



## Reddit GameStop Squeeze Is a Game Changer

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As regulators investigate what's become known as the Reddit GameStop squeeze, industry officials are prognosticating how the rules that regulate the stock market could change after the collision between social media and finance.

One potential outcome: the Securities and Exchange Commission could move to a T+1 settlement date for securities transactions from the current T+2.

While the investigations ensued at press time in early February, retail investors also were filing lawsuits against Robinhood and other brokerages like Charles Schwab and TD Ameritrade for "restricting trading" in GameStop and other stocks, and lawmakers planned hearings on the issue.

A hearing to be held in mid-February by the House Financial Services Committee was dubbed: "Game Stopped? Who Wins and Loses When Short Sellers, Social Media, and Retail Investors Collide."

The events of GameStop and "this massive collision of the world of finance and social media did unveil and flush out some inefficiencies that we have in our marketplace that I think the [SEC]..." as well as the Financial Industry Regulatory Authority, the Depository Trust Co. and other agencies "are going to have to look at longer-term," said Jim Toes, president of the Security Traders Association, in an early February podcast held by STA.

Right now, however, "all the industry wants ... is [for regulators to]: 'Get in, do your investigations,'" Toes said. "If bad people did bad things, punish them, and then give us a report."

Thomas Balcom, founder of 1650 Wealth Management in Fort Lauderdale, Florida, told me in an early February email message that the SEC "should probe the trading of GME since there could be instances of a 'pump and dump' scheme akin to boiler rooms in the late '90's. This impacted both large and small investors alike. If there were crimes committed, folks should be prosecuted."

In a Jan. 27 note to clients, Balcom explained that GameStop's stock price skyrocketed because "retail investors who congregate in chat rooms on websites, such as Reddit, have mounted a concerted effort to hurt hedge funds and investors who short stocks."

Balcom told his clients that they do "have a modest exposure to GameStop. GameStop is a component of the Russell 2000 (U.S. Small Cap) Index. Nearly all of our clients own one or two market linked notes tied to the Russell 2000 Index."

Who Are the Players?

In an early February interview with CNBC, Amy Lynch, founder and president of FrontLine Compliance, said the SEC, FINRA and the Commodity Futures Trading Commission are “very busy right now trying to determine who the players are.”

The SEC, said Lynch, a former SEC examiner and special investigator at FINRA, is “coordinating with exchanges to see what is happening with the trading activity in these issuers. FINRA is taking a look at the broker-dealer platforms and the individuals that own accounts that are trading on those platforms.”

And the CFTC, she said, has “oversight of the options market.”

While “we know the targets are the hedge funds ... we don’t know who the players are on the other side; in other words, who are these traders in the chatrooms that are pushing out the shorts and squeezing [the hedge funds] out?” Lynch said.

She added: “It will be interesting to see if they are the Robinhood-type traders (are individual retail traders) or if they are professionals ... professionals trying to push out the competition, then you have a very interesting case for the regulators to step in with enforcement action against those individuals.”

Matthew Bacon, an advisor with Carmichael Hill in Gaithersburg, Md., told me in an early February email that the WallStreetBets “Reddit thread should ABSOLUTELY be investigated.”

Stated Bacon: “I wouldn’t be surprised if some of the posts came from hedge funds or other institutional players. [Former MassMutual advisor] ‘Roaring Kitty’ is a CFA with some serious investing chops but not a representative of a major institution playing the short squeeze. The investigation should focus on who is attempting to lead the retail market.”

William Galvin, Massachusetts’ top securities regulator, is investigating Keith Patrick Gill, the person behind the Roaring Kitty YouTube streams that, combined with a string of posts by Reddit user DeepF\*\*\*ingValue, drove a sudden increase in GameStop stock trading, slamming hedge funds that had bet against the struggling retailer.

The Massachusetts Securities Division “is looking into whether or not MassMutual should have been aware of Mr. Gill’s activities,” a MassMutual spokesperson said.

#### Tenev’s Take

Vlad Tenev, co-founder and CEO of Robinhood Markets, told Bloomberg Technology’s Emily Chang in a Jan. 28 interview that Robinhood “to be clear, didn’t restrict trading; we restricted buying on about 13 securities on the platform. Customers that held securities could sell them and customers were also able to trade the thousands of other securities on Robinhood without restriction.”

Tenev went on to say that “there’s been an unprecedented market environment the past couple of weeks, where there’s been concentrated investing around stocks that have been very, very popular on social media; so you’re seeing kind of an intersection of social media and finance and individual retail investors participating in the markets like they’ve never before.”

Robinhood’s decision “was a technical and operational decision that we made because Robinhood as a brokerage has financial requirements, including clearinghouse deposits that we

have to make to various clearinghouses, some of these requirements fluctuate based on volatility in the markets, and in this current unprecedented environment can be substantial.”

Schwab insisted in a statement that neither it nor TD Ameritrade “halted buying or selling ANY stocks” the week of Jan. 25. “Neither firm restricted buying or selling basic options.”

Both firms did, though, “adjust margin requirements on select stocks to ensure clients had sufficient assets to pay for stock purchases ... and also restricted certain advanced options strategies,” Schwab explained.

Moving to T+1?

Jennifer Schulp, director of Financial Regulation Studies at The Cato’s Institute’s Center for Monetary and Financial Alternatives, noted on an early February podcast held by Cato that while “it’s completely understandable” that investors would be upset by not being able to make the trades, “it’s not at all unusual for brokerage platforms to have to restrict trading in certain securities or under certain circumstances when situations are unusual.”

However, “that’s not to say that investigations won’t turn up facts that we don’t know right now. Robinhood’s decision, or about Schwab’s decision. ... But this idea of restricting the trading is not unusual,” Schulp said.

With the rapid increase in GameStop’s price and the volatility in the price, “the clearing company ... required a significant amount more capital from these brokerage platforms in order to make the clearing process work.”

During the two days it takes to clear a stock trade, “the risk and the liability for that trade stays on the books of that brokers and as the stock prices increases and gets a little bit wild, it costs more to keep that liability for the brokerage platform,” Schulp explained.

Toes, who interviewed former SEC Commissioner Michael Piwowar during the STA podcast, said the current T+2 “settlement process does appear to be antiquated.”

While serving as acting SEC chairman in 2017, Piwowar finalized a rule to change the settlement date for securities transactions to T+2 from T+3. “That was the easiest regulatory layup in the history of the commission,” said Piwowar, now executive director of the Milken Institute Center for Financial Markets. “We had been at T+3 for 22 years; we were behind the rest of the world,” he said. It was a “win, win, win to shorten the settlement cycle.”

With the changes in technology four years later, “is it appropriate to look at shortening the settlement cycle now” to T+1? Piwowar asked rhetorically. “Of course it is. This should be one of the more high priority things the commission works on.”