

Title: Wrinkle Brain is spitting fire on RH's PFOF model

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Dave Lauer

@dlauer

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Something we don't talk about much is how RH's PFOF model is DOUBLY corrupt. By calculating PFOF based on spread, they are not just incentivized to get their clients to trade more - they also want them trading higher spread, less liquid names. It's a disgusting business model.

Přeložit Tweet

*proportionately high order flow and
ained several market makers an*

g, which Robinhood popularized,
and others. Market maker firms a
dealers at publicly quoted prices.¹³¹
more than they purchased them. M
-dealers rebates for customer ord
nt for order flow (PFOF).¹³² T
hat market makers play in retail

While virtually all commission-free retail trades are routed through market makers, Robinhood's relationship with its market makers leading up to January 28, 2021, was distinct in several ways. One way Robinhood stands out is the number of trades that its customers make on a per-dollar basis. Robinhood generates revenue on every customer trade and is incentivized to get its customers to trade as much as possible. To this end, the company popularized commission-free trading, reducing barriers to entry for the stock market. Furthermore, the company had a lax policy for allowing young traders to trade on margin (buying stocks with borrowed money) and famously employs digital engagement tactics, such as celebrity endorsements and game-like features, to increase customer activity on its platform.¹³³

In the first quarter of 2020, Robinhood users "traded nine times as many shares as Charles Schwab customers, and 40 times as many shares as Charles Schwab customers, per dollar of average customer account."¹³⁴ Despite several major broker-dealers, such as Charles Schwab, eliminating trading commissions in recent years, Robinhood still generated significantly more total orders relative to others in the industry leading up to the Meme Stock Event.¹³⁵



CITADEL SECURITIES EMPLOYEES
ESTIMATED THAT THE PFOF REBATES IT
OWED ROBINHOOD FOR GME THE WEEK OF
JANUARY 28, 2021 WERE APPROXIMATELY
60 TIMES GREATER THAN THE WEEK
BEFORE. AN EMPLOYEE FOR CITADEL
DESCRIBED ROBINHOOD'S PFOF REBATES
AS A RUNAWAY FREIGHT TRAIN IN THE DAYS
LEADING UP TO JANUARY 28, 2021.



purchase and sale price to ensure security at the time of executing a trade on behalf of a customer.¹³⁶ During periods of acute volatility, such as during the Meme Stock Market Event, when significantly more market participants were buying meme stocks than selling them, Robinhood's formula results in disproportionately higher rebate rates. Citadel Securities employees estimated that the PFOF rebates it owed Robinhood for GME the week of January 28, 2021, were approximately 60 times greater than the week before.¹³⁷ An employee for Citadel Securities described Robinhood's PFOF rebates as a runaway freight train.¹³⁸

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