



## **Robinhood CEO, hedge fund execs defend their role in GameStop frenzy**

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Lawmakers grilled Robinhood CEO Vlad Tenev for more than five hours Thursday over the online brokerage firm's role in frenzied buying last month of GameStop shares and other beaten down stocks. Although Tenev apologized for his company's decision to restrict trading in the video game retailer and other high-flying shares, he also defended its business model as one that benefits average investors.

Tenev was joined by two hedge fund managers, Citadel CEO Kenneth Griffin and Melvin Capital CEO Gabriel Plotkin, as well as Reddit CEO Steve Huffman, Reddit investor Keith Gill and the Cato Institute's Jennifer Schulp. Together, the group faced questions about the intersection of social media, hedge funds and small investors that use Robinhood.

The wild volatility in GameStop's stock — which soared nearly 3,000% in January — has sparked criticism from lawmakers about Robinhood's business practices and its links to Wall Street. While Robinhood touts free trading to small investors, it makes its money by routing orders to market makers including Citadel Securities. Tenev said that the company receives more than 50% of its income from such transactions.

"I'm sorry for what happened," Tenev said, adding that the company is reviewing its processes. "I apologize. I'm not going to say Robinhood did everything perfect and we didn't make mistakes in the past."

GameStop shares soared last month as ordinary investors, fueled by Reddit's WallStreetBets message board, piled into the stock. Faced with what Robinhood said was a need to raise more capital to meet clearinghouse requirements, Robinhood halted trading in GameStop and other stocks. That sparked a backlash among customers, questions from lawmakers and a number of lawsuits.

Robinhood, which offers free trading to 13 million investors, promised to "democratize finance." But critics say its business model has an inherent conflict because Robinhood generates revenue by selling customers' stock orders to larger trading firms, including market makers like Citadel Securities, whose founder Ken Griffin also testified in the hearing. (Griffin is the CEO of Citadel, a hedge fund, and also the founder of market maker Citadel Securities, which is a separate business and to which Robinhood and other firms route their trades.)

Tenev denied that his company was pressured by hedge funds to halt trading in GameStop. He added that the trading halt was due to his company's need to raise more capital due to clearinghouse requirements. Robinhood raised \$3.4 billion from investors over four days in order to meet increased capital requirements.

"We don't answer to hedge funds," Tenev told lawmakers. Asked if he was pressured by hedge funds as GameStop's stock soared to halt trading, Tenev said, "Zero at all."

Tenev also faced questions from Rep. Emmanuel Cleaver, Democrat of Missouri, about the death of Alex Kearns, a 20-year-old Robinhood customer who killed himself last year after mistakenly believing he'd lost nearly \$750,000 in a risky trade.

"It was a tragedy, and we went into immediate action to make sure that we made not just the most accessible options-trading product for our customers, but the safest as well," Tenev said.

After Kearns' death, Robinhood clarified how the app displays a customer's buying power, added phone-based support for people who trade using options and took other measures to improve the platform, Tenev said.

### **Sparks fly**

Maloney noted that the Robinhood's January 28 blog post blamed market volatility for its decision to halt trading in GameStop and other stocks, without mentioning the need to raise additional funds due to capital requirements. Tenev said the company "will be reviewing everything about this."

"The \$3.4 billion we raised goes a long way from pushing the firm from future volatility and other black swan events," Tenev said.

Rep. Brad Sherman pressed Griffin on whether market makers like Citadel Securities that have a commercial relationship with Robinhood have an unfair advantage over average investors in how their trades are handled. As Griffin sought to respond, the California Democrat repeatedly interrupted, accusing him of trying to evade the question.

"Don't tell me there are other factors involved and take us down another road," a visibly annoyed Sherman said. "I'm asking you a clear question ... Who gets the better deal — one [trade] that comes from a broker who is being paid for order flow, and one not? Can you testify that, on balance, there's no difference, assuming the same size of the order?"

Sherman then cut Griffin off before he had a chance to fully address the question, saying: "You are doing a great job of wasting my time. If you're going to filibuster, you should run for the Senate."

Rep. Rashida Tlaib, a Michigan Democrat and outspoken critic of Wall Street, said lawmakers consider a small tax on securities trading. Advocates of a so-called financial transactions tax say it would dampen reckless speculation while raising billions of dollars in government revenue.

"We firmly believe that a transaction tax will injure Americans hoping to save for their retirement," Griffin said.

### **"Political theater"?**

Lawmakers also targeted the hearing itself, with Rep. Bill Huizenga, a Republican from Michigan, decrying it as "political theater."

But some lawmakers pushed back against that characterization, including Waters and Rep. Juan Vargas of California, a Democrat.

The character of Robin Hood, a legend from folklore, "was supposed to steal from the rich and give to the poor, and here you almost have the opposite, where you steal from the small retail investor and give it to the large institutional investor," Vargas said, adding that he believes this explained the interest in the the GameStop saga.

### **Payment for order flow**

Lawmakers delved into the issue of "payment for order flow," or when Robinhood steers its customers' stock orders to larger trading firms like Citadel Securities that execute the transaction. In turn, Citadel Securities and other big firms pay Robinhood for sending the trades to them. Both Robinhood's Tenev and Griffin defended the practice, noting that it is legal and approved by the SEC.

But while it the practice is legal, it may be a practice that raises conflicts for Robinhood, given that it makes its money from large trading firms that might have different objectives than small retail investors. Robinhood's Tenev said the company discloses the practice "in multiple places" to its customers.

Tenev and Griffin noted that the practice has allowed companies like Robinhood to offer commission-free trading to small investors. Tenev noted that payment for order flow provides his firm's biggest source of revenue.

"We simply play by the rules," Griffin said. "Payment for order flow has been approved by the SEC. It is customary practice. I do believe it's been an important force for innovation in the industry."

### **Reddit and social media**

The role of Reddit and social media was questioned, given the role of the WallStreetBets message board in promoting GameStop and other high-flying stocks. Tenev said his firm doesn't monitor social media, while Reddit CEO Huffman noted that his company doesn't require people to disclose their identities.

"They can choose to reveal as much or as little as they like," Huffman said.

That question of identity came to the forefront with investor Keith Gill, a Redditor who goes by the name of "Roaring Kitty" and also appeared at the hearing, after he was sued earlier this week for securities fraud. The lawsuit accused him of misrepresenting himself as an amateur investor when the lawsuit claims he is a licensed securities professional.

Gill, who is known for his cat-themed T-shirts and a bright red runner's headband in widely followed videos, changed out his attire for a jacket and tie — although the headband could be seen hanging on poster of a kitten with the words "Hang in There."

Gill, also known as "Roaring Kitty," testified about his role as an investor in GameStop. Gill, who often wears shirts adorned with cats, testified with a poster of a kitten and the words "Hang in There" behind him. AIMEE PICCHI

Gill portrayed himself as an individual investor who did his legwork on GameStop. He also promoted GameStop during the hearing, saying, "I do find it's an attractive investment at this price point."

GameStop shares, which peaked at \$483 in late January, fell 11% on Thursday to close at \$40.69. The retailer's market value has fallen roughly \$32 billion since the company's shares soared last month.

### **Additional regulation?**

In opening remarks, lawmakers on the committee said the hearing is an opportunity to learn more about the connection between Robinhood, hedge funds and small investors. Some Democrats suggested that additional regulation may be needed to protect small investors, while Rep. Patrick McHenry of North Carolina, a Republican, pushed back against the notion.

"If you are wealthy, you are good to go," McHenry said. "And if you aren't, you're too dumb to be trusted with your own money."

He added, "It is easier to buy a lottery ticket than invest in Google."

But some Wall Street analysts are skeptical that any regulatory changes will emerge from the hearing.

"This will not be a substantive conversation or debate. Equity market structure is complex," Jaret Seiberg of Cowen Washington Research Group, told investors in a report. "The vast majority of Congress have little understanding of the inner working of the market."