

[Securities Regulation Daily Wrap Up, TOP STORY—Game Stopped? Lawmakers grill Robinhood, Melvin Capital, and Citadel CEOs over GameStop trading frenzy, \(Feb. 18, 2021\)](#)

Securities Regulation Daily Wrap Up

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A lengthy House hearing examined the causes and impact of the GameStop short squeeze and whether the no-commission brokerage model may actually be harming retail investors.

Members of the House Financial Services Committee examined whether legislators and regulators should take a closer look at the rules governing short sales, best execution, and customer disclosures in the wake of the dramatic rise and fall of shares of GameStop, Inc. and other so-called "meme stocks" touted by retail investors. In a [hearing](#) lasting over three hours, the lawmakers questioned principals of pioneering no-fee brokerage Robinhood Financial, hedge fund manager Melvin Capital Management, and leading market maker Citadel about their role in the GameStop trading frenzy and whether the existing regulatory structure leaves small investors unprotected. The committee also heard testimony from Reddit CEO Steve Huffman and Reddit poster Keith Gill about the role that social media played in the trading surge and whether more needs to be done to ensure the quality of information on Reddit and other social media platforms.

Shares of GameStop had risen dramatically from a close of \$18.84 on December 31 to a high of \$482.85 on January 27, driven in part by calls on Reddit's "Wall Street Bets" channel for retail traders to squeeze hedge fund Melvin Capital for taking a short position in GameStop stock that reportedly exceeded 140 percent of the outstanding float.

Regulatory inequity? Committee Chair Maxine Waters (D-Cal) opened the session by noting that this would likely be the first of a series of three hearings on the matter. Waters observed that the losses apparently suffered by retail investors when the price of GameStop shares plummeted has focused a national spotlight on the practices of institutional investors and reinforced a belief that the markets are "rigged."

In his opening statement, however, Ranking Member Patrick McHenry (R-NC), questioned the idea that many of these retail investors were uninformed, suggesting that the average investor is generally "pretty darn sophisticated." McHenry said that there is a fundamental change occurring in the marketplace, fueled largely by technology, and that trading activity in GameStop reflects the coupling of technology with frustrations created by an uneven, K-shaped economic recovery. In his view, the existing regulatory framework has enshrined inequity in the financial markets, citing as an example the prohibitions against non-accredited investors investing in private securities offerings. McHenry said that it is "time to get serious" about equity and ownership in the economy.

Democratizing finance. After initially being interrupted by Waters and asked to speak directly to the subject matter at hand, co-founder and CEO [Vladimir Tenev](#) of Robinhood Markets said that Robinhood's stated mission to "democratize finance for all" has a special meaning to him, given that he had immigrated with his family to America for a better life when he was five years old. Countering the idea that firms like Robinhood have caused small investors to treat the markets like a casino and ignore the fundamentals of companies, Tenev said that Robinhood sees evidence of long-term holding on the part of its customers, while noting in his prepared remarks that only two percent of customers qualify as pattern day traders. As evidence that Robinhood has helped create value for its customers, Tenev said that the current value of customer assets now exceeds the value of their initial deposits by \$35 billion.

With regard to the reasons for Robinhood's temporary but very controversial restrictions on the purchase of additional shares of GameStop, Tenev said that the action was taken for one reason only: to allow Robinhood to continue to meet its regulatory deposit requirements, and not to help hedge funds. Nevertheless, Tenev stressed, any resulting harm was unacceptable, and he apologized to the firm's customers.

Tenev also expressed the view that the current T+2 settlement process exposes investors and the securities industry to unnecessary risks as investors are left waiting for their trades to clear while clearing brokers have their proprietary cash locked up until the settlement is final days after the trade. In his view, there is no reason why the financial system cannot settle trades in real time, a process which would greatly mitigate these risks while allowing broker-dealers like Robinhood to better react to periods of increased volatility in the markets without restricting the purchasing of securities.

Role of Citadel Securities. [Kenneth C. Griffin](#), CEO of Citadel LLC, the largest market maker in the U.S. equities market, asserted his firm had "no role" in Robinhood's decision to limit trading in GameStop or any other "meme stocks." Griffin said that his firm invests hundreds of millions of dollars each year to serve its customers, adding that the importance of this investment was reflected in the last week of January. Griffin observed that during a period of frenzied retail equities trading, Citadel Securities was the only major market maker to provide continuous liquidity every minute of every trading day. Moreover, when other firms were unable or unwilling to handle the heavy volumes, Citadel Securities executed 7.4 billion shares on behalf of retail investors on January 27, an amount greater than the average daily volume of the entire U.S. equities market in 2019.

Melvin Capital Management. [Gabriel Plotkin](#), the founder and Chief Investment Officer of Melvin Capital Management, said that he was "personally humbled" by the GameStop events. He stressed, however, that contrary to many reports, Melvin Capital was not "bailed out" by an infusion of capital from Citadel. Plotkin said that Citadel proactively reached out to become a new investor in Melvin Capital because it represented an opportunity for Citadel to "buy low" and earn returns for its investors. Despite its difficulties, Melvin Capital always had margin excess and was not seeking a cash infusion, according to Plotkin.

Plotkin testified that most of Melvin Capital's investments are "long" and are taken after extensive research convinces them that a company will grow relative to expectations. If Melvin Capital takes a "short" position, it will generally do so for the long-term after extensive research. Plotkin said that nothing about Melvin Capital's short position prevents a company from achieving its objectives – it is just Melvin Capital's view about whether it will.

Role of social media. Reddit co-founder and CEO [Steve Huffman](#) said that it is important to understand that the WallStreetBets forum in which most of the GameStop discussion took place is one of many investing-related communities on Reddit. He noted that WallStreetBets specializes in higher-risk, higher-reward investments than what might be found in other, conservative, financial communities on Reddit. He stressed that WallStreetBets is first and foremost a real community, as reflected by the use of self-deprecating jokes, memes, and sometimes crass language. While acknowledging that WallStreetBets may look sophomoric or chaotic from the outside, Huffman believes that the community has raised important issues about fairness and opportunity in our financial system.

Huffman added Reddit's analysis of the activity in WallStreetBets showed that bots, foreign agents, or other bad actors did not play a significant role in the community. In every metric that Reddit checked, the activity in WallStreetBets was well within normal parameters, and its moderation tools were working as expected.

Reddit user [Keith Gill](#), who notoriously discussed GameStop stock on WallStreetBets under the username "DeepF*ckingValue," emphasized that he is "not a hedge fund," nor does he have any clients or provide personalized investment advice for fees or commissions. Gill said that he is strictly an individual investor, and his investment in GameStop and his posts on social media were entirely his own.

Gill said that two important factors, which were based entirely on publicly available information, gave him confidence that GameStop was undervalued in 2019 and 2020. First, he believed that the market was underestimating the prospects of GameStop's legacy business and overestimating the likelihood of its going bankrupt. Second, Gill believed that GameStop had the potential to reinvent itself as the ultimate destination for

gamers within the \$200 billion gaming industry by pivoting from a traditionally brick-and-mortar mindset toward a technology-driven business that excels in gaming products, experiences and services.

Gill said that the idea that he used social media to promote GameStop stock to unwitting investors was "preposterous." In his prepared remarks, Gill said that he decided to share his investment ideas on social media because he believed his investment skills had reached a level where sharing them publicly could help others. He also thought that by sharing his ideas and accepting critiques, he would be able to identify holes in his analysis. "As for what happened in January," Gill said, "others will have to explain it."

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