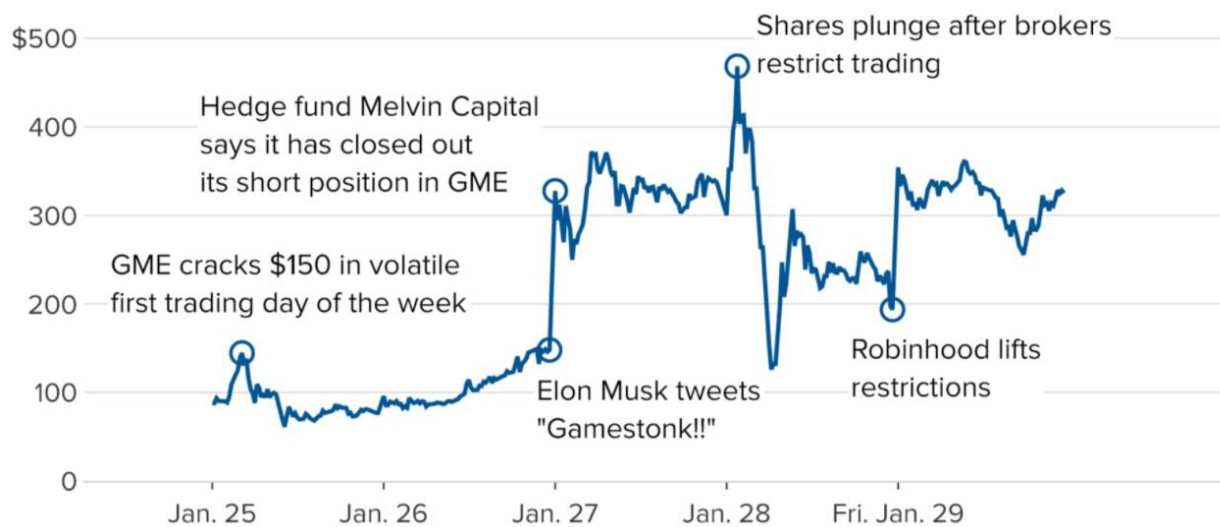


GameStop-Related Market Volatility: Policy Issues

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Video game chain GameStop triggered a market frenzy in early 2021 when its stock price rapidly increased from around \$18 to well over \$400 in intraday trading (**Figure 1**). The developments soon spread to some other stocks and markets. The episode raises several policy issues, including social media's influence over investment decisions, zero-commission trading, short selling, investor protection, market functionality, and financial stability.

Figure 1. GameStop Stock Performance During the Week of January 25



Source: FactSet and [CNBC](#).

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Policy Issues

Multiple issues surfaced during the GameStop-led market volatility that could influence policymaking.

Social Media Influence

Some observers view the GameStop-related market volatility as a form of social rebellion carried out through capital markets and amplified by social media. Specifically, some traders on the WallStreetBets message board expressed a desire to target hedge funds that had bet against GameStop's stock. Accordingly, some of the interest in GameStop appears to have been driven by resentment toward financial establishments rather than conventional economic justifications.

Zero-Commission Brokers and the “Gamification” of Trading

The GameStop phenomenon has also cast a spotlight on recent moves to zero-commission trading by retail brokerage firms. [Robinhood](#), for example, is a zero-commission online and app-based broker serving more than 13 million mostly young retail investors. The zero-trading-fee business model provides convenience for investors to participate in savings and investments. It also draws [criticisms](#) due to concerns that the “gamification” of the trading experience—the use of design elements often found in online games—may give rise to impulsive decisions.

Retail investors' participation in trading reportedly [increased](#) from around 10% to 25% in the first half of 2020 as the Coronavirus Disease 2019 pandemic took hold. Retail investor groups—fueled by social media messages and equipped with new and convenient tools such as Robinhood—could alter market functions and change the normal course of company and investor activities.

Short Selling and “Short Squeeze”

Many traders targeted GameStop's stock because it was heavily shorted. Short sellers gain when the price of a stock falls by borrowing the stock, selling it, and then later buying it back—hopefully at a lower price—in order to return the stock to the lender. A “short squeeze” happens when the shorted stock's price goes up substantially, but short sellers still need to purchase shares at the higher price to close their positions. This put further upward pressure on a stock's price because of the increased purchase demand and in turn, could further escalate the losses for short sellers. The trading in GameStop appears to represent a classic short squeeze: Hedge fund short sellers [reportedly](#) incurred [mark-to-market](#) losses of around \$20 billion as of the end of January.

Investor Protection

Some observers believe that the GameStop phenomenon shares characteristics of speculative bubbles and even signs of manipulation and [pump-and-dump-schemes](#). One executive questioned the role of social media and [argues](#) that “anyone can go on these platforms and tout a stock or a commodity they own and get a big following and then dump it.” Others do not believe such social media actions could amount to [market manipulation](#). One expert [contends](#) that “if someone has been posting on a subreddit [messaging board] that they are very enthusiastic and are acquiring shares in a company, and all the while they are selling, then you have a potential violation. But if in all of the tweets and postings there is no misrepresentation, then you could well find that there are no violations in law.”

Market Functionality and Financial Stability

During GameStop's stock rally, its share price drastically deviated from most analysts' assessment of its economic fundamentals. This type of volatile trading is [believed](#) by some to have increased the market risk for publicly traded companies that could disincentivize these companies from staying public.

Regarding systemic implications, some [argue](#) that although speculative activities are present, the influence is limited to a narrow group of stocks. Others [fear](#) that the event may trigger market-wide contagion.

Others have raised [concerns](#) about the implications of the GameStop event for market infrastructure—specifically, the system for clearing and settling securities transactions.

Policy Options

Some Members of Congress have voiced [concerns](#) about the developments. The chairs of the Senate Committee on Banking, Housing, and Urban Affairs and the House Committee on Financial Services have pledged to hold [hearings](#). Some policy issues that the hearings might evaluate include:

- **Agency actions.** The Securities and Exchange Commission (SEC) has issued two statements on [January 27](#) and [January 29](#) to announce its monitoring and reviewing efforts. A former SEC chairman [suggested](#) four steps the SEC could take to address last week's events: "1) go after market rumormongers aggressively; 2) evaluate the science behind today's day-trading platforms, including the behavioral psychology behind apps like Robinhood; 3) play the role of 'Gloomy Gus' by reminding investors of the risks of speculative excess; 4) improve the boilerplate warnings that are provided to retail investors."
- **Review of trading restrictions at platforms.** Several retail brokers, such as Robinhood and TD Ameritrade, restricted trading of GameStop and other stocks in the midst of volatile trading. Robinhood [cited](#) its need to comply with SEC [net capital requirements](#) and [clearinghouse deposits](#). While users of the trading platforms claim that they suffered losses from such restrictions, some [argue](#) that brokerages have broad powers to block or restrict transactions per their customer agreements with users. However, several Members of Congress have expressed concern that retail investors were cut off from market access while larger institutional players were able to continue trading.
- **Market halts.** GameStop triggered existing SEC [circuit-breaker halts](#) during high market volatility. A state securities regulator [called](#) for further actions to halt trading in GameStop stock for 30 days to allow investors to "cool down."
- **Reevaluation of short selling.** Some observers associate short selling with high-risk speculative behavior and have called for more disclosure or bans on short selling. In contrast, others [argue](#) that short sellers perform valuable functions by ferreting out fraud.
- **Review of potential naked shorts.** A "naked" short is selling short a stock without first borrowing the shares. At one time, the accumulated GameStop shorts were at [140%](#) of its outstanding stock. This has led to some [calls](#) for regulatory review, while others [disagree](#) that it warrants concern.

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