NASHVILLE NOTES

Robinhood’s chutzpah

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I suppose it is happenstance that Robinhood Markets Inc. announced a bank-like deposit account on Dec. 13 that will be offered through its broker-dealer unit a few days before *The Wall Street Journal* ran an article about "small" banks engaged in a "deposit war" as interest rates rise. The cynics among you will have snarky thoughts that when the *Journal* is running a story about "deposit wars" among banks and an upstart fintech company that will pay 3% for "deposit" accounts, rates are poised to fall in the not-too-distant future. But I digress.

The real story is that customer acquisition costs for banks and brokers are going through the roof. The Robinhood account will pay 3% interest when 2%-plus is the going rate for most high-yield deposit products and money market funds. The account will entail no ATM fees, a debit card and no minimum balance. It sounds like a great product, even if the company seemingly cannot make money on it unless margin lending is much bigger than I envision. Otherwise, investing the proceeds in Treasury bills implies a negative spread given yields today at the short-end of the curve are below 3%.

Robinhood co-founders and co-CEOs Baiju Bhatt and Vlad Tenev walked the product back on Dec. 14 after questions arose about what exactly was being offered and the meaning of being backed by the Securities Investor Protection Corp. rather than the Federal Deposit Insurance Corp. A blog post by the two noted that "as a licensed broker-dealer, we're highly regulated and take clear communication very seriously. We plan to work closely with regulators as we prepare to launch our cash management program, and we’re revamping our marketing materials, including the name."

I take the statement to mean regulators read the company the riot act. Nonetheless, it is hard for me to imagine that a regulated broker-dealer could so easily bypass its internal compliance systems to announce a product that has not been properly vetted. Communications by brokers to existing and potential clients are one of many areas that are subject to intense scrutiny by internal compliance and FINRA.

Perhaps there was no internal compliance failure in announcing a bank-like product. Maybe the release was designed to generate a marketing buzz after which forgiveness would be asked if competitors and regulators complained about the chutzpah.

In any event, the deposit (or cash management) product — however it may be repackaged to meet exacting regulatory standards — probably will be a winner for Robinhood among its millennial target audience. The company to date has been wildly successful when defined in terms of customer acquisition, growing its customer base to upwards of 6 million since being launched in 2013 by providing commission-free trading on an easy-to-use mobile app. As I speculated in my prior post on Robinhood, rapid growth rather than meaningful profitability is probably the key attribute that pushed the company's valuation from $1.3 billion in April 2017 when the Series C fundraising occurred to $5.6 billion in May 2018 when the Series D raise was completed.

The rollout of a high interest deposit product is well-timed from a capital markets perspective, too. The company's millennial investors may have been even more shellacked in the equity market than older investors given their alleged preference for FANG and other technology stocks that have been decimated in recent months. So in a sense, paying an above-market rate for deposits should be considered a marketing expense or capex to sustain the growth with the payoff to be realized in the future — assuming most of the accounts the company acquires are profitable.

One final takeaway about marketing acquisition costs relates to banks: The jury is out as to the ultimate success of Robinhood to the extent success is defined as producing a competitive return on capital. However, the fact that

Robinhood has been able to garner about 6 million accounts in less than a decade via a mobile app speaks volumes about the viability of the banks' vast branch networks. At some point banks may have to make a decision to "pay up" for most deposits rather than those obtained at the margin and fund the effort through massive branch closures that have yet to occur but that are ultimately inevitable.

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