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MARKETS

Payments to U.S. Brokers Surged Amid Meme-Stock and Options Boom

Earnings from selling their customers' order flow to electronic trading firms rose 33% last year

Charles Schwab topped the list of recipients of payments for order flow last year.

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By *Alexander Osipovich* Follow

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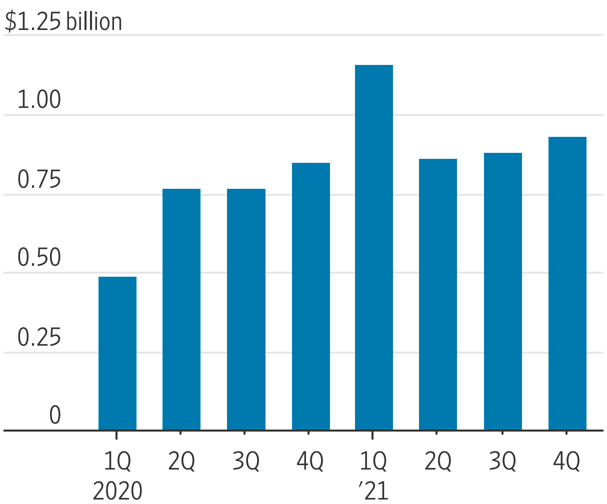
Brokerages serving individual investors received a windfall last year for selling their customers' order flow to electronic trading firms, even as the practice faced increasing scrutiny from regulators.

The dozen largest U.S. brokerages earned a combined $3.8 billion for selling their customers' stock and options orders last year, up 33% from 2020, according to new data compiled by Bloomberg Intelligence and released Tuesday.

Behind the boom was the groundswell of activity by individual investors during the Covid-19 pandemic. As more Americans opened brokerage accounts and swarmed into meme stocks and options, their brokers reaped more payment for order flow, as the practice is called.

Charles Schwab Corp. was the biggest recipient of such payments, collecting a combined $1.7 billion across its Schwab and TD Ameritrade brokerage units last year, according to the Bloomberg data. Behind it was Robinhood Markets Inc., HOOD +4.61% which earned $974 million from selling order flow, the data show.

Total payment for order flow collected by major brokers, by quarter



Note: Brokers included in totals are Ally Invest, Apex, Charles Schwab, E*Trade, Fidelity, Interactive Brokers, Robinhood, TD Ameritrade, TD Ameritrade Clearing, Tastyworks, TradeStation and Webull.
Source: Bloomberg Intelligence

In payment for order flow, brokers route their customers' orders to electronic trading firms known as market makers. The market makers execute the orders and make a profit, typically by collecting a small difference between the buying and selling price of a stock or an options contract. In return, the market maker pays the broker for the right to fill the investors' orders.

Citadel Securities continued to be the biggest source of payment for order flow. The electronic trading giant founded by hedge-fund billionaire Ken Griffin paid the 12 brokerages tracked by Bloomberg just under $1.5 billion for order flow last year, the data show. Other large sources of the payments were Susquehanna International Group LLP and Wolverine Trading LLC, a pair of low-profile trading firms that are significant players in options markets.

Order-flow payments for options grew 47% in 2021 compared with the year before, far outpacing the 13% growth in payments for stock trades, the Bloomberg data show. The swift growth came as small investors flocked into options last year, using them to place leveraged bets on hot stocks like Tesla Inc. and Amazon.com Inc. and powering record trading volumes in options.

"There's more leverage in options and that allows the retail guy to be more creative in his positioning," said Rich Repetto, an analyst at Piper Sandler.

The dozen major brokers made $2.5 billion from selling options orders last year, compared with $1.3 billion from stock orders, the Bloomberg data show. Brokers can earn more money by selling options orders to market makers than they do from similarly sized stock orders, making options a cash cow for firms like Robinhood.

Payment for order flow makes it possible for many brokerages to offer zero-commission trades. Brokers also say investors get better prices on their trades when their orders are sent to market makers instead of exchanges.

But critics contend the practice poses a conflict of interest for brokers, by encouraging them to collect more money rather than pass the savings to their customers. Some critics also say that routing small investors' orders to private firms harms the quality of markets by diverting a sizable portion of trading activity away from public stock exchanges.

Payment for order flow is a decades-old practice and has survived previous bouts of controversy. The Securities and Exchange Commission launched a fresh review of the practice after the trading frenzy in GameStop Corp. and other meme stocks in January 2021. SEC Chairman Gary Gensler has floated the idea of banning payment for order flow, although such a move would likely prompt intense opposition from Wall Street.

Write to Alexander Osipovich at alexander.osipovich@dowjones.com

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