, brokerage firms do not actually execute trades. Instead, major brokers including Robinhood, Vanguard, and Charles Schwab sell orders to market makers who can offer better prices than public exchanges. These market makers include Virtu Capital and Citadel Securities. This process of stock order routing is referred to as Payment for Order Flow (PFOF). See *Stock Order Routing*, ROBINHOOD, <https://robinhood.com/us/en/support/articles/stock-order-routing> [<https://perma.cc/VXE5-FBYQ>]; see also Theresa W. Carey, *Payment for Order Flow (PFOF)*, INVESTOPEdia (Feb. 1, 2021), <https://www.investopedia.com/terms/p/paymentoforderflow.asp> [<https://perma.cc/LHV6-UP6V>].

131. See Investment Advisers Act of 1940, 15 U.S.C. § 80b-2(a)(11) (2018) (excluding from the definition of investment adviser a broker or dealer “whose performance of such advisory services is solely incidental to the conduct of his business as a broker or dealer and who receives no special compensation” for those services).

132. Miller, *supra* note 105, at 84.

Forest of the Canadian Supreme Court, for example, has written that for an advisory relationship to be fiduciary, “there must be something more than a simple undertaking by one party to provide information and execute orders for the other.”¹³³ I am in agreement with Miller and Le Forest. On a conceptual level, brokers and advisers cannot be considered fiduciaries if they do not wield any discretion over the interests of their clients or users.

One could argue that Robinhood wields significant discretion over trading decisions in less straightforward ways. For example, Robinhood used to display to its customers a selection of stocks that it deemed desirable—whether or not it was for the users’ benefit. This practice, which Robinhood has since halted, amounts to general advertisement.¹³⁴ Indeed, a significant charge levied against Robinhood in the MSD complaint details the ways in which Robinhood proffered lists of top stocks to inexperienced investors on the platform without accounting for their suitability.¹³⁵ While this certainly might amount to misleading users to buy stock they might otherwise not buy, the link between this form of advertising and the relevant form of discretion that would compel fiduciary regulation is tenuous at best. Robinhood is not making decisions on behalf of its users. To the extent that we are not ready to impose fiduciary duties on social media companies, in-app-purchase games developers, and the fashion industry for targeting our desires and insecurities, it makes little sense to impose fiduciary duties on Robinhood.

Perhaps a stronger case can be made that Robinhood exercises discretion over how and when a user’s trades are executed, which can cause stock prices to fluctuate before orders are settled. This can become a major cause for concern if Robinhood and the high-frequency trading firms to which user order flows are directed (e.g., Citadel) are engaged in the practice of skimming off the top of orders and giving users a higher price—usually a fraction of a cent on the dollar.¹³⁶ There is some evidence to suggest that this is happening. In 2017, Citadel Securities was fined \$22 million by the SEC for misleading clients about getting the best price for retail orders from investors who are customers of broker-dealers.¹³⁷ Recent articles detailing how Robinhood generates revenues through order flow sales corroborate this finding that commission-free trading is not truly cost-free to users.¹³⁸

133. Miller, *supra* note 105, at 83. (citing the opinion of Justice Le Forest in *Hodgkinson v. Simms*, [1994] S.C.R. 377, 409-10 (Can.)).

134. These were not tailored for each individual user so they cannot be said to have been targeted advertisements.

135. See *supra* Section II.A.1.

136. See Brendan Sullivan, *The Real Way That ‘Free Trading’ App Robinhood Makes Money Will Surprise You*, MODERN CONSENSUS (Feb. 11, 2019), <https://modernconsensus.com/technology/robinhood-high-frequency-trading-citadel-two-sigma-galileo-russell> [<https://perma.cc/GHT9-EVE6>].

137. Press Release, SEC, Citadel Securities Paying \$22 Million for Misleading Clients About Pricing Trades, Release No. 2017-11 (Jan. 13, 2017), <https://www.sec.gov/news/pressrelease/2017-11.html> [<https://perma.cc/MJL2-3RKQ>].

138. See, e.g., Richard Nieva, *Robinhood’s No-Fee Model Has Real Costs: ‘That Is What Scares Me’*, CNET PERSONAL FIN. (May 3, 2021), <https://www.cnet.com/personal-finance/robinhoods-no-fee-model-has-real-costs-that-is-what-scars-me> [<https://perma.cc/7EH8-2RY2>]; Alexander Osipovich &

On the other hand, brokerages also employ systems that severely limit their discretion. It must first be noted that all brokers are also subject to a duty of “best execution,” which requires them to execute orders in a manner that obtains the “most advantageous terms for the customer.”¹³⁹ In addition to this “best execution” requirement, nearly all brokers require users to specify the mechanism by which an order is executed. These include “market orders,” which only execute at the market price; “limit orders,” which execute at a specific limit price or better; “stop orders,” which execute when a stock reaches a specific price; and various combinations of the three.¹⁴⁰ In the case of options trading, Robinhood requires users to set floors and/or ceilings for the price at which they are willing to pay for a contract. These order descriptions, however, are rather misleading since Robinhood, like most brokerages, disclaims that the price is not guaranteed. For example, Robinhood “automatically converts most market buy orders into limit orders with a 5% collar to help cushion against any significant upward price movement.”¹⁴¹ In limited circumstances, they will do the reverse with market sell orders.¹⁴²

These mechanisms, while imperfect, work together to ensure that users are executing trades at or close to their desired prices. It should not be surprising that Robinhood and Citadel are somehow profiting from commission-free transactions considering the fact that they would go bankrupt otherwise. What is more difficult to determine, however, is whether this sort of activity rises to the level of discretion that would warrant the imposition of fiduciary duties. To the extent that what Robinhood and Citadel are doing qualifies as “discretion,” it is extremely limited. Moreover, it is a form of discretion that is distinct and removed from the decision that really counts: the decision to make a trade at any given price, which ultimately rests with the user.

Perhaps the strongest case to be made for the existence of “discretion” is that Robinhood has the power to restrict the trading of certain securities if trading volumes are too high, especially if the activity threatens its ability to meet its capital and clearinghouse obligations.¹⁴³ As the GameStop fiasco showed, such decisions by Robinhood have the potential not only to prevent users from making gains by buying shares, but also to cause significant losses by preventing users

Lisa Beilfuss, *Why ‘Free Trading’ on Robinhood Isn’t Really Free*, WALL. ST. J. (Nov. 9, 2018), <https://www.wsj.com/articles/why-free-trading-on-robinhood-isnt-really-free-1541772001> [<https://perma.cc/6RA3-6VYZ>].

139. *Best Execution*, FINRA (Dec. 6, 2017), <https://www.finra.org/rules-guidance/guidance/reports/2017-report-exam-findings/best-execution> [<https://perma.cc/YVK2-4A68>].

140. *Investing with Stocks: The Basics*, ROBINHOOD, <https://robinhood.com/us/en/support/trading/investing-with-stocks-the-basics> [<https://perma.cc/76NQ-B9J8>].

141. *Market Order*, ROBINHOOD, <https://robinhood.com/us/en/support/articles/market-order> [<https://perma.cc/F42X-6EHV>].

142. *Id.*

143. *See, e.g.*, Maggie Fitzgerald, *Robinhood Restricts Trading in GameStop, Other Names Involved in Frenzy*, CNBC (Jan. 28, 2021), <https://www.cnbc.com/2021/01/28/robinhood-interactive-brokers-restrict-trading-in-gamestop-s.html> [<https://perma.cc/6G5L-C958>] (noting that Robinhood had halted trading of GameStop on its platform on the morning of Jan. 28, 2021).

from getting out of precarious option positions.¹⁴⁴ Many consumer-rights activists have accused Robinhood of supporting the hedge funds that shorted GameStop by halting the trading of GameStop for a day.¹⁴⁵ But one could argue, as Robinhood did, that the decision to restrict trading was not a discretionary act in the interests of its users but a mandatory act compelled by external clearinghouse requirements.¹⁴⁶ Robinhood asserted that it had no other option but to restrict trading because of the unprecedented volume and volatility of the underlying assets, which made it impossible to maintain the minimum deposits to support user trading.¹⁴⁷ Days after halting the trading of GameStop, Robinhood lifted restrictions and allowed a reduced level of trading again.¹⁴⁸

Should we view this episode as demonstrative of the type of discretion that would warrant fiduciary duties? I maintain that we cannot. Unless we see more actions like these in the future, it is hard to say that Robinhood was exercising its independent authority rather than responding to an external obligation. Moreover, one could argue that the clearinghouse restrictions were put in place precisely to respond to the type of market volatility we saw with GameStop. Under this view, Robinhood reacted exactly as it should, but unfortunately stoked massive contempt along the way.

As the foregoing discussion has shown, it is not clear that Robinhood wields any obvious discretion over the interests of its users. To the extent that less straightforward forms of discretion exist, they are not the relevant kinds of discretion that would implicate fiduciary duties. As Miller has observed, mere discretion does not confer a fiduciary status¹⁴⁹—otherwise, all sorts of relationships would be considered fiduciary. Instead, the relevant kind of discretion is that which is derived from the powers of the beneficiary himself or herself. Specifically, the fiduciary, by virtue of the power vested in him/her, “stands in substitution for the beneficiary or a benefactor in exercising a legal

144. See Kelly Anne Smith, *Robinhood Halts GameStop Trading, Angering Lawmakers and Investors*, FORBES ADVISOR (Jan. 28, 2021), <https://www.forbes.com/advisor/investing/robinhood-gamestop-trading> [https://perma.cc/2TN4-NFK6]; see also Adi Robertson, *Robinhood Is Facing Dozens of Lawsuits Over GameStop Stock Freeze* (Feb. 1, 2021), <https://www.theverge.com/2021/2/1/22254656/robinhood-gamestop-stonks-trade-freeze-class-action-lawsuits> [https://perma.cc/K4DH-6WU5] (“Ptryk Krasowski of Illinois, for instance, claims he lost \$220,000 because Robinhood wouldn’t let him exercise GameStop purchase options.”).

145. See Jeff Kearns & Hema Parmar, *Robinhood, Citadel Fight Conspiracies Ahead of Gamestop Grilling*, BLOOMBERG NEWS (Feb. 17, 2021), <https://www.bloomberg.com/news/articles/2021-02-17/robinhood-s-tenev-tells-lawmakers-no-aid-provided-to-hedge-funds> [https://perma.cc/RA7H-F3FF].

146. *What Happened This Week: The Mechanics Behind Your Trades*, ROBINHOOD (Jan. 29, 2021), <https://blog.robinhood.com/news/2021/1/29/what-happened-this-week> [https://perma.cc/T93G-DBA7].

147. *Id.*

148. Oscar Gonzales & David Priest, *Robinhood Backlash: What You Should Know About the GameStop Controversy*, CNET (Mar. 21, 2021), <https://www.cnet.com/personal-finance/investing/robinhood-backlash-what-you-should-know-about-the-gamestop-stock-controversy> [https://perma.cc/J3FF-578X] (noting that Robinhood restored “limited buys” on the afternoon of January 28 and increased the maximum shares of GameStop that could be traded to 500 on February 3).

149. Miller, *supra* note 105, at 72 (noting that another essential characteristic of fiduciary power is that it is *specified*).

capacity that is ordinarily derived from the beneficiary or benefactor's legal personality."¹⁵⁰ Here, Miller is adopting the Hobbesian conception of fiduciary duties as inherently representational and rooted in the act of authorization through personation.¹⁵¹ What this means is that an entity cannot be termed a fiduciary if it is exercising a form of discretionary power that did not originally belong to the supposed beneficiary.

4. What Is in a User's "Best Interest"?

The second defining element of a fiduciary relationship is "best interest," the identification of which poses challenges of its own. What could looking after a user's "best interests" mean in the context of Robinhood? Moreover, how would one measure it? To borrow from the shareholder-director context, one possible answer is that Robinhood (as a fiduciary) bears an affirmative duty to maximize the wealth of its users. Yet upon cursory inspection, this would seem preposterous. While it is safe to say that all Robinhood users would prefer maximized returns, it seems implausible that they would expect Robinhood to ensure that—nor would Robinhood be able to satisfy such a promise. Unlike a hedge fund or a private equity firm that undertakes vast amounts of capital from wealthy private investors with the expectation of market-beating returns, Robinhood makes no such promise to its users. Because Robinhood does not choose stocks for its users, it has no control over what returns its users receive.

An alternative explanation is that looking after the "best interests" of users means ensuring that retail investors can execute trades at reasonable prices. But if lowering transaction costs is really the overriding interest, it is hard to see what Robinhood would be violating. Robinhood has done a commendable job of democratizing investing by providing market access to everyday investors. Robinhood was the first firm to offer its users commission-free trading. Typical brokerages at the time not only charged fees between \$5 and \$10 per trade, but also required account minimums.¹⁵² By eliminating these two requirements, Robinhood significantly lowered the barrier to entry for everyday investors. The subsequent decision by brokerage behemoths like Fidelity, Charles Schwab, Vanguard, and many more, to offer commission-free trading was a direct response to the threat posed by Robinhood.¹⁵³

150. *Id.* at 70-71.

151. See THOMAS HOBBS, *LEVIATHAN* 112 (Richard Tuck ed., 1996) ("[T]he Right of doing any Action, is called AUTHORITY and sometimes warrant. So that by Authority, is always understood a Right of doing any act; and done by Authority, done by Commission, or Licence from him whose right it is.").

152. See Hala Touryalai, *Forget \$10 Trades, Meet Robinhood: New Brokerage Targets Millennials with Little Cash*, FORBES (Feb. 26, 2014), <https://www.forbes.com/sites/halahtouryalai/2014/02/26/forget-10-trades-meet-robinhood-new-brokerage-targets-millennials-with-little-cash> [<https://perma.cc/7TAX-7MST>]; see also *Our Story*, ROBINHOOD, <https://robinhood.com/us/en/support/articles/our-story> [<https://perma.cc/6JU9-XSMC>].

153. See Matt Egan, *This App Completely Disrupted the Trading Industry*, CNN BUS. (Dec. 13, 2019), <https://www.cnn.com/2019/12/13/investing/robinhood-free-trading-fractional-shares> [<https://perma.cc/QW4S-9XNN>].

What if, instead of unfettered access, looking after its users’ “best interests” meant limiting its services to an informed user base and/or promoting greater financial literacy? Indeed, proponents of greater regulation of Robinhood have called on the company to institute more careful screening procedures and training protocols for new users. Under this lens, the best interest is presumably preventing users from making “bad” investment decisions. This argument, however, stands in tension with our general societal aversion to gatekeeping and paternalism. To get off the ground, proponents of this view must answer two nontrivial questions. First, what does a threshold level of financial literacy necessary to trade in securities entail? Second, how would we measure it? Some may see these regulations as a necessary form of intervention that prevents individuals from facing financial ruin, while others may see “bad” investment decisions as an irreplaceable means of gaining experience and familiarity with an unpredictable stock market. It is worth asking whether any proposed regulation would serve the end of democratization rather than gatekeeping and paternalism if people are not allowed to make mistakes on their own. To the extent that greater regulation is necessary, it remains unclear why the imposition of fiduciary duties is the correct path to take when there are better alternatives available.

The final, and perhaps most plausible, explanation is that looking after its users’ “best interest” refers to the maintenance and upkeep of an efficient and accessible platform. Indeed, one of the central contentions in the MSD complaint is the fact that Robinhood had repeatedly failed to prevent outages and disruptions to its platform, which resulted in its users losing out on possible gains from trading.¹⁵⁴ But why should this necessitate the imposition of fiduciary standards rather than a less onerous standard of usability? We do not impose fiduciary liability on internet service providers, metropolitan transportation services, or utilities companies for disrupted services (which are arguably more important than having access to the stock market), so why should we do so with brokerages? The imposition of penalties on these companies, if any, generally do not occur in light of fiduciary principles.

Moreover, it is also essential to note that users have diverging interests and risk tolerances.¹⁵⁵ What is in one user’s “best interest” may not necessarily be in the “best interest” of another. Robinhood’s users are not monolithic and should not be viewed as such. Recent scholars and practitioners have noted that even the most paradigmatic example of shared interests—shareholders of a publicly held company—often have diverging interests upon closer examination.¹⁵⁶ The

154. See *supra* Section II.A.1.

155. See Greg B. Davies, *Measuring Risk Tolerance Badly Is As Bad As Not Measuring It at All*, OXFORD RISK (Feb. 25, 2021), <https://www.oxfordrisk.com/blog-posts/measuring-risk-tolerance-badly-is-as-bad-as-not-measuring-it-at-all> [<https://perma.cc/74J6-K2MZ>] (“Most attempts to measure risk tolerance fail in at least one crucial way, be it confusing the measurement, confusing the audience, or thinking guesswork is a good enough replacement for rigorous psychometric science.”).

156. See, e.g., Martin Lipton & Kevin Schwartz, *Reclaiming “Value” in the True Purpose of the Corporation*, HARV. L. SCH. F. CORP. GOVERNANCE, (Oct. 10, 2020), <https://corp.gov.law>

current debate about whether short-term or long-term growth should inform the decisions of company executives is one example of this divergence of interests at play. Another is the conflict between taxable and tax-exempt shareholders in the context of corporate dividend issuances.¹⁵⁷ I do not wish to suggest that Robinhood bears no affirmative obligation to advance the “best interests” of its users whatsoever. What I am suggesting instead is that the question of what constitutes “best interest” will necessarily be difficult to determine, especially in light of Robinhood’s diffusive user base and its ultimate goal of democratizing investing.

These considerations stand in tension with calls to impose greater barriers to entry and affirmative obligations for brokers like Robinhood. The fact that “best interest” is so nebulous and inchoate in the context of brokers like Robinhood suggests that it would be ill-advised to subject them to our law’s strictest standard of conduct. Because fiduciary duties are so onerous and their penalties so strict, we ought first to be certain that Robinhood is a fiduciary before imposing the duties of loyalty and care. Otherwise, we render the concept of a fiduciary empty and incoherent.

C. A Critique of the Massachusetts Regulation and Its Application

In light of the foregoing discussion, it is clear that the central flaw in the Massachusetts regulation lies in its attempt to impose fiduciary duties on a relationship that is fundamentally not fiduciary in nature. In doing so, the Massachusetts regulation not only contributes to the incoherence of fiduciary law, but also dilutes the efficacy of fiduciary duties in circumstances where they are most needed. For these reasons alone, the Massachusetts regulation and any others like it should be rejected.

There are also more practical reasons for rejecting the Massachusetts regulation or similar regulations to come. First, rather than offering any clarity on the distinction between investment advisers and broker-dealers, the Massachusetts regulation effectively collapses the once-separate regulation of brokers and advisers into one fiduciary regime on the grounds that brokers and advisers have become functional equivalents of one another. In doing so, the Massachusetts regulation ignores the distinct functions that investment advisers and broker-dealers have and will continue to serve.¹⁵⁸ This in turn will impose greater costs on broker-dealers and retail investors alike. Broker-dealers will

.harvard.edu/2020/10/10/reclaiming-value-in-the-true-purpose-of-the-corporation [https://perma.cc/K7TG-PY6A].

157. See Omri Marian, *Is All Corporate Tax Planning Good for Shareholders?*, 52 U.C. DAVIS L. REV. 905, 909-11 (2018) (noting that taxable shareholders are sensitive to the timing of dividend issuances, while tax-exempt shareholders are largely indifferent).

158. See Regulation Best Interest: The Broker-Dealer Standard of Conduct, Exchange Act Release No. 34-86031, 84 Fed. Reg. 33,318, 33,319 (July 12, 2019) (codified at 17 C.F.R. pt. 240) (“As a general matter, broker-dealers and investment advisers have different types of relationships with investors, offer different services, and have different compensation models when providing investment recommendations or investment advisory services to customers.”).

either pass these costs onto consumers or stop offering brokerage services altogether.¹⁵⁹

Second, the fiduciary duties imposed by the Massachusetts regulation are deemed to be effective only when a recommendation is made. This limitation fails to incentivize Robinhood to improve its platform infrastructure and customer service when recommendations are not being made.¹⁶⁰ It is for this reason that the Massachusetts regulation is unsuccessful at addressing the very issues it proclaims to resolve.

Third, the two most meritorious elements of the Massachusetts complaint, which include Robinhood's failure to maintain adequate platform infrastructure to meet its growing user base and its failure to adhere to its internal policies for the approval of option trades, can both be addressed without recourse to the imposition of fiduciary duties. These issues can be addressed through the expansion of Reg SCI, which I will explore in Section III.B.

1. The Function of Broker-Dealers

To understand what is at stake when a state seeks to unify the regulation of broker-dealers and investment advisers, it is necessary to first articulate the distinct functions these two categories of investment actors serve. In doing so, I show why the current bifurcated system of regulation remains necessary despite the existence of companies that engage in both types of activities.

Consider the following two differences between broker-dealers and investment advisers: (1) compensation structure, and (2) market-making activities. As the SEC has noted, “[b]roker-dealers typically provide transaction-specific recommendations and receive compensation on a transaction-by-transaction basis (such as commissions) (‘transaction-based’ compensation or model),” whereas investment advisers “typically provide ongoing, regular advice and services in the context of broad investment portfolio management, and are compensated based on the value of assets under management (‘AUM’), a fixed fee or other arrangement (‘fee-based’ compensation or model).”¹⁶¹ Thus, an investment adviser would still get paid if he/she determines that it is in the client's best interest not to purchase any financial products at all. They might, for example, counsel the client against investments if the markets are too volatile or interest rates are too low.

159. See, e.g., Oliver Wyman, *Standard of Care Harmonization: Impact Assessment for SEC* (Oct. 2010), <http://www.sifma.org/issues/item.aspx?id=21999> [<https://perma.cc/X9K8-YL9B>] (finding that “broker-dealers play a critical role in the financial services industry that cannot be easily replicated with alternative services models. Wholesale adoption of the Investment Advisers Act of 1940 for all brokerage activity is likely to have a negative impact on consumers (particularly smaller investors) across each of the following dimensions: choice, product access, and affordability of advisory services”).

160. This fact, however, did not stop the MSD from trying to use the regulation to penalize Robinhood for platform outages.

161. Regulation Best Interest: The Broker-Dealer Standard of Conduct, 84 Fed. Reg. at 33,319. It should be noted that some investment advisers have adopted a commission-based model for certain financial transactions such as the sale of insurance. This would seem to run afoul of a fiduciary's duty to refrain from engaging in conflicted transactions.

The same is not true for broker-dealers. As a platform that offers commission-free trading of stocks and options, Robinhood generates revenue almost entirely from a process known as “payment for order flow.” This involves routing large volumes of trades to various market-makers for execution in exchange for fees to the brokers. Typically, this involves the receipt of small payments, usually fractions of a penny per share.¹⁶² What this means is that Robinhood’s revenues are directly linked to the number of trades its customers execute.¹⁶³

Industry professionals have noted that a transaction-based compensation model offers retail investors increased choice at a lower cost as compared to a fee-based model.¹⁶⁴ This is because fee-based compensation models have higher barriers to entry that arise from the increased cost of compliance (including administrative, regulatory, and litigation-related costs) imposed by the fiduciary standard. Most fee-only investment advisers, for example, have minimum asset requirements (usually \$250,000, \$500,000, or more) that render their services out of reach for low- and mid-tier investors. Industry professionals worry that imposing a fiduciary standard on broker-dealers will cause them to change their business model from a commission-free transaction-based model to a fee-based one.¹⁶⁵ As the authors of one comment letter note, “[o]ur experience with the DOL Rule taught us that overly broad and overly prescriptive rules that do not preserve the different business models for providing financial services end up reducing access to financial services and increasing costs.”¹⁶⁶

There also exists a more fundamental question about whether a transaction-based model for financial services is even compatible with the fiduciary duties of loyalty and care. Indeed, one of the archetypal agency problems that the fiduciary duty is designed to ameliorate is that of an agent whose compensation

162. See Theresa W. Carey, *Payment for Order Flow*, INVESTOPEDIA (Feb. 1, 2021), <https://www.investopedia.com/terms/p/paymentfororderflow.asp> [<https://perma.cc/F79H-WFVJ>].

163. Gary Gensler, Chair of the SEC, recently noted that a full ban on payment for order flow (PFOF) is “on the table” due to the conflict of interest and best execution issues that it raises for brokers. Avi Salzman, *SEC Chairman Says Banning Payment for Order Flow Is ‘On the Table.’* BARRON’S (Aug. 30, 2021), <https://www.barrons.com/articles/sec-chairman-says-banning-payment-for-order-is-on-the-table-51630350595> [<https://perma.cc/4WYQ-6BMK>].

164. For an extensive list of public comments, most of which are from financial advisers, see *Solicitation of Comments on Proposed Fiduciary Conduct Standard for Broker-Dealers, Agents, Investment Advisers, and Investment Adviser Representatives*, MASS. SEC. DIV. (Dec. 20, 2019), <https://www.sec.state.ma.us/sct/sctfiduciaryconductstandard/fiduciaryruleidx.htm> [<https://perma.cc/8RR3-RUSZ>].

165. *Id.*

166. Letter from the U.S. Chamber of Commerce, Center for Capital Markets Competitiveness (CCMC); South Shore Chamber of Commerce; Cape Code Regional Chamber; Springfield Regional Chamber; & Worcester Regional Chamber of Commerce to William Galvin, Sec’y of the Commonwealth of Massachusetts (Jan. 7, 2020) <https://www.sec.state.ma.us/sct/sctfiduciaryconductstandard/comments/2020-01-07-US-Chamber-of-Commerce-et-al.pdf> [<https://perma.cc/W4C5-SZRQ>] (“[H]ad the DOL Rule been fully implemented: 11 million households would have seen limited or restricted investment products available to them; up to 7 million individual retirement account (‘IRA’) owners would have lost access to investment advice altogether; nearly three quarters of financial professionals would have stopped providing advice to some of their small accounts; and 35% of those professionals would have ceased serving accounts below \$25,000.”).

is directly tied to a principal's usage of his or her services. Normally, this paradigmatic conflict of interest can be resolved through adequate and timely disclosure. However, Section 12.207(2)(c) explicitly states that “disclosing conflicts alone does not meet or demonstrate the duty of loyalty.”¹⁶⁷ What this suggests is that even if a broker-dealer were able to make “all reasonably practical efforts” to avoid or eliminate conflicts of interest, as required under Section 12.207(2)(b), the broker-dealer may not necessarily meet the new duty of loyalty.¹⁶⁸ This would open broker-dealers to increased threats of litigation. Were it possible to eliminate conflicts of interest through disclosure, it would likely take significant effort and resources to ameliorate these conflicts at the scale and volume on which Robinhood operates,¹⁶⁹ jeopardizing the economic feasibility of a commission-free trading model.

Some scholars like Jerry W. Markham have gone as far as to suggest that the imposition of fiduciary or fiduciary-like duties will force broker-dealers to hold customer funds in low-return cash accounts that can be exploited in “carry” trades, which arbitrage the difference between long-and-short-term interest rates, and lead customers to concentrate their wealth in “cookie-cutter accounts” that are not well-insulated from systemic market shocks.¹⁷⁰ Markham predicts that these factors will lead to “the failure of many large financial institutions, absent a massive, politically unpalatable government bailout.”¹⁷¹

Another salient difference is that broker-dealers, unlike investment advisers, are often market-makers: financial institutions that maintain enough trading volume in a market to ensure seamless transactions among buyers and sellers.¹⁷² Imposing fiduciary duties on broker-dealers would prevent them from engaging in critical market-making activities such as principal trading. In contrast to agency trading, principal trading involves the buying and selling of securities on a broker-dealer's own behalf rather than on behalf of a client,¹⁷³ and it is well understood to be an essential activity of broker-dealers because it helps to establish market liquidity and improves market efficiency.¹⁷⁴ For

167. 950 MASS. CODE REGS. 12.207(2)(c) (2020).

168. 950 MASS. CODE REGS. 12.207(2)(b) (2020).

169. See Robinhood Markets, Inc., Registration Statement (Form S-1) (July 1, 2021), <https://www.sec.gov/Archives/edgar/data/1783879/000162828021013318/robinhoods-1.htm> [<https://perma.cc/BB77-ZQMZ>] (noting that Robinhood has 17.7 million “monthly active users” and \$81 billion in “assets under custody”).

170. Jerry W. Markham, *Regulating Broker-Dealer Investment Recommendations – Laying the Groundwork for the Next Financial Crisis*, 13 DREXEL L. REV. 377, 382 (2021).

171. *Id.*

172. Barclay Palmer, *Broker vs. Market Maker: What's the Difference?*, INVESTOPEDIA (May 2, 2021), <https://www.investopedia.com/ask/answers/06/brokerandmarketmaker.asp> [<https://perma.cc/W9NR-5SZA>].

173. See Will Kenton, *Principal Orders*, INVESTOPEDIA (Jun. 17, 2020), <https://www.investopedia.com/terms/p/principalorders.asp> [<https://perma.cc/7KFB-ZB6D>].

174. See Forte, *Principal Trading*, MEDIUM (Mar. 2, 2021), <https://medium.com/community-economics-by-forte/principal-trading-1e4e133b2c57> [<https://perma.cc/G3TV-BREE>] (“When you see the term ‘broker-dealer’ in financial discussions, it’s because many marketplace professionals take on both roles, holding and managing inventory of their own as well as agenting transactions between third parties.”).

example, brokerages often step in as principals to complete orders when there is a dearth of third-party sellers and buyers. Investors are more likely to enter the market if they know that they can reliably exit positions.¹⁷⁵ Brokerages provide this market-making service because they are able to generate some income for themselves through principal trading—the gains are usually based on the bid-ask spread.

Investment advisers, by contrast, simply do not have the same level of flexibility necessary to trade from their own accounts and therefore cannot undertake this market-making role.¹⁷⁶ The Investment Advisers Act explicitly prohibits an adviser from conducting principal trades with clients, because it would amount to self-dealing, unless the adviser offers prior written disclosure to the client and obtains the client's consent.¹⁷⁷ To this day, there exists a dearth of well-conceived proposals detailing how principal trading can be reconciled with the duties of care and loyalty should broker-dealers be deemed fiduciaries.¹⁷⁸ Unlike a strict fiduciary standard, the less onerous suitability standard serves as a reasonable tradeoff between investor protection and market efficiency.

As these two differences illustrate, there are compelling reasons why the institution of a unified fiduciary regime for both broker-dealers as well as investment advisers would be unappealing, notwithstanding the existence of companies that provide both types of services to customers. A broker-dealer's compensation model and core market-making functions are fundamentally incompatible with the fiduciary standard.

2. The Recommendation Trigger

A second practical issue with the Massachusetts regulation is that the application of fiduciary duties is not deemed to be ongoing outside of the recommendation period (except in a few circumstances).¹⁷⁹ When asked about when broker-dealers would be bound by the newly established fiduciary duties, the Secretary of the Commonwealth of Massachusetts, William Gavin, answered that the fiduciary duty would not be imposed on a broker-dealer beyond the time a recommendation is made, “unless the broker-dealer or agent has: (1) discretion in a customer's account (unless the discretion relates solely to the time and/or price for the execution of the order); (2) a contractual fiduciary duty; or (3) a contractual obligation to monitor a customer's account on a regular or periodic

175. See Robert B. Thompson, *Market Makers and Vampire Squid: Regulating Securities Markets After the Financial Meltdown*, 89 WASH. U. L. REV. 323, 342 (2011).

176. See Arthur B. Laby, *Selling Advice and Creating Expectations: Why Brokers Should Be Fiduciaries*, 87 WASH. L. REV. 707, 743 (2012).

177. Investment Advisers Act of 1940, 15 U.S.C. § 80b-6(3) (2018).

178. Laby, *supra* note 176, at 745 n.213.

179. *Adopting Release*, *supra* note 54, at 3 (“Section 12.207(1)(b) of the Final Regulations extends the duty beyond the recommendation period under certain circumstances. This extended duty is based upon ancillary factors that occur outside the traditional broker-dealer customer relationship.”).

basis.”¹⁸⁰ What this suggests is that, to the extent Robinhood may be said to not be offering any recommendations to customers, Robinhood is beyond the regulation of Section 12.207. Thus, the Massachusetts regulation would not fully address the indiscretions at issue in the MSD’s complaint—namely the failures by Robinhood to maintain adequate trading infrastructure, prevent outages, and review options trades by its users.

It is worth noting that this recommendation trigger is not particular to the Massachusetts regulation. Both Reg BI and the suitability standard have similar recommendation triggers that would render the “best interest” and “suitability” standards inapplicable on an ongoing basis when recommendations are not being made. Reg BI, for example, establishes a best-interest obligation on broker-dealers when “making a recommendation of any securities transaction or investment strategy involving securities to a retail customer.”¹⁸¹ With regards to the suitability standard, FINRA notes that “[t]he new rule continues to use a broker’s ‘recommendation’ as the triggering event for application of the rule and continues to apply a flexible ‘facts and circumstances’ approach to determining what communications constitute such a recommendation.”¹⁸² What all of this suggests is that none of the aforementioned regulations helps the MSD accomplish its ultimate goal of forcing Robinhood to maintain a platform that offers better services and protections for retail investors. So long as Robinhood is not engaged in the offering of any recommendations or advice to its users, the efficacy of these regulations is severely limited.

The recommendation trigger also raises a separate, but equally important and practical, question about whether a recommendation can be effectively identified. FINRA currently advises brokers to apply a “facts and circumstances” approach, which is not only time intensive but also ambiguous. In an industry where millions of users with disparate trading experiences and objectives are engaging in numerous transactions each day, the costs associated with determining whether each of these transactions was predicated on a recommendation impose significant costs on an industry with exceedingly thin profit margins.

Beyond theoretical incoherence, there exist compelling practical reasons for rejecting the imposition of fiduciary duties on broker-dealers. As I have endeavored to show in this Section, such a move would threaten the viability of a broker-dealer’s compensation model as well as its market-making function—key factors that allow retail investors to access an exceedingly liquid market at no cost per trade. What is perhaps even more troublesome is the fact that a

180. *Massachusetts Fiduciary Conduct Standard for Broker-Dealers and Agents Frequently Asked Questions & Answers*, SEC’y COMMONWEALTH MASS. (May 1, 2020), <https://www.sec.state.ma.us/sct/setfiduciaryconductstandard/fiduciaryrule-faq.htm> [<https://perma.cc/AB9R-ZADH>].

181. Regulation Best Interest: The Broker-Dealer Standard of Conduct, Exchange Act Release No. 34-86031, 84 Fed. Reg. 33,318, 33,470 (July 12, 2019) (codified at 17 C.F.R. pt. 240).

182. FINRA, Reg. Notice 11-02, *SEC Approves Consolidated FINRA Rules Governing Know-Your-Customer and Suitability Obligation* (effective July 9, 2012), <https://www.finra.org/rules-guidance/notices/11-02> [<https://perma.cc/62WG-F9Q4>].

fiduciary rule like the Massachusetts regulation is still subject to a recommendation trigger and would therefore fail to protect consumers from the infrastructural problems alleged in the Massachusetts complaint. In Part III, I argue that a possible alternative to the imposition of strict fiduciary duties is the expansion of a preexisting regulation, Regulation Systems Compliance and Infrastructure (Reg SCI), to include brokers-dealers.

III. A Better Case for Regulation

Given that attempts to impose fiduciary duties onto Robinhood are largely unsound as both a theoretical and practical matter, how else might we consider protecting investors against platform outages and misunderstandings that arise when they engage in complex trades? One solution comes to mind: expanding Reg SCI, a preexisting regulation that imposes heightened infrastructural and reporting requirements on entities critical to the securities markets, to include all brokers like Robinhood. Doing so would offer investors protection against many of the issues detailed in the MSD complaint, while also avoiding the problems associated with imposing a fiduciary standard as described above.

A. The Suitability Standard and Its Limits

As I argue in the following Section, the limitations associated with the existing suitability standard do not merit a wholesale replacement with a separate fiduciary regime. This is because the problems associated with the suitability regime stem not from its content, but its scope. The suitability standard, according to FINRA Rule 2111, actually refers to three types of suitability obligations by which brokers are bound: (1) reasonable-basis suitability, which requires a broker “to have a reasonable basis to believe, based on reasonable diligence, that the recommendation is suitable for at least some investors,” (2) customer-specific suitability, which requires a broker to have “a reasonable basis to believe that the recommendation is suitable for that customer” based on a customer’s specific investment profile, and (3) quantitative suitability, which requires a broker with control of a customer’s account to have “a reasonable basis for believing that a series of recommended transactions . . . is not excessive and unsuitable for the customer” in light of the customer’s investment profile.¹⁸³ FINRA notes that a customer’s investment profile “includes, but is not limited to, the customer’s age, other investments, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs [and] risk tolerance,” among other variables.¹⁸⁴ Failure to conduct adequate due diligence on both the product and/or the customers constitutes a violation of Rule 2111. Crucially, a recommendation made by a broker under a suitability regime would not automatically be deemed a conflicted transaction

183. *Suitability*, FINRA, <https://www.finra.org/rules-guidance/key-topics/suitability> [https://perma.cc/RA6V-E9HQ].

184. *Id.*

even if the broker is compensated under a transaction-based model, as most brokers are. This eliminates the need for costly compliance and disclosure which, as noted above, would not necessarily mean that a broker is complying with its duty of loyalty under Section 12.207(2)(c).

In response to violations of the suitability standard, FINRA may impose any number of sanctions listed under Rule 8310, including, but not limited to, censure, fines, suspension, and expulsion of members or persons associated with a member.¹⁸⁵ Regulators are already using these enforcement mechanisms to put Robinhood on the defensive. For example, in addition to the current case brought by the MSD, Robinhood had also been in talks with FINRA to settle ongoing investigations into its options-trading practices and the slew of outages from March 2020.¹⁸⁶ Robinhood reached a settlement with FINRA on June 30, 2021 to pay approximately \$70 million for “systemic failures and significant harm suffered by millions of customers.”¹⁸⁷ It appears that the relative laxity with which Robinhood allowed its users, who are mostly beginners, to engage in options trading was one of the many indicators of a suitability violation.¹⁸⁸ This represents a failure by Robinhood to follow its own supervisory procedures for the approval of options trades.

To the extent that proffering lists of top stocks to users may be construed as recommendations, Robinhood may also be deemed to have failed to meet its suitability standard. In proffering stocks to all of its users in a general matter and without regard for their individual needs and risk tolerances, Robinhood arguably violated the customer-specific suitability requirement. It is telling that none of Robinhood’s other major competitors—Fidelity, Charles Schwab, Vanguard, and others—engage in this sort of behavior.¹⁸⁹

185. *FINRA Rule 8310: Sanctions for Violation of the Rules*, FINRA, <https://www.finra.org/rules-guidance/rulebooks/finra-rules/8310> [<https://perma.cc/7822-TFZR>] (authorizing the following sanctions: “(i) censure a member or person associated with a member; (ii) impose a fine upon a member or person associated with a member; (iii) suspend the membership of a member or suspend the registration of a person associated with a member for a definite period or a period contingent on the performance of a particular act; (iv) expel a member, cancel the membership of a member, or revoke or cancel the registration of a person associated with a member; (v) suspend or bar a member or person associated with a member from association with all members; (vi) impose a temporary or permanent cease and desist order against a member or a person associated with a member; or (vii) impose any other fitting sanction”).

186. See Peter Rudegeair, *Robinhood in Talks to Settle FINRA Probes Into Options-Trading Practices, Outages*, WALL ST. J. (Feb. 26, 2021), <https://www.wsj.com/articles/robinhood-in-talks-to-settle-finra-probes-into-options-trading-practices-outages-11614366379> [<https://perma.cc/Q5BT-SGNF>]; Dan Ennis, *Robinhood Set Aside \$26.6M to Settle with FINRA*, BANKING DIVE (Mar. 1, 2021), <https://www.bankingdive.com/news/robinhood-finra-settlement-gamestop/595900> [<https://perma.cc/56K3-RCTT>].

187. *FINRA Orders Record Financial Penalties Against Robinhood Financial LLC*, FINRA (June 30, 2021), <https://www.finra.org/media-center/newsreleases/2021/finra-orders-record-financial-penalties-against-robinhood-financial> [<https://perma.cc/CQ82-NXQH>].

188. Administrative Complaint, *supra* note 74, at 9, ¶ 19 (“Of the more than 71,744 Massachusetts residents that Robinhood identified as being approved for options trading during the Relevant Time Period, at least 14,439 customers had no investment experience and 34,374 customers had limited investment experience. These customers represent 68% of all Massachusetts residents approved for options trading.”).

189. Robinhood has since stopped displaying lists of popular stocks to users on their front page. As of March 24, 2022, these lists can still be found using “browse” tab.

The suitability standard might also come into play when Robinhood offers shares of its own stock to its users. For example, in July of 2021, Robinhood offered its nearly 13 million user base an opportunity to participate in its IPO, which led to the participation of over 300,000 users.¹⁹⁰ This offering, a portion of which was reserved for Robinhood's users, would seem to fall within the suitability standard governing brokers because there is likely a recommendation being made. Given Robinhood's purported commitment to democratizing investing, this move should not strike observers as entirely odd. Nevertheless, it is still worth questioning whether Robinhood truly had the best interests of its users in mind when it decided to eschew Wall Street and well-connected institutional investors. Did Robinhood's users actually get a good deal, or did Robinhood simply not have faith in its ability to market its shares to financial professionals? These are all questions that would be relevant in determining whether the suitability standard has been breached.

What the discussion above illustrates is that far from being an ineffectual standard without bite, the suitability standard remains an effective, albeit limited, tool that regulators can use to reign in the behavior of broker-dealers like Robinhood. The suitability standard's requirement that a broker-dealer's recommendation be tailored to match the distinct needs of a specific investor strikes a careful balance between investor protection and investor access. But the suitability standard alone is insufficient to protect consumers. As I argue in the next Section, the best case for regulatory reform lies in supplementing the suitability regime with an expanded version of Regulation Systems Compliance and Infrastructure (Reg SCI).

B. Expanding "Regulation Systems Compliance and Infrastructure"

One of the issues with the current suitability standard is that it does not restrict broker conduct as significantly as one might expect. Under the current regime, the trigger for the application of the suitability standard (as well as Reg BI) is the existence of a "recommendation" by a broker of investment strategies and products to customers.¹⁹¹ This means that the suitability standard is not an ongoing standard. FINRA has clarified that determining whether a recommendation has been made is an "objective rather than a subjective inquiry," and that one should consider "whether—given its content, context and manner of presentation—a particular communication from a firm or associated person to a customer reasonably would be viewed as a suggestion that the

190. See Anirban Sen & David French, *Exclusive: Robinhood Aims to Allow Users to Buy into IPO*, REUTERS (Mar. 21, 2021), <https://www.reuters.com/business/finance/exclusive-robinhood-aims-allow-users-buy-into-ipos-sources-2021-03-25> [<https://perma.cc/3VQW-SCF9>]; Marie Baudette, *Robinhood Sold IPO Share to More Than 300,000 of Its Customers*, WALL. ST. J. (July 31, 2021), <https://www.wsj.com/articles/robinhood-sold-ipo-shares-to-more-than-300-000-of-its-customers-11627767683> [<https://perma.cc/PW7A-6SDE>].

191. *Suitability*, FINRA, <https://www.finra.org/rules-guidance/key-topics/suitability> [<https://perma.cc/RA6V-E9HQ>] ("A broker's 'recommendation,' which is based on the facts and circumstances of a particular case, is the triggering event for application of the rule.").

customer take action or refrain from taking action regarding a security or investment strategy.”¹⁹² The language of this recommendation trigger suggests that Robinhood is not bound by the suitability standard when it is simply executing stock or options trades on behalf of its customers. If Robinhood decides to halt the practice of proffering lists of securities to its users, does that mean that Robinhood should escape the suitability standard altogether? Massachusetts clearly thinks not, but the stronger interpretation seems to be that Robinhood can largely avoid the suitability standard except in circumstances when it is making a recommendation.

One solution is to supplement the suitability standard with an expanded version of Regulation Systems Compliance and Integrity (Reg SCI), an existing SEC regulation that imposes enhanced operations, remediation, and reporting standards on entities that are considered critical to the infrastructure of the U.S. securities markets. Doing so would force brokers not only to make sure that their recommendations are suitable to users, but also to take the necessary steps to ensure that their platforms are up-to-date and appropriate for all customers, regardless of whether a recommendation is offered. Such an ongoing standard would require Robinhood to invest more in protecting its platform from outages and external cyber threats.

Adopted in November 2014, Reg SCI was designed to “reduce the occurrence of systems issues, improve resiliency when systems problems do occur, and enhance the Commission’s oversight and enforcement of securities market technology infrastructure” for entities engaged in one of six key securities market functions: trading, clearance and settlement, order routing, market data, market regulation, and market surveillance.¹⁹³ More specifically, Reg SCI applies to “SCI entities,” which include self-regulatory organizations, exchanges, alternative trading systems, clearing agencies, municipal securities rulemaking boards, and FINRA, and subjects them to four requirements.¹⁹⁴ These include: (1) the establishment of minimum standards for written policies and procedures that ensure operational and infrastructural “capacity, integrity, resilience, availability, and security,”¹⁹⁵ (2) the swift remediation of any “systems disruptions, systems intrusions, or systems compliance issues” and subsequent reporting of these SCI events to the SEC as well as the public,¹⁹⁶ (3) the conducting of annual reviews by “objective, qualified personnel” for compliance

192. FINRA, Reg. Notice 11-02, *SEC Approves Consolidated FINRA Rules Governing Know-Your-Customer and Suitability Obligation* (effective July 9, 2012), <https://www.finra.org/rules-guidance/notices/11-02> [<https://perma.cc/B77S-6BZK>].

193. *Spotlight on Regulation SCI*, SEC, <https://www.sec.gov/spotlight/regulation-sci.shtml> [<https://perma.cc/ET26-GGGW>].

194. *Id.* (“Regulation SCI applies to ‘SCI entities,’ a term which includes self-regulatory organizations (‘SROs’), including stock and options exchanges, registered clearing agencies, FINRA and the MSRB, alternative trading systems (‘ATs’), that trade NMS and non-NMS stocks exceeding specified volume thresholds, disseminators of consolidated market data (‘plan processors’), and certain exempt clearing agencies.”).

195. Regulation Systems Compliance and Integrity, Exchange Act Release No. 34-73639, 79 Fed. Reg. 72,252, 72,252 (Dec. 5, 2014) (codified at 17 C.F.R. pts. 240, 242, 249).

196. *Id.*

with Reg SCI,¹⁹⁷ and (4) the submission of said reviews, along with any responses from senior management, to the company's board of directors and the SEC.¹⁹⁸ Failure to adhere to the requirements of Reg SCI may result in fines and other forms of sanctions from the SEC.¹⁹⁹

Notably, Reg SCI excludes broker-dealers from the definition of "SCI entities."²⁰⁰ Given the rising popularity and influence of fintech brokerages like Robinhood, such a blanket exclusion for all broker-dealers is no longer tenable.²⁰¹ The scale and speed at which the fintech companies of today, which are often backed by hedge funds and venture capital, are able to acquire new retail investors, execute huge volumes of transactions in seconds, and disrupt storied industry players, have made the securities markets more competitive but also subject to more risks.²⁰² It is high time that the SEC consider expanding the scope of Reg SCI to capture broker-dealers that exert disproportionate influence on the market according to metrics such as user base, trading volume, or assets under custody.²⁰³ To be clear, broker-dealers that continue to operate at a small scale or through face-to-face interactions with their clients would continue to be exempt.

This is by no means a radical idea. At the time of Reg SCI's passage, several SEC Commissioners expressed concerns about whether Reg SCI went far enough and encouraged further investigation into whether an expansion to its scope was warranted by the growing volume of trades that broker-dealers were handling.²⁰⁴ Commissioner Kara M. Stein, for example, expressed

197. *Id.*

198. *Id.*, at 72,346.

199. While SCI entities may be subject to fines and sanctions, individuals may only be found liable for indirect violations such as aiding or abetting a Reg SCI violation. *See id.* at 72,312 (noting that "Regulation SCI does not impose any direct obligations on personnel of SCI entities").

200. *SEC Open Meeting on Regulation SCI: Key Topics and Takeaways*, SIFMA, <https://www.sifma.org/resources/general/sec-open-meeting-on-regulation-sci/#aguilar> [<https://perma.cc/9Q4K-RAB3>].

201. The number of active monthly users on Robinhood rose to 18.9 million as of Q3 of 2021, compared to 10.7 million in Q3 of 2020. Assets under Robinhood's custody rose to \$95 billion in Q3 of 2021, compared to \$44 billion in Q3 of 2020. *See* News Release, *Robinhood Reports Third Quarter 2021 Results*, ROBINHOOD (Oct. 26, 2021), https://s28.q4cdn.com/948876185/files/doc_news/Robinhood-Reports-Third-Quarter-2021-Results-2021.pdf [<https://perma.cc/JSZ8-LLS6>].

202. Consider the example of Coinbase, the most popular platform for cryptocurrency trading, which provides services to over 73 million verified users, has over \$255 billion of assets under custody, and facilitates over \$327 billion of trades each quarter. *See About Coinbase*, COINBASE, <https://www.coinbase.com/about>. While the question of whether cryptocurrencies are securities remains a hotly contested issue, Coinbase voluntarily became a SEC registered broker-dealer in 2018. *See* Crypto Disrupt, *Coinbase to Become SEC Regulated Broker Dealer*, MEDIUM (June 8, 2018), https://medium.com/@crypto_disrupt/coinbase-to-become-sec-regulated-broker-dealer-c759d56f05a6 [<https://perma.cc/XD4E-MPM9>].

203. The SEC should turn to experts in finance and macroeconomics to determine where the line should be drawn and whether the line should be self-adjusting.

204. *SEC Open Meeting on Regulation SCI*, *supra* note 200 ("In closing, Aguilar said that more work needs to be done to address market participants not covered by the final rules, such as broker-dealers that operate proprietary trading platforms. He noted that these broker-dealers handle nearly 18 percent of all trade volume and nearly all retail orders. He also highlighted that the Reg SCI does not apply to broker-dealers and other entities that run proprietary trading algorithms, which he said 'presents very serious risks' as evidenced in the 'flash crash' of 2010.").

disappointment in the fact that Reg SCI missed an opportunity to regulate “over 4,400 broker-dealers, 32 alternative trading venues trading equities, and 43 alternative trading venues trading fixed income and other non-equity securities,” which collectively handle around \$14 trillion of equity trades each year.²⁰⁵ She concluded that “all firms with direct access to the markets and execution venues should be required to have procedures for testing their systems.”²⁰⁶ Mary Jo White, then Chair of the SEC, also directed her staff to investigate whether a Reg SCI-like framework should be developed for other market participants like broker-dealers. Furthermore, she noted that these standards “potentially could lay the foundation for the development of a uniform set of SCI standards” in the future.²⁰⁷ Ultimately, the SEC decided not to expand Reg SCI for reasons undisclosed.

There are five important benefits to expanding Reg SCI to cover large broker-dealers like Robinhood. First, supplementing the suitability standard with an expanded Reg SCI would allow regulatory agencies to address activities that are beyond the scope of a recommendation. Second, expanding Reg SCI would be administratively less burdensome than instituting a new fiduciary standard. Third, Reg SCI would force brokers to undertake measures that minimize the frequency and severity of platforms failures and cyberattacks, as well as establish up-to-date policies for the remediation and reporting of these incidents. Fourth, Reg SCI may be tailored to impose requirements in addition to the four that are currently in effect. For example, Reg SCI might be amended to require regulated broker-dealers to collect information about an investor’s trading background, risk tolerance, and income so that the platform is well-tailored to meet his or her needs. Reg SCI may also require broker-dealers to establish a permanent customer service hotline where employees can explain complex transactions to users—a service that might have prevented Alex Kearns’s death in June 2020.²⁰⁸ In addition, users might also be expected to undergo an options training certification before they are allowed to make complex trades on the platform. Active monitoring of excessive trading activity may also be warranted. These changes would help address the charges from the MSD complaint that broker-dealers like Robinhood introduce inexperienced retail investors to complex financial products without offering them adequate support. Fifth, this change would preserve the distinct regulation of brokers and advisers. For all the talk about the convergence of broker-dealers and investment advisers, there are still important differences that render the imposition of fiduciary duties on broker-dealers inappropriate as matters of theory and practice. Unlike the imposition of

205. Kara M. Stein, *Statement: Regulation Systems Compliance & Integrity*, SEC (Nov. 19, 2014), <https://www.sec.gov/news/public-statement/spch111914kms> [<https://perma.cc/2WF6-VDRM>].

206. *Id.*

207. Mary Jo White, *Statement at Open Meeting on Regulation SCI*, SEC (Nov. 4, 2014), <https://www.sec.gov/news/public-statement/spch112014mjw> [<https://perma.cc/CD6D-87WR>].

208. See Peter Rudegeair, *Robinhood Has a Customer Service Problem*, WALL ST. J. (Apr. 28, 2021), <https://www.wsj.com/articles/robinhood-has-a-customer-service-problem-11619602202> [<https://perma.cc/X69L-CES4>] (noting that Robinhood only allowed options-trading customers to speak with a company representative by phone after the death of Alex Kearns).

fiduciary duties, an expansion to Reg SCI would preserve the suitability regime and allow brokers to engage in fundamental market-making activities such as principal trading.

It is important to acknowledge that expanding Reg SCI would impose significant compliance costs on broker-dealers like Robinhood and may render the brokerage business unprofitable for some firms. To this argument, a few responses may be levied. First, the costs of complying with Reg SCI are much lower than what a broker might face if it were to be regulated as a fiduciary instead. Not only are fiduciary duties considered the most onerous duties that the law can impose on agents, but they also prohibit brokers from engaging in presumptively conflicted activities, which would cut off entire revenue streams. Second, the expanded version of Reg SCI considered in this Note would only be applicable to broker-dealers that exert a significant influence on the markets and would exclude all others. Third, many of the processes required by Reg SCI, such as the maintenance of infrastructural capacity, resilience against cyberattacks, and remediation procedures, are generally considered sound business practices which have already been implemented in many of the most respected firms in the United States. In the long run, compliance with Reg SCI may even reduce the operational costs, bad publicity, and tragedies that we have come to associate with brokerages like Robinhood. To the extent that a firm cannot remain profitable while meeting these requirements, the firm ought to reconsider its business model.

Conclusion

The case for imposing fiduciary duties on broker-dealers like Robinhood is flawed not only as a theoretical matter but also raises significant practical threats to market access and wealth creation among retail investors. Robinhood's relationship with its diffuse customer base simply does not have the requisite characteristics of a fiduciary relationship to warrant the imposition of strict fiduciary duties. To impose them regardless of this fact, as Massachusetts has, threatens to destroy the line separating advisers and brokers, which has existed since the enactment of the Investment Advisers Act of 1940.

This Note argues that Robinhood should continue to be regulated within the existing suitability regime, which is designed to deal specifically with broker-dealers and recognizes the distinctive market-making roles that they serve. In lieu of regulating broker-dealers in the same manner as investment advisers (as the Massachusetts regulation does), the suitability standard should be supplemented with an expanded version of Reg SCI. Doing so would not only preserve the coherence of fiduciary law, but also help the MSD better achieve the consumer protections it is currently seeking in its administrative complaint.