GameStop and the Market Manipulation Puzzle

Presentation at Queen Mary University

1 March 2020

Paul Oudin
DPhil in Law, University of Oxford
Lawyer at the Paris Bar
Rules for Growth Institute

UNIVERSITY OF OXFORD
FACULTY OF LAW

DROIT ET CROISSANCE
FAIRE DU DROIT UN VECTEUR DE CROISSANCE

Introduction

Introduction

❖ Overview of the GameStop case

- **GameStop** is a videogame retailer listed on the NYSE which enjoyed a 15x increase in its share price from mid-August 2020 to end of January 2021
- Company considered as overvalued by many investors → some short-sellers had **significant short positions** on GameStop shares
- End of January: a few ‘gurus’ called Reddit users to massively buy shares and call options in view of triggering a price surge: ‘**short squeeze**’
- GameStop’s short sellers & ‘unlucky’ retail investors suffered substantial losses
- Robinhood suspended trading in GameStop’s shares (won’t be discussed here)

PART I

Economics of Market Manipulation

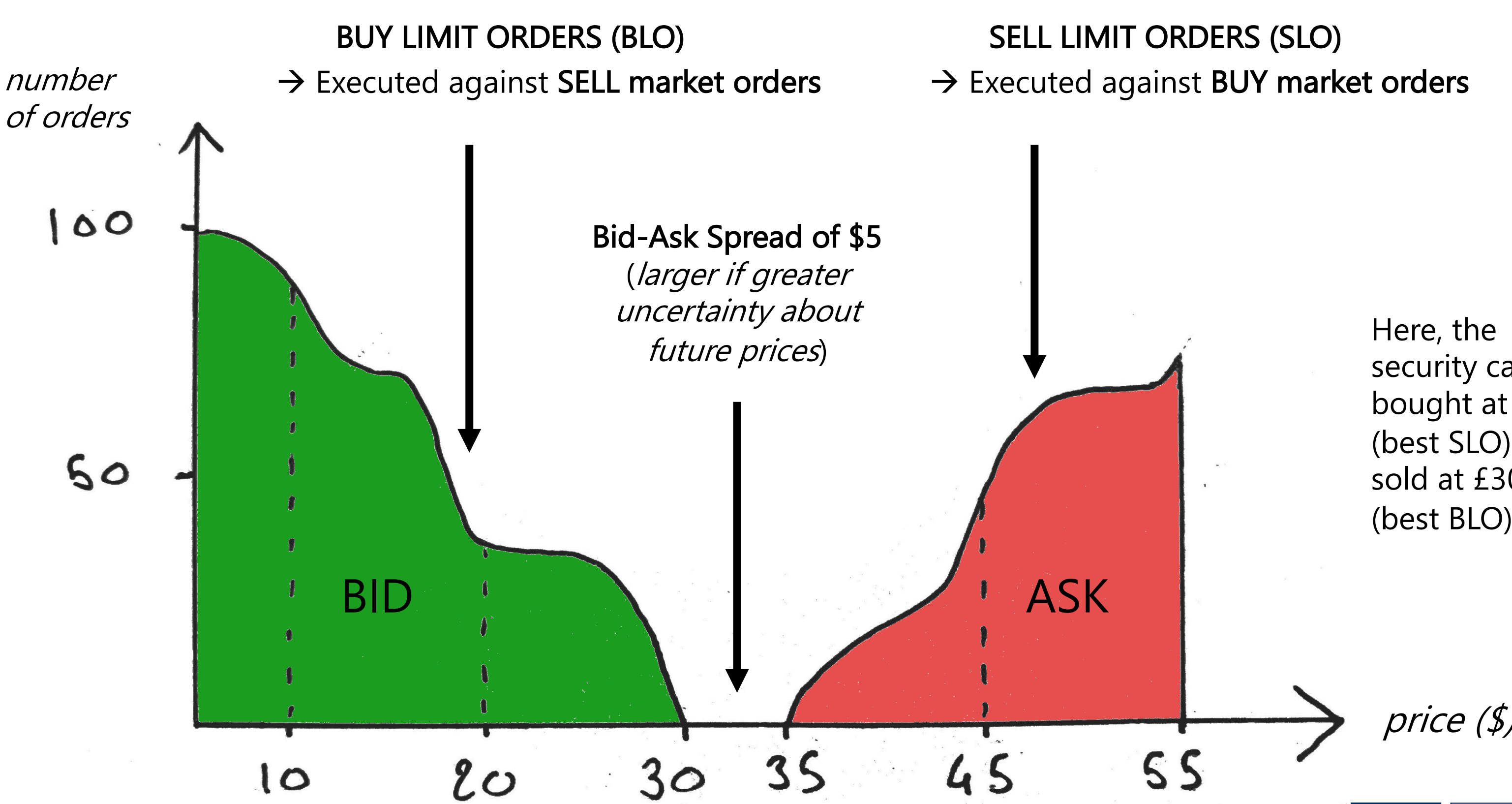
PART I — Economics of Market Manipulation

Market manipulation has a **microeconomic** impact (specific market)…

Which may have **macroeconomic / systemic** consequences (financial markets at large).

PART I — Economics of Market Manipulation

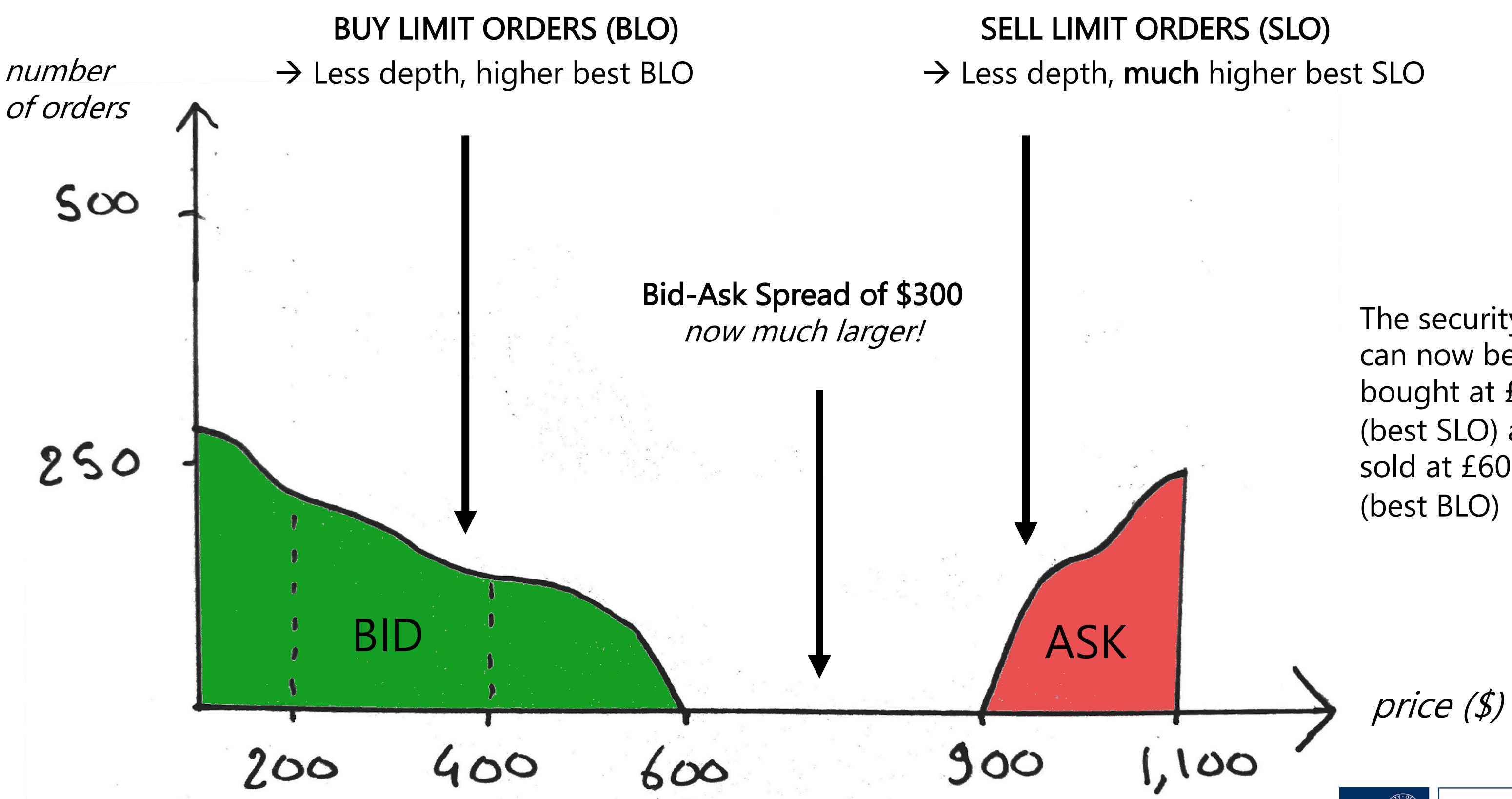
❖ Technical Perspective: the Order Book in ‘Normal’ Times



Here, the security can be bought at £35 (best SLO) and sold at £30 (best BLO)

PART I — Economics of Market Manipulation

❖ Technical Perspective: the Order Book in ‘Abnormal’ Times



The security can now be bought at £900 (best SLO) and sold at £600 (best BLO)

PART I — Economics of Market Manipulation

❖ Microeconomic Considerations

- For markets to be **efficient** (ie for capital to be allotted to its best use):
- Prices must reflect the fundamental value of companies whose shares are traded (**price accuracy**); and
- Trades must not be too costly & difficult to execute (**liquidity**)
- Manipulation leads to price inaccuracy and illiquidity, which is the primary reason why it is forbidden

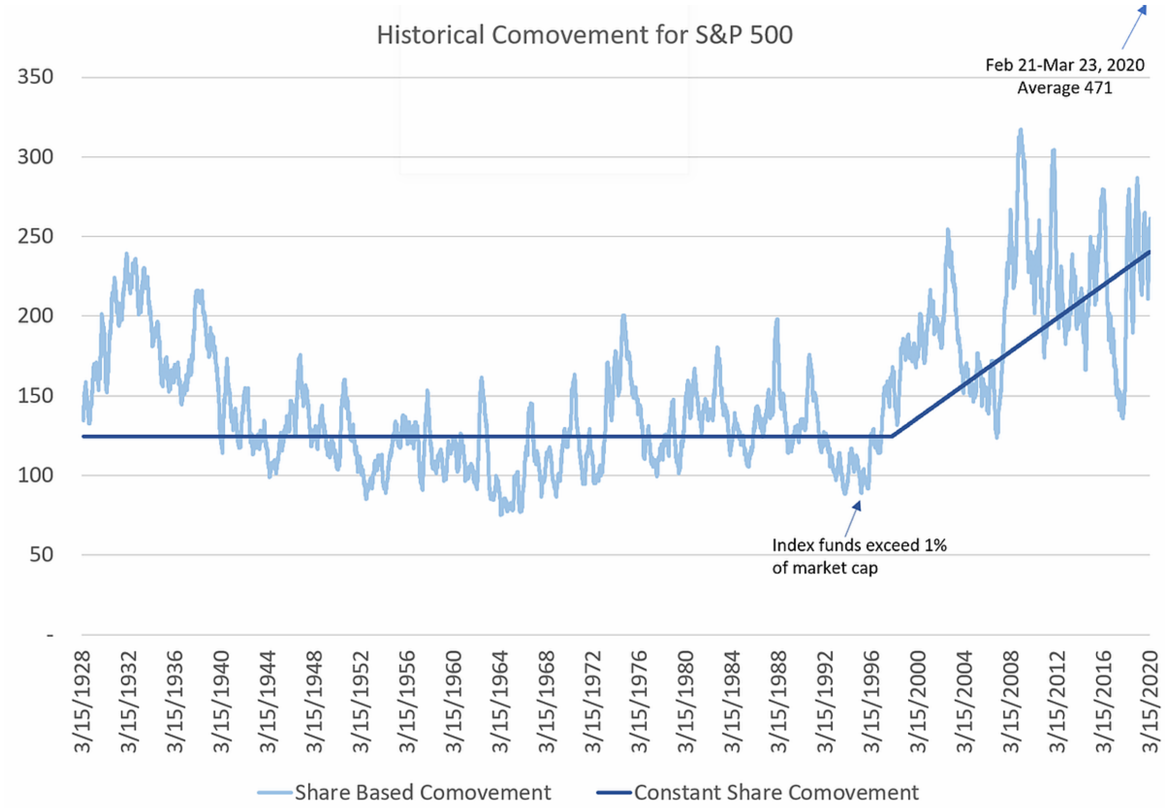
PART I — Economics of Market Manipulation

❖ Macroeconomic & Systemic Impact

- Microeconomic effects we just discussed can have macroeconomic consequences
- **GameStop**: less short sellers (discouraged by short squeezes) means less incentives to bet against companies → less incentives to do research on overvalued companies → **more volatility and asset price bubbles**
- This macroeconomic effect can itself be amplified by other factors and have **systemic** consequences: considerable increase in volatility and amplification of bubbles due to the increase in passive investment
- Not even to mention losses incurred by retail investors…
- Hence the importance of dissuading events such as those that surrounded GameStop

PART I — Economics of Market Manipulation

❖ Macroeconomic & Systemic Impact



Source: Logica Capital Advisers, LLC

PART II

A Critical Analysis of Market Manipulation Rules

PART II — A Critical Analysis of Market Manipulation Rules

❖ Texts

- Different definitions of market manipulation in the **US** (*Securities Exchange Act (SEA)*, 1934) and **EU** (*Market Abuse Regulation (MAR)*, 2014)

- **Abstract definitions** in both cases (necessary as defining market manipulation accurately is virtually impossible) but US definitions are more precise and restrictive

- **Illustrations**:

  - **EU** — **Art 12(1)(a) & (c) MAR**: 'entering into a transaction' or 'disseminating information' that 'secures, or is likely to secure, the price of one or several financial instruments [...] at an abnormal or artificial level'

  - **US** — **Art. 9(a)(5) SEA**: 'for a consideration, [...] to induce the purchase or sale of any security [...] by the circulation or dissemination of information to the effect that the price of any such security will or is likely to rise or fall because of the market operations of any one or more persons conducted for the purpose of raising or depressing the price of such security'

PART II — A Critical Analysis of Market Manipulation Rules

❖ **Can GameStop-Related Events be Considered as Manipulation?**

- Yes in the EU (subject to national authorities' interpretation)
- More difficult in the US
- Illustration: calls on retail investors to massively buy securities to provoke a short squeeze

PART II — A Critical Analysis of Market Manipulation Rules

❖ Do We Need Reforms?

- US: probably, EU: not necessarily, but ESMA guidelines might be useful

→ Whatever the rules adopted concretely, and at a minimum, acts that can be **reasonably anticipated to create an excessive microeconomic or macroeconomic risk** should be prosecuted

→ People (professional and retail investors alike) should be incentivised to be careful about the externalities of their acts for financial markets

PART II — A Critical Analysis of Market Manipulation Rules

❖ Where Are We Now?

- **February 18** — Hearings of the **US House Committee on Financial Services**
  - Discussions mainly focused on Robinhood's trading suspension and payment for order flow
  - Not much has been said about market manipulation rules
- **February 23** — Hearings of the **EU Committee on Economic and Monetary Affairs**
  - Various topics covered; emphasis put on differences between US and EU; concerns expressed about short selling and the possible need for lower disclosure threshold
  - Luis Garicano's intervention: ESMA guidelines would be a suitable answer to the risk of manipulation (yay!)

Contact

Paul Oudin
DPhil in Law, University of Oxford
Lawyer at the Paris Bar
Member of the Rules for Growth Institute
paul.oudin@law.ox.ac.uk