The Robinhood Affair: Are Retail Brokers the Weakest Link?

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Robinhood Securities LLC has lived up to its namesake's reputation, as a small army of retail investors seek to profit at the expense of some very large short-selling hedge funds. The GameStop short squeeze took at least one hedge fund to the brink of insolvency and has brought the opaque activities of short selling and stock lending to the attention of the world beyond Wall Street. Robinhood has just completed a [$2.4bn fundraising].

One major additional challenge is the lack of information on solvency risk due to patchy credit rating agency (CRA) coverage in this area. However, consensus credit risk data draws on multiple well-informed sources to provide wide coverage and much-needed context for this rapidly developing situation. It can help by comprehensively monitoring counterpart risk and informing and helping to manage client communications.

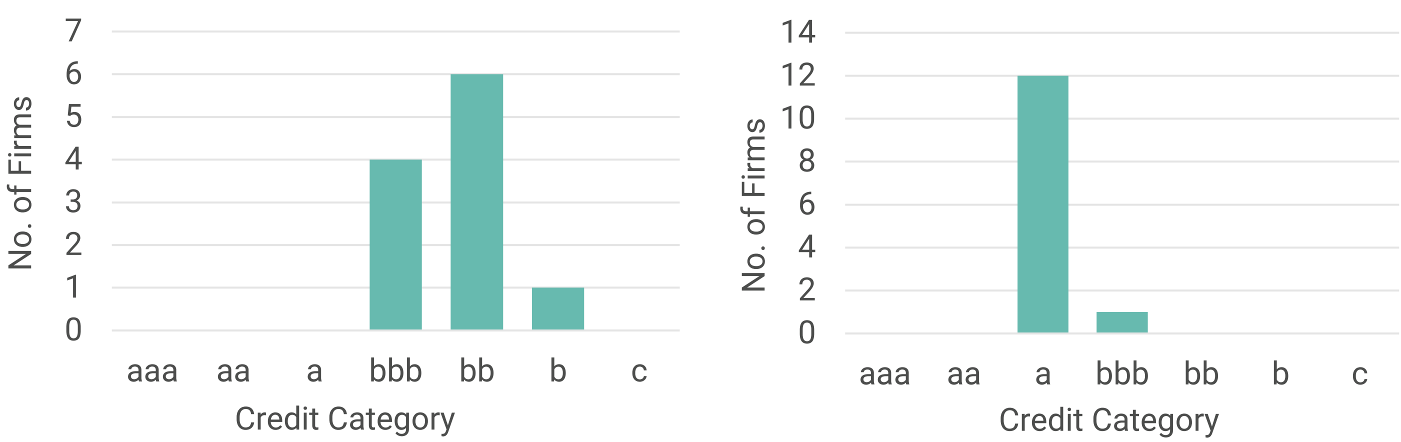
The main players are Retail Brokers (including Robinhood), Prime Brokers who facilitate covered short selling by hedge funds, Agent Lenders who make covering stock available to borrow, and their Beneficial Owner clients – especially large pension funds – who are the ultimate owners of those stocks. This complex ecosystem results in a network of connections between often unrated counterparts.

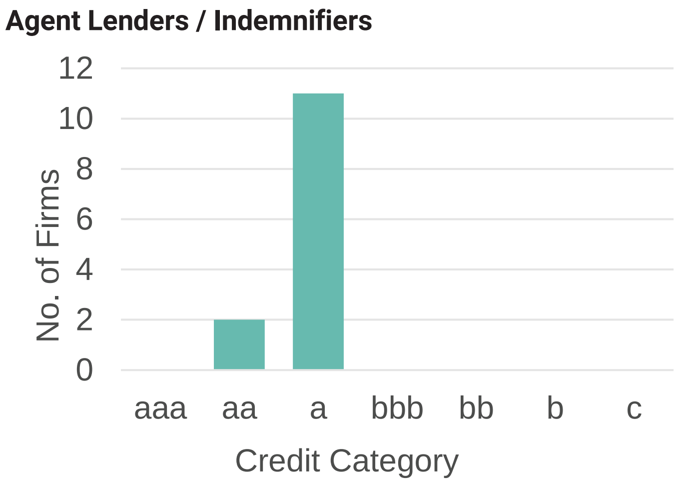
For Beneficial Owners, counterpart risk can be mitigated by indemnities offered by their agents. But these are only as strong as the firm offering them. Prime Brokers protect themselves by taking collateral from hedge funds which, when eligible, is posted with Agents. Some retail brokers may be lending retail investors cash on margin to purchase stocks, and also lending stocks to cover short positions to their prime broker clients to enhance returns.

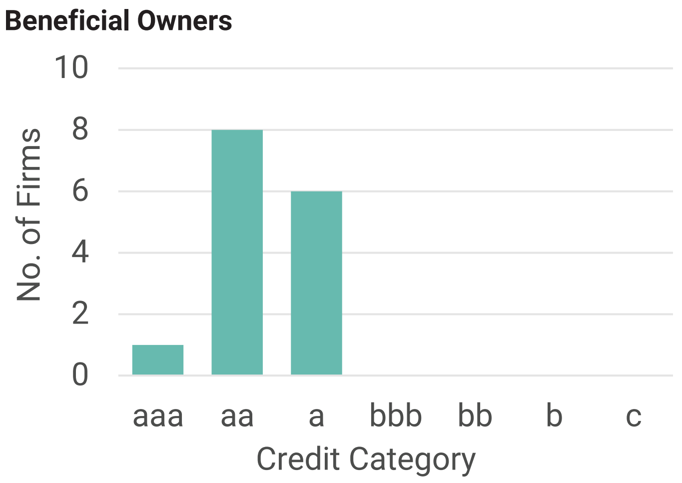
So how do the main players look from a credit perspective? Figure 1 shows the credit distributions for some of the largest and most influential firms or funds in each of these four groups.

Figure 1: Credit Distributions by Segment

Retail Network Members **Major Prime Brokers**







This shows that Beneficial Owners are the strongest group from a credit perspective, predominantly in the **aa** categories (i.e., upper investment grade). None of the sample are in the non-investment grade category or even in the **bbb** (lower investment grade) category. Agent Lenders are mainly in the **a** category, with a minority in the **aa** category. Prime brokers are nearly all in the **a** category, with just one in **bbb**. Retail brokers are mainly **bb** (i.e. upper non-investment grade) with four in the **bbb** and one in the b category.

Deeper analysis of the CRA vs Consensus rating breakdown between these four groups shows that while the Prime Brokers and Agent Lenders have multiple agency ratings, Retail Brokers and Beneficial Owners are mainly unrated. All these firms have consensus ratings – showing that this dataset fills some key gaps in risk management for all players in this complex network.

At a time when the attention of the financial world and far beyond is drawn to the unusual circumstances occurring in this sector of the financial network, it is important to have access to as much information as possible. With so many questions now being asked, having access to consensus ratings helps provide both additional context and important answers.

Access to consensus data is now possible via a growing number of channels. Credit Benchmark is partnering with technology and data providers to make this important information accessible in client workflow.

For example, some innovative Securities Lending Agents are already sharing consensus credit data under license as part of their client reporting suite and the Global Peer Financing Association now use consensus rating data to approve hitherto unrated peers as trading counterparts.

Furthermore, the calculation of Risk-Adjusted-Returns securities lending returns is now possible by subscribing to a premier IHS Markit performance benchmarking service, incorporating Credit Benchmark consensus data.

Credit Benchmark data is also now available on Bloomberg – high level credit assessments on the single name constituents of the sectors mentioned in this report can be accessed on CRPR <GO> or via CRDT <GO>.

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About Credit Benchmark

Credit Benchmark produces a comprehensive view of credit risk by creating over 57,000 Consensus Credit Ratings and analytics on the credit quality of financials, corporate, funds, and sovereign entities globally across emerging and developed markets. 75% of the entities covered are otherwise unrated.

The data is sourced from the risk departments of more than 40 global financial institutions, representing the work of over 20,000 analysts and is also used by regulators to monitor Basel rules on capital adequacy.

Credit Benchmark collects a specific measure of credit risk: a one-year, forward-looking Probability of Default (PD) and forward-looking senior unsecured Loss Given Default (LGD).

The underlying inputs from contributors are subject to a rigorous data quality approval process and derived from models that are approved by regulatory authorities. The resultant accuracy of each PD and LGD leads to a credible market view of credit risk.

After being anonymized and aggregated, the contributed risk estimates are mapped to the appropriate credit category on the Credit Benchmark Consensus scale, which is calibrated periodically and can be used as a comparison to the scales published by the rating agencies.

Credit Benchmark produces regular data updates with history going back to 2015.

Contact

CB USA
12 East 49th Street, 9th Floor
New York, NY, 10017
Telephone: +1 646 661 3383

CB UK
131 Finsbury Pavement, 5th Floor
London, EC2A 1NT
Telephone: +44 (0)207 099 4322