Testimony of Alan Grujic

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Introduction

Good morning, Chairwoman Waters, Ranking Member McHenry, and distinguished members of the Committee. My name is Alan Grujic. I am founder and CEO of All of Us Financial, a San Francisco-based online broker, launched in May 2020. Our mission is to empower and educate retail investors. Thank you for the opportunity to discuss January's unprecedented activity in GameStop and associated lessons learned to improve our markets.

The "All of Us" Story

I am Canadian by origin, a US citizen, and have lived in San Francisco since 2005. I am an engineer by training, but my career has been in capital markets. For a decade, I worked for Toronto-Dominion Bank across the globe. In 2002, I co-founded a high-frequency trading firm, Infinium, which traded a wide variety of financial products on a global basis. In 2011, I founded a quantitative hedge fund, Galiam, which constructed and traded portfolios in a fully-automated fashion. Our clients included large global financial institutions.

In my market travels, I found that no one was properly solving a critically important problem: leveling the playing field for retail investors. Retail investors operate at a disadvantage and underperform the broader markets over time. I decided to apply my experience to try to address this critical societal need.

The narrative that "markets are rigged" and that big institutions steal from the little girls and guys out there is mostly not correct. That narrative exploits fear and reduces rich complexity to a simple fairy tale. Find a victim, finger a villain, promote a hero.

We don't live in Sherwood Forrest. Our markets are well-structured, highly competitive, and expertly regulated. There is also plenty of room for improvement, particularly as we adapt to a changing world. One needed improvement is to deliver institutional-grade capabilities to retail investors. Technology platforms can deliver institutional-quality infrastructure, data, knowledge, access, and influence into the hands of, and in the service of, retail investors.

That's our mission at All of Us.

January's Activity in GameStop

Social media has changed individual behaviors. As with most things, change can be both good and bad. An implement can be both a tool for building and a weapon for destroying.

In markets, we regularly experience unanticipated events, when history-based risk models don't provide effective warning. With GameStop, groups of individual investors acted in concert, at a speed and size unimaginable without social media in its current form. Robinhood and others didn't have the required capital to cover client positions. Yes, Robinhood could have been more proactive. But market participants need to upgrade risk models to reflect the current state, in which quick collective action at scale can cause concentration risk to spike. Concentration risk can by managed by accounting for this unprecedented activity in our business management, capital reserves, and forecasting.

Social media can empower individuals, but also influence them. When does influence become manipulation? As a professional trader and investor, I fear traders in GameStop were being manipulated to take actions not in their best interests. Manipulation is illegal, and I expect regulators have paid close attention and will take appropriate action.

While pundits debate who “won” and “lost” the GameStop battle, we should be very concerned about the disorderly and volatile battlefield. Disorderly and overly volatile markets lead to business failures, extreme shifts in fortunes (both good and bad), and larger risk premiums. Instability and uncertainty are bad for our economy. Well-designed and operated markets are the solution. Our industry must learn from the GameStop growing pains and improve.

Payment for Order Flow, Plus Transparency & Alignment

Let me say this for the record: we are paid for order flow at All of Us. Because we believe in radical transparency and alignment, we share that revenue with our customers. In fact, one of our core principles is to share every revenue stream. We believe that is the best way to align our interests with our customers, and also the best way to educate our customers about how the markets work. Some view disclosure as a point-in-time regulatory requirement. We view disclosure as a real-time foundation for customer education and alignment.

PFOF is not a necessary component of our market structure, but it is one of several effective ways for markets to operate. I acknowledge there is fear of bad actors and conflicts to be managed, but that is not uncommon in markets, business, and life.

Importantly, regulation requires all market makers to trade with customers at the best prices available in the market—and there is a comprehensive execution audit trail for brokers and regulators to monitor. This does not guarantee that customers always get the best execution possible, but it does ensure that customers get very good execution. Above this very high hurdle, brokers compete to deliver value to customers in a variety of ways.

As we consider PFOF, there are some truths that we should face.

First, in any risk market, liquidity has value. Provision of liquidity is a service extended; removal of liquidity is a service consumed. Market makers provide a valuable service and need to earn a return.

Second, transaction services, such as matching buyers with sellers and settling trades, have value. A broker can avoid market makers and send orders to an exchange, but the exchange will also need to earn a return for this service.

Third, market makers are indifferent between PFOF and price improvement, because the net price to them is the same. Brokers care, however. Brokers also need to earn a return for providing services in a highly competitive environment. If we remove PFOF, it seems likely that commissions will increase. Other innovations, such as fractional shares, may become uneconomical. And as brokers replace lost revenues, unintended consequences for retail investors are likely.

Last, some claim separating retail and institutional flow harms retail investors. They are incorrect. The opposite is true. Market makers earn a return by providing liquidity, and they earn more money from retail flow than institutional flow. Market makers offer price improvement or PFOF to retail investors; often, market makers try to *avoid* institutional flow. If we force a combination of retail and institutional flow, so that everyone gets the same average price, that price will be worse for retail and better for institutional than it is today.

Short Selling Transparency & Securities Lending

Short selling is also an instrument that can be used for good or bad purposes. A short seller, just like a buyer, that manipulates market it is bad. But a short seller that provides liquidity to a buyer to facilitate a trade is good.

Vitalik Buterin, the creator of Ethereum, has said that "short-selling is to markets as criticism is to free speech." I agree. Unfortunately, public company management is not always truthful, and short sellers that believe management is misrepresenting facts add information and liquidity to the market by expressing this view.

More transparency and efficiency in securities lending is welcome. All of Us shares revenues associated with securities lending with our customers. Improvements here would benefit retail investors.

Room for Improvement: T+2

Modern technology can facilitate near-instant settlement, via distributed ledger technologies or other means. Any delay in settlement increases the risk in the financial system. It is obvious that the longer two parties wait to settle a trade, the higher the risk that one fails to meet their end of the bargain. Moving from T+2 to T+0 means less settlement risk, which means less capital required to manage this risk, which leads to greater capital efficiency—which ultimately improves the real economy.

Gamification & "Social Investing"

Social media platforms and gamification are powerful forces, which can also be used for both good and bad purposes. But we need to go forward, not back. Society is evolving and younger generations want products and services delivered via social media platforms. Gamification and social investing can drive financial literacy education and encourage healthy behavior, such as regular saving and investing.

All of Us uses social and customer competitions to provide context and guidance. Last October, we launched our "Sharpeshooter Challenge" to reward customers who reduced portfolio risk. Everyone knows that you need to take risk to earn a return, but we want to raise awareness that risk can lead to both positive and negative outcomes. With the right tools, retail investors can learn to measure and manage risk.

Brokerage is highly competitive and social investing innovations will continue. I expect that FINRA and the SEC are considering how to update regulation to address an evolving society, as previously done to meet technological change. The right balance is to facilitate innovation for the benefit of a rapidly growing number of retail investors, while ensuring continuity of policy and practice that delivers investor protection.

Conclusion

Our markets are a wonderful means for all to build wealth. Market participants are innovative and competitive, infrastructure is transparent and resilient, regulators are expert and well-resourced. But as the GameStop activity shows, our markets can always be improved. And efforts to educate and improve the experience of retail investors are critical as markets become increasingly accessible—and more and more people invest for the first time.

I appreciate the opportunity to appear before the Committee today. I look forward to answering your questions at the appropriate time.