Sometimes the wildest idea, to all appearances the most impossible idea, becomes so firmly fixed in your head that you finally take it for something that can be realized… That’s not all: if the idea is united with a strong, passionate desire, you will quite likely at some time finally take it for something fateful, essential, predestined, for something that just cannot fail to be and to happen![[1]](#footnote-1) - Fyodor Dostoevsky.

**Introduction:**

‘There are decades where nothing happens and there are weeks where decades happen’[[2]](#footnote-2) these are the putative words of communist revolutionary Vladimir Lenin. And despite their author’s well-known antipathy to capitalism, these words capture vividly the explosion of economic activity that the American capital market experienced over the course of a few weeks in January 2021. And decades did pass over the course of those weeks, enough that the ownership of GameStop, a destitute and heavily shorted videogame store ‘could have completely changed ownership more than 10 times’[[3]](#footnote-3). This incident singlehandedly advanced policy discussions on a system wide scale, on issues as far-ranging as the surreptitious psychological techniques latent in investing apps to the appropriateness of the duration of the settlement cycle undergirding the stock exchange.

This event is known as the GameStop short squeeze. Its origins like its consequences are mired in uncertainty and its impact has been felt globally. This incident exists in an interdisciplinary interstice of finance, law, and technology and as such total exegesis is difficult. Nevertheless, it is the ambition of this essay to explore from a legal perspective some of the salient issues and to forecast their future. The areas in need of examination are naked short selling, gamma squeezes, market manipulation, the trading halt, payment for order flow and gamification.

The tug-of-war between retail and institutional investors became a battle of biblical scale as the combatants were characterised as David and Goliath. But this simple retelling conceals the manifold nuances spread throughout the story, with market actors in all tax brackets testing the boundaries of the ethical and the efficacious. And in a heated political climate after a year in lockdown, it was a surprise stress test on an already strained system. As Lawrence Goodman notes ‘lost in the headlines and struggles between good and bad or big and little is the issue that should be of greatest concern – financial stability’[[4]](#footnote-4).

Though the nature of much of the claims and accusations are bent by bias and many of the issues demand empirical inquiry so that proper judgement can be passed. The GameStop episode was heaven for some, hell for others and is in limbo with lawmakers. So, let the author be your *Virgilian* guide through the *Purgatario* that is the likely legal and regulatory repercussions of the GameStop short squeeze.

**Naked Short Selling:**

A major point of contention during the short squeeze was the fact that more than 100% of GameStop stock had been sold short, the total short interest in January 2021 peaked around 140%[[5]](#footnote-5). To the average observer this seems absurd after all how can one exceed 100% of anything finite? After shares have been lent and sold those same shares can be lent and sold again and again. It is therefore possible on paper for ‘more than 100% of the float of a stock to be shorted’[[6]](#footnote-6).

Now while it is in fact possible to short beyond a company’s total float, doing so elicits another related problem, naked short selling which is actually illegal. In a naked short ‘the seller does not borrow or arrange to borrow the securities’[[7]](#footnote-7) within the settlement time resulting in a failure to deliver. Regulation SHO introduced the locate requirement which mandates that a broker-dealer must have either ‘Borrowed the security, or entered into a bona-fide arrangement to borrow the security’[[8]](#footnote-8) or at least have ‘Reasonable grounds to believe that the security can be borrowed’[[9]](#footnote-9). Furthermore, a degree of leeway is given in delivery[[10]](#footnote-10) should the stock be considered a threshold security[[11]](#footnote-11). If examined from a European perspective a precognition of catastrophe is possible. Diego Valiante views the shortcomings inherent in regulation SHO as being responsible for the squeeze. Citing the flimsy excuse of reasonable grounds as well as the permissible delays as over empowering short sellers to make risky bets. Saying that,

delays in the delivery of shares, combined with the gigantic size of the underlying short interest, should have rung the alarm bell of too large naked short positions that can cause an artificial price movement… there is no doubt that regulation played a key role in the build-up of such high level of short positions, which ultimately created the conditions for a squeeze of these dimensions to happen. As a result, GameStop is also the story of regulatory and supervisory failure, which is dearly costing investors of all backgrounds[[12]](#footnote-12).

Given these flaws it looks as if this regulation is in need of reform. However, the question of how the American short-selling regime might be remedied proves difficult as every action has an opposite and unintended reaction.

Even before this incident academics have been petitioning for greater disclosure requirements[[13]](#footnote-13) and without doubt the GameStop episode has expedited such demands. Increased openness at first always seems helpful however greater transparency is double edged. Naturally the more a short seller is compelled to disclose the greater chance Redditors will attempt to raid their position. As Tom Stevenson of Fidelity notes: ‘Greater transparency of short trades was a good thing after the carnage of the credit crunch. Today it risks providing ammunition to market manipulators. The short squeeze has never been easier to target’[[14]](#footnote-14). Stevenson continues to caution on the distinct possibility that ‘if the short-selling pressure valve is jammed shut… a more generalised FOMO-fuelled boom turns to bust as it did 20 years ago’[[15]](#footnote-15).

Stock market showman Jim Cramer has similarly remarked on retail investors exploiting extant short interests. In a segment on meme stocks, he exclaimed that ‘every time a bunch of shorts try to go after AMC they get smacked down by the legion of bear bombers’[[16]](#footnote-16). Regarding both AMC and GameStop, he further explains that: ‘I’m not saying either of these stocks are necessarily worth buying here but you can't short them because the shareholder base will destroy you every time’[[17]](#footnote-17). Naturally, this kind of activity frustrates attempts at price correction and an efficient allocation of capital.

One solution put forward to hinder hedge funds is a mandatory holding period of positions[[18]](#footnote-18). And another is to place ‘caps on short selling in an effort to make it harder for hedge funds to have large short positions’[[19]](#footnote-19). This could be achieved by imposing ‘additional reporting and disclosure requirements for short sellers, or through caps on the amount of stock they can short’[[20]](#footnote-20) says Daniel Smith OF ACA compliance. Lawmakers might not even need to close this loophole themselves, as hedge funds might be proactive in this area imposing internal restrictions on the amount of stock they short as a new facet of risk management.

In contrast, the UK’s short-selling regulatory regime is considerably less lax than its American opposite. As a consequence of attempts at pan-European legal harmonisation, England’s short selling laws are disparately located across a number of supranational statutes incorporated into domestic law after Brexit as retained EU law[[21]](#footnote-21). Pertinent to the current conversation are the disclosure requirements and restrictions on naked short sales detailed in Regulation (EU) No 236/2012[[22]](#footnote-22). Said disclosure requirements are spread across articles 5 and 6. The former of which handles confidential notifications to a competent authority - the FCA - upon the construction of a significant net short position[[23]](#footnote-23). The latter article alternatively commands public disclosure of significant net short positions. The public notification threshold is 0.5% of the issued share capital and every 0.1 % above that[[24]](#footnote-24). Additionally, article 9 describes the method of notification and disclosure[[25]](#footnote-25). Naked or ‘uncovered’ short selling as it is called in the act is prohibited by article 12 of the EU regulation[[26]](#footnote-26). While it reads similarly to its American counterpart, it differentiates itself by noticeably excluding the justification by faith provision present in rule 203(b)(1)(ii) of regulation SHO.

Contemplating the likelihood of similar short squeezes happening in the UK, an authoritative commentator on the matter is Mark Steward, Executive Director of Enforcement and Market Oversight at the FCA. Who preliminarily precludes the possibility of such a situation occurring on *Angleterre*, saying:

The FCA’s approach to short selling… gives us and the market a very high degree of transparency over short selling positions. … While here in the UK we did see an overall reduction in the value of net short positions during the Gamestop incident, we have not seen short positions of the size generated in US markets in this incident, nor would such short positions be created without substantial scrutiny by us and the market, as they are built up[[27]](#footnote-27).

It is to be expected then that short selling is by no means as prevalent in the UK as it is in the USA. Even in ordinary day-to-day operations the short interest in American companies is orders of magnitude greater than those in Britain. For perspective, in August 2021 one of the most shorted companies in America is SCWorx Corp with 57.7% of its outstanding shares shorted[[28]](#footnote-28). For comparison in the UK the most shorted company is Cineworld with only 7.69% of its shares shorted[[29]](#footnote-29). Thus, it is improbable that short squeezes of the same scale or of a similar volatility will happen in the UK. Though of course there are other factors contributing to this beyond London firms having a reticence on making bets with unlimited upside risk. One must also bear in mind the sizeable retail trading community in America which is unmatched in the UK.

GameStop is a commercial coelacanth, its inability to adapt and thus the inevitability of its extinction was too tempting an opportunity for short sellers to pass. These self-same short sellers got greedy and collectively constructed a short interest in GameStop amounting to around 140%. The millions then lost by these hedge funds is the peripeteia stemming from this hubris. Short selling is after all ‘Wall Street’s most dangerous game’[[30]](#footnote-30) but what if any new rules will be added in the wake of this incident? There is a lot of room for regulatory manoeuvring in America. The recent research of Joshua Mitts[[31]](#footnote-31) reveals the extent to which ‘“Negative activist” hedge funds mastered the art of driving down share prices’[[32]](#footnote-32) and his prescription is greater disclosure requirements. While transparency seems to make short seller’s an easier target, public discussion of disclosed positions will give hedge funds a heads up on the possibility of attempted squeezes as they will ‘now look to monitor retail trade chat forums and message boards in an effort to anticipate and benefit from any future retail investor driven volatility’[[33]](#footnote-33). On the other hand, the UK has cemented its position and seems to be content with its current short-selling laws and won’t make any major moves.

**The Gamma Squeeze:**

During the January episode there was a pair of parallel phenomena cooperating to drive up GameStop’s share price, the first of which was the short squeeze, an age-old market event. However, its partner is the recently discovered phenomenon of a Gamma squeeze. In a prophetic article from October 2020, Boris Schlossberg sketched the outline of a novel market event effectuated by day trades that could mechanistically drive up the price of a stock. The chief attribute of which was ‘that much of the upside activity is being driven by options volume coming from retail demand’[[34]](#footnote-34). He further explains that ‘the relentless bid for the high beta names… has forced option dealers to continuously hedge by buying the underlying name which in turn only propels prices higher’[[35]](#footnote-35). This trading tactic is crypto-coercive in that market-makers are forced to buy the optioned security in order to offset their exposure, an exercise commonly called hedging in-industry. ‘Hedging is a risk management strategy employed to offset losses in investments by taking an opposite position in a related asset’[[36]](#footnote-36). In this case market-makers are buying the underlying stock to limit their potential losses, however it is exactly this ‘hedging activity that can create the conditions that make a gamma squeeze possible’[[37]](#footnote-37).

Being that the core mechanic of a gamma squeeze is the mass purchasing of call options, regulators could try to dam the flow of such market activity. However, Trace Schmeltz warns that ‘placing artificial limits around market liquidity tools like options could create different market distortions. By putting a limit on the number of call options that trade… you would drive up the price of the calls, which might be problematic for other stocks’[[38]](#footnote-38). Surprisingly the gamma squeeze itself was not subject to much scrutiny from lawmakers who preferred to focus on the more sensational aspects of the short squeeze. Nevertheless, unabated, this tactic could be cynically used to push-up prices to heights where they don’t belong based purely on trading volume. Therefore, it is imperative that regulators begin to pay attention to this new type of manoeuvre before its disruptive potential is fully realised.

**Market Manipulation:**

The financial phrase du jour in late January 2021 was Market Manipulation. Indeed, it was a crime of which everyone involved was indicted, or at least so they accused each other. The hedge funds had shorted and distorted the true price of GameStop while the Redditors had conspired online to push the price up. And Robinhood had seemingly sold-out its users to placate the abstract entity known as Wall Street.

In spite of the flippancy with which market manipulation was alleged it is in fact notoriously difficult to prove and it may yet turn out that the whole GameStop short squeeze was one dramatic move after another without a hint of illegality. However, in the absence of such a finding it is important that the conduct of major participants be assessed. To this end different market actors should be discretised into separate categories based upon their status during the short squeeze. In particular our focus shall be on the most visible and vocal proponents of GameStop on social media. Along these lines then those that supported the short squeeze will be split into two groups: The influencers internal and external to Reddit. Their articulations and actions shall be analysed and measured against the law to see if what they said or did constitutes market manipulation.

First in line for examination is the role played by an influential intelligentsia internal to Reddit that apparently motivated a mass of their fellow investors to push in the same direction consequently causing the short squeeze. By expressing their seemingly sincere opinions on social media this group has made themselves vulnerable to accusations of manipulation.

And there can be no doubt that a number of popular posters on r/WallStreetBets have near market moving potential. For instance, in September 2020, u/Jeffamazon laid out his elaborate game plan for ‘The REAL Greatest Short Burn of the Century’[[39]](#footnote-39) wherein he explains the vast short interest in GameStop and advocates options buying as a technique to drive up the price.

But of course, the real *homme de l'heure* is Keith Gill or Roaring Kitty as he is known on YouTube and u/DeepFuckingValue on Reddit. Beginning in late July[[40]](#footnote-40) and early August of 2020[[41]](#footnote-41) he began to make the bull case for GameStop on YouTube with a cogent appeal to fundamentals as well as an insistence on the importance of certain overlooked aspects of the business. His advice is unpretentious and digestible. However, the cost of his success has been the threat of investigation and litigation. The question now is, did Keith Gill over the course of his communications manipulate the market and is he legally liable to the people he purportedly misled? The difficulty in answering this question lies in the irregularity of the facts. Gill never lied nor did he deceive. He thought GameStop was a sound stock to purchase, discussed it and bought it, as is evinced by the pictures of his portfolio that he routinely posted on Reddit[[42]](#footnote-42).

Market manipulation in America is covered by SEC rule 10b-5[[43]](#footnote-43) which states in relation to securities that: ‘It shall be unlawful for any person, directly or indirectly, by the use of any means… (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made’. While in the UK the applicable law is the EU Market Abuse Regulation (EU) 596/2014[[44]](#footnote-44). Therein article 12(1)(c) defines market manipulation as:

‘disseminating information through the media, including the internet… which gives, or is likely to give, false or misleading signals as to the supply of, demand for, or price of, a financial instrument, … where the person who made the dissemination knew, or ought to have known, that the information was false or misleading’.

Article 15 plainly prohibits such activity. It may be said that Gill’s advice inspired some investors but none of what he said was necessarily untrue or misleading. The contributors at Cadwalader cabinet comment that ‘there is nothing inherently wrong with a private citizen saying, "I bought this stock; I like it; and you should buy it too."’[[45]](#footnote-45). Echoing this sentiment is Scott Silver, managing partner of Silver Law Group, who said that if Keith Gill ‘is what he says he is, he’s not breaking the law… There’s absolutely nothing wrong to tell others to buy a stock if it’s honest and in good faith’[[46]](#footnote-46). Therefore, if Gill made no materially false statements and his holding pattern is consistent therewith[[47]](#footnote-47), he should be shielded from a market manipulation charge.

Nonetheless he has still been hit with lawsuits[[48]](#footnote-48) alleging that he misrepresented himself as an amateur investor and that his advice videos had induced others into purchasing securities. Hagens Berman filed the suit against Gill and his former employer Mass Mutual Life Insurance on behalf of Christian Iovin and all others similarly situated[[49]](#footnote-49). If Gill giving investment advice online is so ‘egregious’, then one must also inquire if Mad Money host, Jim Cramer, pressing the ‘Buy! Buy! Buy!’ button on his soundboard while discussing the upside potential of a new company at its IPO[[50]](#footnote-50) is also acceptable. Is it not also reasonable to sue him? Possibly indemnifying Gill against legal liability is the presence of a disclaimer in the description section of every video and also uploaded on his YouTube channel is a disclaimer video[[51]](#footnote-51). Part of which plays at the beginning of his livestreams[[52]](#footnote-52). These questions are unlikely to be answered anytime soon however as this class action complaint was short lived, as a notion of voluntary dismissal has since been submitted[[53]](#footnote-53).

Furthermore FINRA, may also target Gill on account of his being a registered broker.

Although a self-confessed ‘Roaring Kitty fan’, Steven Lofchie admits that he likely ‘broke some rules… they are FINRA rules… so, I think he will be subject to FINRA disciplinary action… [but] the violation of FINRA rules does not give rise to private rights of action’[[54]](#footnote-54).

As a registered broker[[55]](#footnote-55) Gill is expected to comply with the rules laid out by FINRA, the financial sector’s self-regulatory body. The FINRA rulebook is mammoth but some of the rules that Gill could have conceivably broken are rule 2210[[56]](#footnote-56) or perhaps rule 2111[[57]](#footnote-57). Gill may encounter problems with the fact that his extracurricular activity was not approved by his employer and it is uncertain whether the stock picks he discusses in his videos constitutes recommendations. Punishment for rule breaking ranges from fines to censure to suspension[[58]](#footnote-58). In the grand scheme of things, if Gill infracted on these obligations, they are relatively minor infringements.

During the short squeeze a small number of high-profile personalities interjected on the matter. Their comments, though brief, were enough to increase the price of GameStop’s shares. By wantonly elevating share volatility these celebrity endorsements do not bode well for overall market stability. The individuals in mind are venture capitalist and Social Capital founder Chamath Palihapitiya and Tesla CEO and Reddit fan favourite Elon Musk. Both of whom discussed the incident and resultingly also seem to have had a disproportionate impact on the trajectory of the squeeze.

Palihapitiya’s posts on social media[[59]](#footnote-59) and various television appearances[[60]](#footnote-60) assisted in legitimising the short squeeze and he himself boosted the stock by buying GME call options[[61]](#footnote-61) although he quickly closed out his position[[62]](#footnote-62).

However all together more noteworthy is the chicanery of confidence man extraordinaire, Elon Musk, who with a single non-sensical tweet tacitly supporting the short squeeze[[63]](#footnote-63) sent the stock soaring. ‘Shares of GameStop were up more than 60% in after-hours trading following Musk’s tweet, which linked to the “wallstreetbets” Reddit page’[[64]](#footnote-64). This is not the first time the Tesla CEO has sent stocks to dizzying heights; ecommerce company Etsy had its stock price jump 8%[[65]](#footnote-65) when Musk mentioned it on twitter[[66]](#footnote-66). And his followers accidentally boosted the wrong company[[67]](#footnote-67) after Elon enjoined them to ‘Use Signal’[[68]](#footnote-68). Comic as this may be Elon has also affected the share prices of his own company consequently drawing criticism from investors and the SEC. On one occasion he tweeted that the Tesla stock price was ‘too high’[[69]](#footnote-69) sending shares tumbling down[[70]](#footnote-70). And on another he said he was ‘considering taking Tesla private at $420’[[71]](#footnote-71) the SEC response to which was to charge him with securities fraud for making ‘false and misleading tweets’[[72]](#footnote-72). The end result of which was that both Musk and Tesla had to pay $20 million each and subsequent communications from Musk concerning his business must be screened and approved by his legal team[[73]](#footnote-73). Besides these sporadic utterances, something else worthy of note is Musk’s longstanding vendetta against the short sellers that have doubted the long-term prospects of his business. He has labelled the practice ‘illegal’[[74]](#footnote-74), a ‘scam’[[75]](#footnote-75) and has urged his followers to ‘Get Shorty’[[76]](#footnote-76). It is clear that his pointed and reckless remarks pose a problem to regulators concerned with the stability of the stock market. ‘There is a strange irony in Elon Musk's ability to influence market movements and at the same time to criticise the practice of short selling’[[77]](#footnote-77) says Dan Lane an analyst at Freetrade, who goes on to advocate for additional speech regulation stating that ‘Regulators… need to proactively enforce rules and clarify what is acceptable’[[78]](#footnote-78).

Through social media especially maverick executives like Musk can function as a financial fifth column undermining the investments of individuals and groups in the same percentile of world wealth as him. In 280 characters or less Musk can move markets, however his online antics do not transgress market manipulation laws in the traditional way. His non-Tesla tweets are Teflon coated and it is doubtful if even legendary prosecutor Miles Edgeworth could secure a conviction. Succinctly, he has the power to pump and dump at his fingertips. Should this go unregulated? That is a question lawmakers will have to ask themselves as it is unlikely that the Tesla CEO will stop tweeting any time soon. The SEC would need to take extraordinary measures to curtail such destabilising statements however this is exceptionally difficult in America on account of the first amendment.

Market moving economic commentary on social media straddles the line of legality. Online spaces like YouTube, Reddit and Twitter can equally facilitate education and exploitation. And market manipulation through social media will likely become a bigger problem in the future even if it is not verifiable in this instance. It seems only honesty and factual inerrancy can and should shield internet authors from either criminal or civil charges. Although special attention must be reserved for celebrities that recklessly recommend or endorse stocks to their followers. Though this is an issue unlikely to be resolved soon. It should also be said that the great mass of retail investors has been effectively exonerated if not by the impossibility of proving their individual intents then by the pyrrhic logistics of investigation.

**Trading Halt.**

Angular stock charts are like cuneiform the deciphering of which can divulge a Sumerian epic and tracing the trough of the 28th January reveals a tragedy. That day Robinhood announced it would be restricting trading in certain securities including GameStop. Expectedly, outrage ensued[[79]](#footnote-79) as the price of GameStop stock plummeted. This shock move even impacted stock prices in Europe[[80]](#footnote-80). The questions to be asked then are: Why did they do this? Was it legal? And what will the consequences be?

Robinhood’s decision refracted through the hermeneutic of suspicion inclines one to assume that corporate collusion occurred. That Ken Griffin and Gabe Plotkin contacted Vlad Tenev demanding that he halt trading on Robinhood so to save Melvin Capital from further losses. This however is not a story that holds up under scrutiny. For starters, Melvin Capital had already closed out of its short position ‘days before’[[81]](#footnote-81). And while other brokerages like TD Ameritrade[[82]](#footnote-82) and Trading 212 on the other side of the Atlantic[[83]](#footnote-83), also halted trading none provoked the same furore that Robinhood’s restrictions did. In his congressional testimony, Tenev said that ‘Any allegation that Robinhood acted to help hedge funds or other special interests to the detriment of our customers is absolutely false’[[84]](#footnote-84). Instead insisting that the trading halt was ‘to allow us to continue to meet our regulatory deposit requirements’[[85]](#footnote-85). ‘On 28 January, the company was informed by its clearing house, NSCC, that it had a deposit deficit of approximately $3bn – up from $124m just days before’[[86]](#footnote-86) - which Robinhood is obligated to meet. So yes, contrary to any conspiracy theory it does indeed seems like Robinhood’s stated reason is the real reason for the restrictions. Was this course of action however legal?

Swiftly thereafter America’s infamous litigiousness was vindicated as a salvo of lawsuits were filed in a variety of district courts[[87]](#footnote-87). The most famous of which is that filed by Brendon Nelson in the Southern District of New York which accuses Robinhood inter alia of acting ‘purposefully and knowingly to manipulate the market’[[88]](#footnote-88). One day after the filing 26,000 people joined the class[[89]](#footnote-89). The legality of an act is appreciable only with reference to the contravention of some law. So which law did Robinhood break? The plaintiffs are accusing Robinhood of making a myriad of mistakes including: ‘alleged breaches of contract, breaches of the implied duty of good faith and fair dealing, negligence, and breaches of fiduciary duty. … as well as exclusionary and anticompetitive conduct in prohibiting plaintiffs from effectuating trades’[[90]](#footnote-90). Section 9(a)(2) of the Securities Exchange Act 1934 and SEC rule 10b-5 as well as SEC Rule 15c3-1 also have all been brought up in relation to the trading restriction. While Robinhood’s actions may have had the organic effect of lowering GameStop’s share price, the exorbitant demand of additional deposit requirements is a supervening event. Its obligation to clearing houses and systemic stability is prior to the caprice of its customers.

However, there are a number of obstacles in the way of a successful suit, not least Robinhood’s customer agreement which all of its users no doubt dutifully read. Said agreement contains a provision which reads: ‘Robinhood may at any time, at its sole discretion and without prior notice to Me: (i) prohibit or restrict My access to the use of the App… and My ability to trade, (ii) refuse to accept any of My transactions, (iii) refuse to execute any of My transactions’[[91]](#footnote-91). With bulletproof boilerplate language like this Robinhood effectively has reserved their right to restrict trading as these please, nominally rendering their actions legal. As well as that a mandatory arbitration clause is included in the customer agreement thus circumventing the courthouse in the short-term. The presence of these terms presumably indemnifies them from the majority of the lawsuits now being served on the company. Despite facing similar restrictions on their ability to trade, Europeans have proved to be reluctant litigants and although discussed[[92]](#footnote-92) no lawsuits were ever initiated in the UK.

When asked if Robinhood’s decision was illegal, Tom Gorman, partner at Dorsey & Whitney LLP, replied simply with

Probably not, certainly not by restricting the trading through their brokerage firm, they have obligations… spelled out in all those customer agreements… presumably they followed their own customer agreements and there is an overlay of SEC regulations which require them, for example, to have a certain amount of net capital on file. If they don’t, the SEC will shut them down[[93]](#footnote-93).

On the onslaught of incoming lawsuits, Michael Bixby, an attorney for Levin Papantonio Rafferty, offered a brief cost-benefit analysis, saying ‘If you lost $10,000, that might be a heck of a lot of money to the individual but it would be difficult to justify the cost of litigation’[[94]](#footnote-94). That said however, Joe Patrice remarks that ‘class actions aren’t always about winning. The suit gets the story out there and feeds a public relations nightmare for a company that claims to be all for retail trading… until retail investors start outperforming the sharps[[95]](#footnote-95)’. And that in spite of the fact that ‘this case will very likely be kicked to the curb very soon… Robinhood’s troubles after enraging its customer base are likely just beginning’[[96]](#footnote-96).

In lieu of legal proceedings, Robinhood’s erstwhile customers may migrate to other brokerage platforms in protest. Andrew Ross Sorkin wrote that ‘After becoming the venue of choice for small investors, the app risks alienating a core customer base’[[97]](#footnote-97). Insofar as the particular issue of trading restrictions is concerned Robinhood may escape official sanctions for the simple fact that they did nothing technically wrong however uncomfortable the whole experience was for its customers. That said internally at least Robinhood will have to review its risk management and overhaul its procedures, given that the increased demands were foreseeable granted the cascading volatility of GameStop. Outside of Robinhood however are things beyond its control. The whole affair has shone a great spotlight on the business bringing with it much unwanted attention, especially from regulators and politicians, who are looking to target Robinhood for whatever reason they can find. Hence the discursive prevalence of Payment for Order Flow and Gamification. Issues only tangentially attached to the January episode. It is instead through these vectors that lawmakers will likely make their attack with a newfound focus on consumer protection.

The trading halt has also accelerated the process of shortening the settlement cycle. Unanimously there have been calls to shorten the settlement cycle as a means to tackle extreme collateral demands during periods of volatility. ‘Although nowadays trades are executed in microseconds, the settlement takes up to two days… the system is considered obsolete in an age where modern computing systems enable much faster trade settlement.’[[98]](#footnote-98).

On the 28th January, there was not one but two falls that fateful day. The first and most obvious the drop in price of GME and secondly the Miltonian fall from grace that Robinhood inflicted upon itself. Tenev laments that, ‘We knew this was a bad outcome for [our] customers… But we had no choice as we had to conform to our requirements’[[99]](#footnote-99). This cause célèbre was so potent as to temporarily unify a Texan senator with a diametrically opposed New York Congresswoman. In the absence of evidence proving that Robinhood’s decision was at the behest of third parties it must be assumed that they were acting honestly. Of course, this act of corporate self-preservation has had the double effect of harming that segment of its customer base which owned GameStop stock and especially that constituent element who had bought in late. Hanlon’s razor dictates that one should ‘never attribute to malice that which is adequately explained by stupidity’ and indeed it seems as if Robinhood’s lack of foresight and the subsequent rash restrictions are adequately explained by stupidity.

**Payment for Order Flow:**

The practice of Payment for order flow (henceforth PFOF) has become a cornerstone of the controversy and perhaps inordinately so. It essentially involves selling a customer’s orders to market-makers who are willing to pay for them. The sum paid per order often amounts to a fraction of a penny. Its implementation was instrumental in the move to zero commissions trading, but critics say it causes a conflict of interests. Ironically in spite of the attention PFOF has received as a result of the short squeeze it in actuality had little to do with causing or sustaining said short squeeze. Nonetheless PFOF has become a focal point in the greater debate about retail brokerages and consumer protection spurred by the GameStop short squeeze.

As it stands in America presently, PFOF ‘is a perfectly legal way of doing business and increasing revenues at brokerages’[[100]](#footnote-100) so says Amy Lynch, founder of Frontline Compliance. This is in contradistinction to the UK where the practice has been basically banned since 2012[[101]](#footnote-101), the rationale behind this ban being that:

‘These payments create a conflict of interest between the firm and its client by incentivising the firm to execute its client orders with counterparties willing to pay the highest commission and so undermine the firm’s ability to act as a good agent’[[102]](#footnote-102).

In the UK instead investing apps earn their revenue by offering their customers a number of additional services. Freetrade, for example, ‘makes money by selling investors an upgrade from the free platform to a premium version with more features’[[103]](#footnote-103). In America PFOF is permissible so long as does not transgress a number of FINRA rules. One of which is rule 5310 – Best Execution – which commands that

In any transaction for… a customer… a member… shall use reasonable diligence to ascertain the best market for the subject security and buy or sell in such market so that the resultant price to the customer is as favorable as possible under prevailing market conditions’[[104]](#footnote-104).

And it has been announced that the ‘potential conflicts of interest in order-routing decisions’[[105]](#footnote-105) will be subject to inspection in FINRA’s 2021 risk monitoring report.

Ron Shevlin’s condemnation of Robinhood is categorical: ‘Because Robinhood makes money by selling order flow, it will always place the needs and priorities of the companies that pay for that order flow over the needs and wants of its users’[[106]](#footnote-106). This inherent conflict of interest is central to most of the criticism PFOF receives. Lamenting the oversimplistic view of PFOF popularly promulgated, David McDonagh, CEO of Commonstock, upholds PFOF as ‘the business model that enabled the increase in market participation, which is unquestionably a net positive’[[107]](#footnote-107). In light of how PFOF has assisted in the establishment of zero-commission trading, President and CEO of FINRA Robert W. Cook has inquired if the potential conflicts are ‘adequately addressed through disclosure?’[[108]](#footnote-108). If so banning PFOF would be superfluous. Furthermore, best execution and price improvement are another aspect in the PFOF debate but what matters more than the hypotheticals of opponents and proponents of PFOF is empirical data. A recent report entitled ‘The Good, The Bad, And The Ugly About Payment For Order Flow’[[109]](#footnote-109) documented the systems benefits but proceeds to suggest that the negatives surpass the positives in terms of worse pricing.

With PFOF, Robinhood has become a victim of its own success. With more than four fifths of its income stemming from the practice in Q1 of 2021[[110]](#footnote-110) it has become over-reliant on a seemingly unsustainable business model and now seems trapped within an Icarus paradox. Robinhood has been mulcted in the past as a consequence of shortcomings related to PFOF, it had to pay $1.25 million in 2019, $65 million in 2020[[111]](#footnote-111) and a record breaking $70 million in 2021[[112]](#footnote-112). But these fines seem only to be the prelude to Robinhood’s problems. Democrats are especially eager to end PFOF and have already drafted a bill to ban it[[113]](#footnote-113). Moreover, the current SEC chairman Gary Gensler, a long-time critic of the practice, has expressed his dismay with it[[114]](#footnote-114). And the UK’s success in spite of a prohibition provides an unwelcome precedent to the Pao Alto start-up. PFOF is critical to Robinhood’s operations such that David Trainer is of the opinion that a ban would spell their end, as Robinhood’s competitors

can afford to continue offering free stock trading without the payment for order flow revenue thanks to their ability to leverage superior scale to generate meaningful revenue from other services… Robinhood doesn’t have anywhere near the scale needed to generate enough revenue from other services to offset the loss of payment for order flow revenue[[115]](#footnote-115).

**Gamification:**

Coinciding with the critique of PFOF is the adjacent analysis of Gamification. The dictionary definition of Gamification is ‘the process of adding games or gamelike elements to something so as to encourage participation’[[116]](#footnote-116). By itself the encouragement of participation in the financial markets does not seem malevolent but the exact form this encouragement takes is in issue as it allegedly makes investing addictive.

Robinhood’s business model has not impressed in-industry heavyweights who have made public their discontents with the company. Berkshire Hathaway CEO Warren Buffett spoke about how Robinhood has ‘become a very significant part of the casino aspect… that has joined into the stock market’[[117]](#footnote-117). And likewise, his vice chairman, Charlie Munger has referred to Robinhood as ‘a gambling parlor masquerading as a respectable business’[[118]](#footnote-118). In retaliation Robinhood accused the ‘old guard’[[119]](#footnote-119) of gatekeeping investing. Regardless of the rationale behind Buffet’s and Munger’s remarks, they invite an investigation into the internal mechanics of Robinhood’s app or at least that aspect of it which inspires gambling; gamification.

A common critique of the Reddit crowd is that their type of market participation better resembles gambling than investing. So far have they strayed from the value investing fundamentals of Graham-Dodd[[120]](#footnote-120) that it can no longer be considered as such. An important distinction that must be bore in mind is that between investing and trading which ‘are two very different methods of attempting to profit in the financial markets’[[121]](#footnote-121). The difference is timing, traders prefer brevity and ‘taking smaller, more frequent profits’[[122]](#footnote-122).

Lending credibility to the claim that trading is akin to gambling is the arrival on the scene of obnoxious characters like Dave Portnoy who meandered into the markets when quarantine put an end to his ability to bet on sporting events[[123]](#footnote-123).

And even the founder of r/WallStreetBets, Jamie Rogozinski, says that the forum ‘treats stock trading like a video game’[[124]](#footnote-124). Trading so conceived seems to have become a new outlet for addicts. Writing for the addiction centre, Suzette Gomez points out that ‘while people focused on the money made, experts noticed monolithic signs of gambling addiction’[[125]](#footnote-125). Gomez goes on to relay a statement from Kevin Whyte, executive director of the National Council on Problem Gambling, who ‘warns that Robinhood’s styling has features like common betting apps. He claims it encourages immediacy and frequent engagement. Through its design, Robinhood induces dopamine rushes’[[126]](#footnote-126).

Apropos of Whyte’s criticism, it is timely to interrogate the underlying intentionality of Robinhood’s creative process. In 2015, Robinhood’s app won the Apple Design Award, they said in their subsequent statement that: ‘Design is core to what we do. It determines the directions we take, the features we build, and the ways we communicate with our customers. It's our hope that the carefully-crafted Robinhood experience will inspire more and more people to start investing[[127]](#footnote-127)’. Ominously enough that is exactly what it does. Robinhood’s user interface is slick and streamlined and is intuitive for all digital natives. However, ‘great UX doesn’t guarantee great customer outcomes’[[128]](#footnote-128). In his review, Eric Reed notes that ‘the problem with this product is that it makes investment too easy… At the same time, Robinhood’s design tends to nudge its investors into taking bigger risks’[[129]](#footnote-129). Rana Foroohar insists upon the risks inherent to this modality of investing. Novices, she says, are ‘being induced to trade as much as possible, as fast as possible, via digital nudges designed by behavioural scientists whose job it is to create the most addictive interfaces’[[130]](#footnote-130). Belying the confetti and saccharine colour scheme is a web of design decisions comprising a choice architecture constructed to positively reinforce preferred behaviours through controlled dopamine releases. With Robinhood’s platform so considered, behavioural economics, the contemporary branch of epiphenomenalism transplanted into finance, begins to take centre stage. Elsewhere Keith Whyte has said that ‘A lot of day trading is indistinguishable from gambling… [both] tend to hit the same pleasure and pain pathways that are activated in all risky and addictive behavior’[[131]](#footnote-131).

Robinhood’s response to this has been to tiredly repeat that it does not glorify gambling[[132]](#footnote-132). Instead preferring to think of its interface as an ‘accessible, modern design’[[133]](#footnote-133). Others have also met the criticisms of gamification with scepticism. Paul McCurdy of Katten Muchin does not perceive the Robinhood app to be in violation of any rules, saying ‘I don’t think confetti is illegal, and I don’t think it is dangerous’[[134]](#footnote-134). Moreover, in some respects it is disingenuous to rest any future action against Robinhood on consumer protection concerns or on an assumption of the overall incompetence of retail investors. The work of Ivo Welch contradicts industry wisdom on the madness of crowds. Having recorded the relative successes of retail traders, he finds that

it is easy to spin a tale in which RH investors fit the stereotype of the unsophisticated gamblers… being taken advantage of by more sophisticated professional traders.… However, this cannon-fodder narrative is incomplete to the point of being misleading[[135]](#footnote-135).

If Robinhood is perceived to be an incorporeal croupier and its users merely gamblers it will set the regulatory tone of how this realm of fintech is to be treated, as implicit in gambling is a whole host of social pathologies which can conveniently be employed to expedite policies.

Gamification is on FINRA’s radar, as Amy Sochard, FINRA’s VP of advertising regulation, has ‘indicated that the organization will seek public feedback on gamification practices utilized by some stock trading platforms to attract investors with a view toward issuing new rules’[[136]](#footnote-136). Their focus is on the ‘risks associated with app-based platforms with interactive or “game-like” features that are intended to influence customers’[[137]](#footnote-137). A priori there is no prohibition on gamification, however without due regard for requisite consumer compliance orders, companies’ employing the process may find themselves under scrutiny. Gary Gensler has said ‘If you use gamification features and folks are trading more actively … That's a challenge for their future and security. I think we have to take a look at this’[[138]](#footnote-138). Furthermore, Democrats have proposed the SEC conduct a study on gamification[[139]](#footnote-139). However, Larry Tabb, director of market structure research for Bloomberg intelligence, thinks actual legislative action is dubious, saying that ‘A congressional review adds to the drama, but new regulatory risk is probably minimal’[[140]](#footnote-140).

In England however, there are ‘Major plans to stiffen the sanctions that can be imposed for breaches of UK consumer protection law’[[141]](#footnote-141). Concordant with the UK’s preference for protectionism, regulators have already called for comment on this new product design philosophy. In their consultation request, ‘Reforming Competition and Consumer Policy’, Whitehall has given notice of its intent to prevent the ‘online exploitation of consumer behaviour’. Saying specifically, that

Online businesses may do things without the knowledge of the consumer or nudge them towards decisions that they would not have normally taken without the nudge … As more information becomes available to businesses, some have utilised it in a way that distorts free choice… [to] push consumers towards certain choices which benefit the firm rather than the consumer[[142]](#footnote-142).

With regard to the ignoble use of gamification, the UK Government is ‘considering strengthening the law so that it is easier for enforcement agencies… to take action against particular exploitative designs’[[143]](#footnote-143).

Well, is it, Game over for gamification? Given gamification’s frequent appearances in official documents from both the House or Representatives and the House of Commons it is an issue very much on the agenda and therefore it can be expected it will come under increasing scrutiny in both jurisdictions. The crackdown will focus on those elements that are readily interpretable as sludge or as dark patterns, those features that unduly influence the choices and behaviour of consumers. Gamification viewed holistically with other parts of Robinhood’s business model, namely PFOF, undermines the moral mission of Robinhood. The effect of gamification is to increase engagement, inferentially then on an investing app its purpose is to encourage the user to invest more. When this effect is cross referenced with the extant incentive structures of PFOF a malign complementarity is uncovered which will taint Robinhood’s reputation in the perception of regulators and legislators. In response to the threat of regulation, Robinhood might proactively remove those aspects of its app that are perceived as gamified or infringing on the agency of the user. And to an extent it already has, the confetti is gone from the app but the rest of the dopamine inducing tricks and techniques also concealed therein remain.

**Conclusion:**

In Act III scene I of Hamlet, in Shakespeare’s celebrated soliloquy, the titular Prince of Denmark lists ‘the law’s delay’[[144]](#footnote-144) as inspiring his suicidal ideation and four centuries later legislative lethargy is still sufficient to motivate melancholy in any man. The GameStop short squeeze unveiled issues across the legislative landscape and although this ‘recent equity market kerfuffle was not a direct threat to the stability of the financial system… one of the most powerful lessons of the past quarter century is that the authorities must energetically learn from near misses and ugly episodes’[[145]](#footnote-145) so wrote Sir Paul Tucker. Steven Lofchie however hopes that this incident will ‘not be used as a pretext to further… rulemaking that does little to help retail investors’[[146]](#footnote-146).

Predictions are a perilous endeavour such that Fyodor Tyutchev cautions us against making them, warning that ‘A thought once uttered is untrue’[[147]](#footnote-147). Nevertheless, professional commentary can compensate for a lack of clairvoyance. Thus, in some areas an oceanic divide between the USA’s and the UK’s regulatory regime is becoming apparent. On either side of the Anglosphere their respective positions on Naked Shorting are unlikely to change. Though novel now, if it should become a normal occurrence expect scrutiny to mount on Gamma squeezes, especially in America where shorts interests are usually larger. Retrospectively it looks as if little can be done about the alleged market manipulation on all levels, it is not obvious how or if any laws were broken but now hedge funds residing in either lower Manhattan or the City of London will integrate social media monitoring into their risk management strategies. Through its user agreement Robinhood has indemnified itself against the lawsuits stemming from the trading halt. Moreover, the issues arising out of its obligations to clearing houses will invoke internal restructuring within the company as well as expedite settlement cycle reduction in the market at large. While not a problem in Britain, in America regulatory and political opposition to Payment for Order Flow has established itself across the system. While it is unlikely to be outlawed immediately the persistence of Democrat control of the executive and legislator will remain a source of anxiety for Robinhood. Gamification is set to become the next target for consumer protection advocates and is a point of policy convergence for America and Britain. Its positives will be downplayed, and its downsides will be overstated as regulators from Washington and Westminster step-in to control purportedly predatory practices.

All that said, ambiguity is ongoing as different aspects of the episode warrant differing responses. Though lingering uncertainty on what if any action at all will be taken might lead to the event being not inaccurately described as a damp squib. As the memory of this incident recedes the whole affair might retreat from the minds of regulators while hedge funds and broker-dealers consciously reinvent themselves to avoid investigation and future losses. And as the price of meme stocks drop and gradually dissipate, it may be as Marx said, ‘All that is solid melts into air’[[148]](#footnote-148).

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