The Hard Lessons of Democratized Investing: A Reply to Gramitto Ricci and Sautter

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In their response to *Regulating Democratized Investing*, Professors Gramitto Ricci and Sautter advocate for reforming the public education system in lieu of my regulatory proposal for protecting an emerging class of "ultra-retail investors."[1] While I support the educational reforms they propose, I continue to believe that Robinhood and its competitors warrant a shift in regulatory strategy.

As an initial matter, it is important to reiterate that my proposal is not intended to stamp out the investment activity that Gramitto Ricci and Sautter celebrate.[2] In fact, as a technical legal matter, my proposal could be characterized as *de*regulatory. I made the proposal in the context of legal uncertainty over whether Robinhood's current activities comply with existing rules, such as requirements to screen investors for options trading and requirements to refrain from recommending investments.[3] The proposal would shield small accounts of up to $1,000 from this regulatory uncertainty without enacting additional requirements outside of the safe harbor.[4]

Candidly, however, Gramitto Ricci and Sautter have a point when they say the proposal "concedes" to new limits on ultra-retail investing.[5] I do in fact hope that brokers will steer customers to the safe harbor because I think it provides a better balance of competing considerations than current regulatory mechanisms.[6] If that happens, ultra-retail investors may experience the resulting account limits as restrictive, at least compared to a more laissez-faire approach. In other words, I admit that I am more willing than Gramitto Ricci and Sautter to intervene and potentially take some air out of the ultra-retail bubble. Why is that?

For one, I am skeptical that educational reform will work in a reasonable time frame. Our public education system is fragmented,[7] subject to political

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1 *See* Sergio Alberto Gramitto Ricci & Christina M. Sautter, *The Educated Retail Investor: A Response to "Regulating Democratized Investing,"* 83 OHIO ST. L.J. ONLINE 205, 207 (2022).

2 *See id.* at 206.

3 *See* Abraham J.B. Cable, *Regulating Democratized Investing*, 83 OHIO ST. L.J. 671, 691–98 (2022).

4 *See id.* at 703–10.

5 *See* Gramitto Ricci & Sautter, *supra* note 1, at 205.

6 *See* Cable, *supra* note 3, at 699–703, 710 (critiquing current regulatory approaches for being either ineffectual or too aggressive and claiming that the proposal "represents a balance between providing access and choice, on the one hand, and preventing catastrophic losses, on the other hand").

7 *See, e.g.*, Morgan Polikoff, *The Challenges of Curriculum Materials as a Reform Lever*, BROOKINGS (June 28, 2018), https://www.brookings.edu/research/the-challenges-of-

disputes,[8] and struggling to meet core learning objectives.[9] I support increased personal finance education, but I do not think regulators should wait for those efforts to pan out.

I am also more ambivalent about ultra-retail investing than Gramitto Ricci and Sautter. I agree there are benefits to increased participation in the stock market. Chief among these benefits is the chance to learn by doing. Robinhood has a demonstrated ability to grab the attention of its users, and Robinhood can (and does) use that attention to provide real-time education about the stock market and corporate governance.[10]

One must acknowledge, however, that some lessons will be hard. Robinhood users are exposed to the risks of complicated options trades, concentrating investments in meme stocks, and the volatile and opaque world of crypto.[11] According to the business press, many of these investors have taken significant losses and some are calling it quits.[12] Presumably, some of the people suffering these losses are among those least able to absorb them.[13] It is not obvious, as an empirical matter, that the status quo most effectively promotes ultra-retail investing and its identified benefits. In the long run, effective guardrails might make for a more encouraging experience.

There is also a questionable ethical dynamic to the Robinhood business model. Some Robinhood users engage in the activities that Gramitto Ricci and

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curriculum-materials-as-a-reform-lever/ [https://perma.cc/46EP-N6UE] ("[T]he very fragmented nature of educational governance makes getting virtually any reform adopted at scale a real challenge.").

[8] *See, e.g.*, Sara Randazzo, *To Increase Equity, School Districts Eliminate Honors Classes*, WALL ST. J. (Feb. 17, 2023), https://www.wsj.com/articles/to-increase-equity-school-districts-eliminate-honors-classes-d5985dee [https://perma.cc/MSF8-YKJZ] (describing political disputes over the elimination of honors classes in an effort to promote equity).

[9] *See, e.g.*, Sarah Mervosh & Ashley Wu, *Math Scores Fell in Nearly Every State, and Reading Dipped on National Exam*, N.Y. TIMES (Oct. 24, 2022), https://www.nytimes.com/2022/10/24/us/math-reading-scores-pandemic.html [https://perma.cc/XA5G-KU64] (reporting results of the National Assessment of Educational Progress).

[10] *See* Gramitto Ricci & Sautter, *supra* note 1, at 215–16.

[11] *See* Cable, *supra* note 3, at 674.

[12] *See* Spencer Jakab, *How Robinhood Investors Robbed Themselves*, WALL ST. J. (Jan. 21, 2022), https://www.wsj.com/articles/how-robinhood-investors-robbed-themselves-11642777209 [https://perma.cc/524N-9PVY] ("Herding into the same stocks made novice investors feel like geniuses, but the party is over and it was predictable."); Caitlin McCabe, Gunjan Banerji & Alexander Osipovich, *The Unraveling of Robinhood's Fairy Tale*, WALL ST. J. (June 18, 2022), https://www.wsj.com/articles/the-unraveling-of-robinhoods-fairy-tale-11655524803 [https://perma.cc/C2L8-KCJK] ("The number of new funded accounts and active users on the platform had spiked dramatically during meme stock and dogecoin rallies in the early part of 2021, but by the second half of last year the number of monthly active users started to drop as the speculative fervor in the markets slowed.").

[13] *See* Gramitto Ricci & Sautter, *supra* note 1, at 205–06 (describing increased participation in the stock market as a tool for combatting income and wealth inequality).

Sautter applaud—buying and holding stocks in modest amounts and participating in corporate governance through voting and other forums.[14] In fact, this might even describe a majority of Robinhood users.[15] Yet, Robinhood appears to make most of its revenue on more speculative activities—churning, complex options trades, and crypto.[16] This raises the question of whether pro-social investing is funded by the speculative activities of Robinhood's super users. Is this an exploitive arrangement? That might depend on the profile of the super users—are they experienced day traders who speculate with eyes wide open or are they novice investors who get in over their heads because they are susceptible to digital engagement practices? For me, this uncertainly takes some of the shine off the ultra-retail revolution.

In sum, I want to leave space for ultra-retail investing because I believe it provides the benefits many have identified.[17] But I am reluctant to "go for the jugular" if that means assuming more investing by more novices is the best way to achieve those benefits.[18]

[14] *See id.* at 206 (describing the advantages of "easing access to the stock market").

[15] *See* Cable, *supra* note 3, at n.92 (indicating that Robinhood accounts are mostly small (median of $240) and mostly hold equities); Gramitto Ricci & Sautter, *supra* note 1, at n.18.

[16] *See* Cable, *supra* note 3, at n.141 (indicating that Robinhood generates most of its revenues from options trades and a disproportionate amount of its revenues from crypto trades).

[17] I also question whether investing should be more heavily regulated than arguably equivalent activities such as gambling or frivolous consumption. *See id.* at 708.

[18] *See* Gramitto Ricci & Sautter, *supra* note 1, at 217.