

Introductory statement

ECON Exchange of views in relation to GameStop share trading and related phenomena

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Dear Chairwoman, honourable Members of the Parliament,

I would like to thank you for inviting me to today's exchange of views with the ECON Committee and for giving me the opportunity to present some introductory remarks in relation to the recent developments around trading in GameStop shares and related phenomena.

To begin with, I would first like to underline the importance of ensuring investors' confidence in financial markets and closely monitoring the use of modern technologies for, and around, investing activities as carried out by retail investors. The Gamestop situation touches on several relevant regulatory and supervisory issues, across the areas of investor protection, trading, market abuse and post-trading processes.

Briefly, to recall, the unprecedented trading situation centred in the second half of January 2021 on the shares of firms such as US videogame retailer GameStop or US movie theatre company AMC Entertainment, which have seen their equity prices surge amid high trading volumes and extreme volatility. Indeed, large purchases of shares and of call options, combined with very high short positions created the conditions for unprecedented price increases.

The shares were heavily promoted by certain internet sites and in social media, which encouraged massive purchases by retail investors using leverage, and was amplified by forced buying from short sellers and underwriters of options, resulting in a so called "short squeeze". As a result, GameStop and AMC share prices surged by 1,745% and 839% in January respectively, with consequent growth in their market capitalisation as well as their share traded volumes. At the end of January, when US brokers took steps to curtail activity, extreme movements in individual shares dissipated and concerns about possible contagion towards

shares of other issuers diminished.

Overall, this had a significant impact on US equity trading volumes in January 2021, with volumes traded higher than in March 2020 - during the COVID-19 market stress - and twice as high compared to January 2020. However, trading activity related to GameStop or AMC shares on European venues remained marginal.

The likelihood of similar events happening in the European Union (EU) appears limited. While some EU shares were mentioned in the press as potential targets after the GameStop related events, European short positions levels are lower than in the US, with only 20 issuers with net short positions above 10% (at a maximum of 16%). This limits the risk of a GameStop style “short squeeze”. Moreover, short positions – especially large positions leading to public disclosures – have reduced markedly since the end of January. No increase in overall short-selling activity in the EU was observed in January 2021. While a few EU shares with larger short positions have seen some short-lived price spikes in the last week of January, the price increases were much more limited compared to US levels.

The observed extreme price volatility combined with the broad participation of retail investors raises, in the first place, investor protection concerns. In view of this, ESMA issued a Statement¹, on 17 February 2021, urging retail investors to be careful when taking investment decisions exclusively on the basis of information from social media and other unregulated platforms, if the reliability and quality of that information cannot be verified. While alerting them to the significant risks of investing in stocks characterised by very high price volatility, which will be even more profound for investors using leverage, ESMA stresses the importance of gathering investment information from reliable sources before taking an investment decision. Retail investors also need to clearly keep in mind one’s investment objectives, the ability to bear losses and the benefits of diversification. In this context, I would like to draw your attention to the importance of financial education which can help to get better outcomes for retail investors.

ESMA closely coordinated its monitoring and assessment of the Game Stop phenomena with the National Competent Authorities (NCAs), which also issued their own clarifications, as well as with colleagues from the US Securities and Exchange Commission (SEC) and the Financial Conduct Authority (FCA).

The use of new technology can help increase retail investors participation in financial markets, and thus contribute to one of the objectives of the Capital Markets Union Action Plan. However, there are concerns that specific aspects of online brokers’ business models may incentivise the adoption of risky short-term trading strategies by retail investors. Moreover, there are potentially concerns about the transparency of the fee structure. In particular, the role of online brokers’ business models in creating the recent surge in retail investor participation should be further investigated. We have observed the growing popularity of providers like RobinHood over the last 12 months, with the pandemic appearing to act as a catalyst for this increase in

¹ ESMA70-155-11809

retail trading, against a backdrop of further digitalisation and falling trading commissions in finance.

The phenomenon of zero-commission trading needs to be looked at in more detail. To be sure, as such lower costs for retail investors are a welcome development, given the importance of costs in determining investors' long-term returns. However, there is no such thing as a *free lunch*. Payments for order flow from third parties such as market makers may substitute commissions that are otherwise paid by clients, creating conflicts of interest and resulting in less transparency for retail clients. In my view, the practice of payment for order flow needs to be carefully assessed against the MiFID II requirements on conflicts of interest, best execution and inducements. Next to zero-commission trading, other practices also deserve scrutiny, such as the use of investment apps combined with a phenomenon known as the *gamification* of investing, potentially impacting retail investors' risk awareness and contributing to the popularity of leveraged trading strategies.

Furthermore, from a market integrity perspective, the GameStop situation posed certain questions regarding the applicable market abuse regime requirements and prohibitions. I would like to underline that any trading strategy likely to give misleading signals as to the supply, demand or price of a financial instrument, or likely to secure its price at an abnormal or artificial level may represent market manipulation. While a simple intention to buy the shares of an issuer on which large short sale positions are established does not constitute market abuse, coordinated strategies to buy and sell at certain conditions and at a certain point in time with the objective to inflate the share's price could constitute market manipulation. Moreover, posting false or misleading information about an issuer or a financial instrument on social media may also represent market manipulation.

Another set of considerations and lessons learnt relates to the suspension of buy orders on certain platforms. The sudden exclusion of retail investors from trading GameStop shares via RobinHood was argued, by the platform, as being driven by the large margin calls issued by the clearing house to cover the new positions and related risks, reflecting the heightened volatility and concentration associated with this sudden large trading activity by Robinhood clients. In the EU, from our discussion with the supervisors of EU CCPs, no major changes in margin requirements were noticed as the EU stocks that followed a similar situation did not experience as much volatility and concentration as in the US case.

ESMA will continue to monitor developments and may take further action where appropriate.

To conclude, I would like to thank you for your interest in ESMA's work and perspective on this important matter, that is relevant for market integrity, investor protection and financial stability across the EU.

I look forward to answering any questions you may have.