# Robinhood Financial to Pay $65 Million to Settle SEC Probe

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WASHINGTON—Robinhood Financial LLC has agreed to pay $65 million to settle regulatory claims that it didn't sufficiently disclose its business deals with high-speed trading firms, the Securities and Exchange Commission said Thursday.

The fine is a setback for the fast-growing company, which has helped millions of investors access the stock market during this year's extraordinary coronavirus-fueled volatility, many of them newcomers to investing.

The settlement resolves one regulatory cloud over Robinhood, a Silicon Valley startup that launched trading in 2015 and says its mission is to reduce barriers to investing. The company's sleek technology makes trading visually appealing and encourages users to speculate although Robinhood says most of its customers aren't active day traders.

According to the SEC, Robinhood failed until 2018 to fully reveal on its website how it makes money from its deals with speedy trading firms such as Citadel Securities and Virtu Financial Inc. Robinhood and other retail brokerage firms generate revenue by routing customers' orders to high-speed traders, which pay for the right to execute many of the trades.

The practice, known as payment for order flow, can create a conflict of interest for brokers like Robinhood because of the incentive to maximize the broker's revenues rather than ensure customers get a good price on their trades.

Some of Robinhood's customers got prices "that were inferior to other brokers' prices," the SEC said in a press release. The firm nonetheless claimed on its website from 2018 to 2019 that its order-execution quality was as good or better than its rivals', the SEC said.

Robinhood resolved the case without admitting or denying the SEC allegations, and said the settlement applies to problems that "do not reflect Robinhood today."

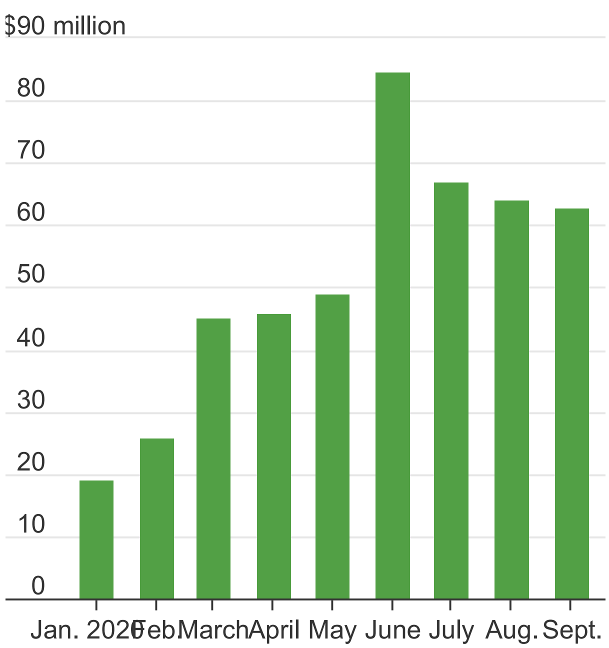
"We recognize the responsibility that comes with having helped millions of investors make their first investments, and we're committed to continuing to evolve Robinhood as we grow to meet our customers' needs," said Dan Gallagher, Robinhood's chief legal officer.

The Wall Street Journal reported in September that the SEC was investigating Robinhood's payment-for-order-flow disclosures.

The announcement of the settlement comes one day after Massachusetts securities regulators filed a new complaint against Robinhood, alleging the company aggressively markets its service to rookie investors and doesn't have sufficient controls to protect them. State regulators can enforce their local securities laws, while the SEC enforces federal statutes.

Robinhood revenues from payment for order flow, monthly

Source: Robinhood, Piper Sandler




Robinhood removed references to payment for order flow from its website in 2014 over concerns that the practice was viewed negatively, the SEC said in a settlement order. The decision followed the publication of a book by Michael Lewis, "Flash Boys," which put high-speed traders in a negative light.

A page on the company's website titled "How Robinhood Makes Money" failed to mention the payments until October 2018, even though payment for order flow was Robinhood's largest source of revenue, the SEC said.

The company also instructed its customer-service representatives not to mention the payments from high-speed traders when investors asked about Robinhood's sources of revenue, the SEC said.

Robinhood pressed the high-speed traders for higher payments, which reduced how much the trading firms could benefit Robinhood's clients by executing trades at better prices, the SEC said. Such firms typically seek to fulfill small investors' buy or sell orders at prices slightly better than what is available on public stock exchanges, an arrangement that can benefit retail brokers' customers.

The SEC's order against Robinhood alleges that it gave worse prices to some customers than the investors could have gotten from rival brokers, even after taking into account Robinhood's practice of commission-free trading. Yet the company's website claimed, in 2018, that Robinhood's "execution quality and speed matches or beats what's found at other major brokerages," the SEC's order says.

How Robinhood Is Shaking Up the Brokerage Industry

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As millions of new traders sign up for the investment app Robinhood, the company is facing scrutiny for enabling some inexperienced users to make risky bets. WSJ spoke with a financial education professional and two Robinhood traders about how the app is shaking up the brokerage industry.

Customers lost $34 million from 2016 to 2019 by trading on Robinhood instead of through other brokers, because they could have gotten better prices from the competing brokers, the SEC alleged.

The $65 million penalty reflects the size of those losses and the company's alleged misstatements to customers, a person familiar with the matter said.

Robinhood was aware in late 2018 of the issue, which mostly affected larger orders. By the following year, according to the SEC's order, one internal analysis concluded: "no matter how we cut the data, our % [percent of] orders receiving price improvement lags behind that of other retail brokerages by a wide margin."

The settlement with the SEC requires Robinhood to hire an independent consultant within 60 days. The consultant must review how Robinhood's policies address payment for order flow and its duty to provide clients with best execution of orders.

The company was valued at $11.7 billion in a funding round that concluded several months ago. Robinhood recently hired Goldman Sachs Group Inc. to lead an initial public offering expected to take place next year, people familiar with the matter said. A Robinhood spokeswoman declined to comment on the company's IPO plans.

Payment for order flow is a crucial source of revenue for Robinhood, especially because it doesn't make money from trading commissions. During the first three quarters of this year, Robinhood collected $466 million in payments from high-speed trading firms, according to an analysis of its regulatory filings by Piper Sandler.

Robinhood has amassed more than 13 million customer accounts, with more than 3 million new accounts created this year. It surged in popularity because it charged no commissions—an approach that has since been copied by more established brokers—and offered trading through an easy-to-use smartphone app.

The median age of a Robinhood investor is 31, the company says.

As Robinhood has grown, it has added more legal experts to navigate the complex regulatory world that it inhabits. Mr. Gallagher, a former SEC commissioner, joined the firm as chief legal officer earlier this year.

The firm also hired Janet Broeckel, a former Goldman lawyer, as its head of litigation and investigations. John Markle, a former top lawyer at TD Ameritrade, joined as Robinhood's deputy general counsel.

—Maureen Farrell contributed to this article.

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