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GameStop and the Reemergence of the Retail Investor

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GAMESTOP AND THE REEMERGENCE OF THE RETAIL INVESTOR

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Abstract

The GameStop trading frenzy in January 2021 was perhaps the highest profile example of the reemergence of capital market participation by retail investors, a marked shift from the growing domination of those markets by large institutional investors. Some commentators have greeted retail investing, which has been fueled by app-based brokerage accounts and social media, with alarm and called for regulatory reform. The goals of such reforms are twofold. First, critics argue that retail investors need greater protection from the risks of investing in the stock market. Second, they argue that the stock market, in term, needs protection from retail investors.

This Article challenges calls for broad-based regulatory reform. It argues that, although retail investing is likely to impact the capital markets, claims about the harms from increased retail investing are overstated. More importantly, the debate overlooks potential benefits from retail investing both to investors themselves and the capital markets. Regulators should not be clamping down on the conditions such as commission-free trading, gamified trading platforms, and the expanded use of social media, that have enabled a generation of new investors to participate in the capital markets. These innovations, through their ability to facilitate direct market participation by retail investors have the potential to democratize the capital markets and increase the connections between ordinary citizens and U.S. businesses. Regulators should instead be focusing on how to facilitate the effectiveness of that process.

The Article defends the reemergence of the retail investor and its potential promise in enabling citizen capitalism – providing ordinary citizens with a stake in the nation's productivity while, at the same time, increasing the accountability of those businesses to societal interests. It explains that retail investment can reduce the increasing problematic power of institutional intermediaries. It also holds the possibility of increasing corporate consideration of stakeholder interests without the need for formal structural changes or heavy-handed regulation.

Critically, however, effective citizen capitalism requires retail shareholders to participate in the capital markets on an informed basis. Although the extent to which the GameStop frenzy reflected rational investing behavior is questionable, its effect has been to draw retail investors to the market, and there is evidence that retail investment and engagement will both continue and evolve. The Article identifies opportunities to improve the retail investing experience, including greater oversight of sources of investment information, limiting the manipulative use by brokers of customer information, and the extension of fintech innovation to mechanisms for improving financial literacy. Attention to these concerns, rather than heavy-handed efforts to discourage retail investing, will increase the effectiveness of the retail investor.

[**] Saul A. Fox Distinguished Professor of Business Law, University of Pennsylvania Law School. I am grateful for helpful comments from the participants in the Penn Law Faculty Ad Hoc workshop, the Southeastern Association of Law Professors Annual Meeting, the National Business Law Scholars Conference, the panel on the 21st Century Berle & Means Corporation: A Revolution in Retail Investing at Monash University and New Frontiers of Shareholder Engagement, Bocconi University.

Introduction

The GameStop trading frenzy in January 2021 marked a reemergence of the retail investor in the securities markets.[1] An unprecedented number of new and largely inexperienced investors opened app-based brokerage accounts and began trading so-called meme stocks – companies that included GameStop, AMC and Express.[2] Interest in these stocks – interest that critics argued was divorced from fundamentals -- was fueled by postings on social media.[3] The trading led to high levels of market volatility and charges of market manipulation.[4] Several hedge funds that shorted the meme stocks suffered significant trading losses,[5] at least one retail-oriented brokerage firm faced dramatically increased capital requirements forcing it to limit trading temporarily,[6] regulators demanded information[7] and, in 2021, Congress held four hearings.[8]

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[1] Historically most stock in the United States was owned by retail investors. Sarah Haan notes, for example, that "a 1948 survey of major manufacturing corporations found that 91% of common stockholders were individuals, and that individuals (men, women, and joint accounts) held a combined average of 59% of outstanding issues." Sarah Haan, *Corporate Governance and the Feminization of Capital*, Dec. 8, 2020, at n. 33, avail. at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3740608. Although institutional investors own 70-80% of most large public companies today, the institutionalization of the markets is a relatively recent phenomenon. See Jill E. Fisch, *Rethinking the Regulation of Securities Intermediaries*, 158 U. PA. L. REV. 1961, 1862-63 (2010) ("The ownership of public equity has shifted substantially from retail to institutional investors since Congress enacted the federal securities laws in the 1930s")

[2] See, e.g., Drew Harwell, *As GameStop stock crumbles, newbie traders reckon with heavy losses*, Wash. Post, Feb. 2, 2021, https://www.washingtonpost.com/technology/2021/02/02/gamestop-stock-plunge-losers/ (describing "newbie" investors who "plowed billions of dollars through Robinhood and other online brokerages into GameStop").

[3] See Reuters, *How 'dank memes' changed Wall Street: Understanding crazy Gamestop-Reddit phenomenon*, Fin. Exp. Jan. 30, 2021, https://www.financialexpress.com/investing-abroad/featured-stories/how-dank-memes-changed-wall-street-understanding-crazy-gamestop-reddit-phenomenon/2182611/ (describing the role of Reddit and other social media platforms).

[4] See, e.g., Dave Michaels, *GameStop Mania Is Focus of Federal Probes Into Possible Manipulation*, Wall St. J. Feb. 11, 2021 ("Federal prosecutors are investigating whether market manipulation or other types of criminal misconduct fueled the rapid rise last month in prices of stocks such as GameStop Corp.").

[5] See, e.g., Laurence Fletcher, *Hedge fund that bet against GameStop shuts down*, Fin. Times, June 22, 2021, https://www.ft.com/content/397bdbe9-f257-4ca6-b600-1756804517b6 (reporting "big losses" for Melvin Capital and Light Street Capital).

[6] See, e.g., Avi Salzman, GameStop's *January Trading Halt — and the Search for a Fix*, Forbes Feb. 26, 2021, https://www.barrons.com/articles/gamestop-trading-was-halted-by-a-plumbing-problem-there-could-be-a-fix-51614193956 (observing that "other brokers also placed limits on some transactions).

[7] The SEC, for example, both launched an investigation into the GameStop frenzy and initiated a request for information and public comments on digital engagement practices. See Thornton McEnery, Opinion: *After 9 months of investigation into GameStop stock frenzy, the SEC concludes that things got crazy for a second there*, MarketWatch, Oct. 18, 2021, https://www.marketwatch.com/story/after-9-months-of-investigation-into-gamestop-stock-frenzy-the-sec-concludes-that-things-got-crazy-for-a-second-there-11634592761 (describing the SEC's report following its nine-month investigation into the GameStop frenzy); SEC, Request for Information and Comments on Broker-Dealer and Investment Adviser Digital Engagement Practices, Related Tools and Methods, and Regulatory Considerations and Potential Approaches; Information and Comments on Investment Adviser Use of Technology to Develop and Provide Investment Advice, Release Nos. 34-92766, Aug. 27, 2021 (seeking information on the use of digital engagement practice by brokers and online trading platforms).

[8] See Game Stopped? Who Wins and Loses When Short Sellers, Social Media, and Retail Investors Collide: Hearing Before the H. Comm. on Fin. Servs., 113th Cong. (2021), https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=407107; Game Stopped? Who Wins and Loses When Short Sellers, Social Media, and Retail Investors Collide, Part II: Hearing Before the H. Comm. on Fin. Servs., 113th Cong. (2021), https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=406268; Game Stopped? Who Wins and Loses When Short Sellers, Social Media, and Retail Investors Collide, Part III: Hearing Before the H. Comm. on Fin. Servs., 113th Cong. (2021), https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=407748; Who Wins on Wall Street? GameStop, Robinhood, and the State of Retail Investing: Hearing Before the S. Comm. On

The GameStop frenzy may be a product of the times -- investors confined by the pandemic lockdown and flush with stimulus checks seeking a form of engagement and entertainment. Whether the new investors who downloaded the Robinhood and Webull apps, lured perhaps by free stock promotions and confetti, will continue as long-term direct investors or will move on with their lives as the economy reopens remains to be seen. Their emergence, however, raises serious questions about the role of retail investors in the capital markets.

In particular, the frenzy blindsided regulators that had largely become accustomed to the invisibility of the retail investor. In recent years, most retail investors' purchases were intermediated through diversified mutual funds, retirement plans and professional advisors.[9] The role of these intermediaries was to shelter retail investors from the risks associated with direct investing – the risks of poorly informed trades, insufficient diversification, costly products, and fraud.[10] Regulators focused their attention on protecting retail investors from these intermediaries by questioning the size and structure of their fees and seeking to mitigate potential conflicts of interest.[11]

The result of this intermediation was tremendous growth in the size and importance of institutional investors.[12] Institutional investors took up the mantle of effecting market discipline through their trading decisions.[13] Similarly, institutional investors became the driving force behind shareholder voting, most recently using the votes that they exercise on behalf of their beneficiaries to demand that issuers pay greater attention to ESG issues such as climate change. [14] Commentators now worry that institutional investors exercise too much power – that their herding behavior jeopardizes market stability and that their common ownership limits the competitive behavior of their portfolio companies.[15] Remarkably little attention is paid, however, to retail investors.

The GameStop frenzy upset these norms and, as such poses new challenges for capital market regulation. Critics argue that that retail investors need to be protected from the capital markets – from Reddit and gamification-fueled investments in meme stocks and from using margin trading and options in connection with those investments.[16] They further argue that the capital markets need to be protected from retail investors whose behavior contributes to market volatility, increases systemic risk, and undermines allocational efficiency.[17] Congress and the SEC are investigating a variety of regulatory changes in response to these concerns that could include restrictions on payment for order flow, transaction-based fees or taxes, limitations on the use of social media in connection with

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Banking, Hous., & Urban Affairs, 113th Cong. (2021), https://www.banking.senate.gov/hearings/who-wins-on-wall-street-gamestop-robinhood-and-the-state-of-retail-investing.

[9] See, e.g., Jill Fisch, *Mutual Fund Stewardship and the Empty Voting Problem*, __ Brooklyn J. Corp. & Comm. L. __ (forthcoming 2022) (observing that "institutional investors own 70-80% of the stock in large publicly-traded companies in the United States"); Fisch, *supra* note 1, at 1963 (reporting that 92% of the money in the mutual fund industry is contributed by the household sector).

[10] See, e.g., Jill Fisch, Tess Wilkinson-Ryan & Kristin Firth, *The Knowledge Gap in Workplace Retirement Investing and the Role of Professional Advisors*, 66 Duke L.J. 633 (2016) (reporting differences in financial literacy between ordinary people and investment professionals).

[11] See Fisch, *supra* note 1 at 1965 (reporting on regulatory efforts to address intermediary excessive fees and conflicts of interest).

[12] See John C. Coates, *The Future of Corporate Governance Part I: The Problem of Twelve* (Harvard Law Sch., Pub. Law Working Paper No. 19-07, 2018), https://ssrn.com/abstract=3247337.

[13] See, e.g., John C. Coffee, Jr., *Liquidity Versus Control: The Institutional Investor as Corporate Monitor*, 91 Colum. L. Rev. 1277 (1991) (evaluating institutions' use of exit and voice in monitoring their portfolio companies).

[14] See Fisch, *supra* note 9.

[15] See, e.g., C. Scott Hemphill & Marcel Kahan, *The Strategies of Anticompetitive Common Ownership*, 129 Yale L.J. 1392, 1397-98 nn. 12-14 (2020) (summarizing the common ownership literature).

[16] See *infra* notes __ through __ and accompanying text.

[17] See *infra* notes __ through __ and accompanying text.

securities trading, and increased compliance requirements for brokerage firms that serve the retail market.[18]

In considering whether a regulatory response to the GameStop frenzy is warranted, however, regulators should consider more carefully the potential costs and benefits of increased retail participation in the securities markets. This Article argues that existing calls for such a response have overstated the costs of retail trading and overlooked the benefits. In particular, the Article challenges the idea that it is somehow dangerous or inappropriate for retail investors to purchase securities that are traded in the highly regulated U.S. public markets, securities of corporations that publish reports, on a regular basis, about their financial condition and business operations that are audited and subject to SEC oversight for accuracy.

The central contribution of this Article is to make the affirmative case for the benefits of increased engagement by retail investors in the capital markets. The Article explains that retail investing has the potential to increase the involvement of ordinary citizens in the country's economic development. The current move has engaged a population that has not traditionally participated in the capital markets and offers them the potential to realize the economic rewards of such participation. Retail investing offers a valuable counterpoint to the increased concentration and herding by institutional investors, particularly the largest mutual fund sponsors. Finally, retail investing has the potential to enhance the accountability and legitimacy of business and its leaders.

This is not to understate the fact that a shift to increased retail investment creates new challenges and is likely to impose costs. Investors will make mistakes and lose money. Stock prices may be more volatile, and traditional market participants will have to adjust their behavior to account for the reemergence of retail. Rather than focusing on keeping retail investors out of the market, however, this Article argues that the lesson from the GameStop frenzy for regulators is the need to focus on understanding the new drivers of retail investing and how to ensure that those drivers can best promote informed and efficient investing behavior. Toward that end, the Article highlights the importance of focusing on the information sources used by retail investors, the possible misuse of customer information by app-based brokers, and the potential to harness the power of fintech to increase investor financial literacy.

The Article begins with a brief overview of the GameStop trading frenzy and its extension to broader direct retail participation in the capital markets. In addition to describing the trading history, the Article highlights the factors that likely contributed to the frenzy. Part II identifies the problems that have been attributed to the increased retail participation in the capital markets associated with the GameStop frenzy. In Part III, the Article critically evaluates these problems and argues that they are, for the most part, overstated. Part IV defends increased retail engagement with the capital markets both from the perspective of individual investors and broader society. Part V briefly identifies lessons from GameStop about how to improve the retail investing experience.

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[18] See, e.g., Letter from Elizabeth Warren to Acting Chair Allison Herren Lee, Jan. 28, 2021 https://www.warren.senate.gov/imo/media/doc/01.29.2021%20Letter%20from%20Senator%20Warren%20to%20Acting%20Chair%20Lee.pdf (asking the SEC what steps it will take "to ensure that securities markets better reflect prices that are in line with the intrinsic and fundamental value of underlying companies" and "to update and implement rules defining market manipulation"); SEC Chair Gary Gensler, *Prepared Remarks at the Global Exchange and FinTech Conference,* June 9, 2021, https://www.sec.gov/news/speech/gensler-global-exchange-fintech-2021-06-09 ("I've asked staff to make recommendations for the Commission's consideration on best execution, Regulation NMS, payment for order flow (both on-exchange and off-exchange), minimum pricing increments, and the NBBO, with the aim of continuing to make our markets as efficient as possible.").

I. Background – The GameStop Frenzy

Shares in GameStop stock increased from less than $4/share in July 2020 to as high as $483 in January 2021.[19] Millions of retail investors bought GameStop stock in early 2021, and on several days it was the most actively-traded stock on Wall Street.[20] Its price swings were so large that the New York Stock Exchange halted trading six times in a single day.[21] GameStop was the most visible of a number of so-called meme stocks that experienced similar retail investor interest and trading volatility.[22]

The GameStop story began with GameStop, a Fortune 500 company whose primary business is the sale of videogames and consumer electronics.[23] GameStop was founded in 1996, conducted its initial public offering in 2002, and its shares are listed on the New York Stock Exchange.[24] GameStop's business initially focused primarily on the sale of new videogames through its thousands of retail stores; it subsequently developed a distinctive business model of buying used videogames from its customers and reselling them.[25]

Over time, GameStop lost market share to competitors that relied on digitalized sales of downloadable games. It failed to earn a profit since 2017.[26] GameStop's poor financial condition was exacerbated when the March 2020 lockdown in response to the Covid-19 pandemic forced it to close its retail stores, many of which were in empty shopping malls.[27] In August 2020, GameStop stock was trading at around $4/share.[28]

Retail investor interest in GameStop began with a few small investors, including Keith Gill. According to his congressional testimony, Gill began to follow GameStop and to purchase its stock

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[19] Historical price data from Yahoo Finance show GameStop trading at an intraday price of $3.77 on July 20, 2020 and $483 on January 28, 2021, Yahoo! Finance, GameStop, Inc., Historical Data, https://finance.yahoo.com/quote/GME/history?period1=1485907200&period2=1643673600&interval=1d&filter=history&frequency=1d&includeAdjustedClose=true.

[20] Mark DeCambre, *GameStop's surge is making it one of the most traded stocks in the U.S.*, MarketWatch, Jan. 27, 2021, https://www.marketwatch.com/story/gamestops-stock-surge-is-making-it-one-of-the-most-traded-in-the-u-s-11611767301.

[21] Matthew Fox, *GameStop stock hit with 6 trading halts as volatility spike results in $176 daily trading range*, Markets Insider, Mar. 10, 2021, https://markets.businessinsider.com/news/stocks/gamestop-stock-price-trading-halts-volatility-spike-176-trading-range-2021-3.

[22] See Derek Horstmeyer & Valerie Mayer, *Meme Stocks and Systematic Risk*, Enterprising Investor, Aug. 9, 2021, https://blogs.cfainstitute.org/investor/2021/08/09/meme-stocks-and-systematic-risk/ (describing increased volatility associated with meme stocks).

[23] GameStop, Corporate Fact Sheet, https://news.gamestop.com/static-files/a07563a1-de5d-43d0-bb11-d6bfd309dacd.

[24] *Id.*

[25] Abha Bhattarai & Taylor Telford, *Despite record stock surge, GameStop is still struggling to stay afloat*, Wash. Post, Feb. 1, 2021, https://www.washingtonpost.com/business/2021/02/01/gamestop-retail-stores/

[26] *Id.*

[27] Shannon Liao, *GameStop closes all stores*, CNN.com, Mar. 22, 2020, https://www.cnn.com/2020/03/20/tech/gamestop-open-essential-business/index.html (reporting GameStop's decision to close all its stores as part of the March 2020 lockdown); Brian Sozzi, *GameStop stores are still empty despite Reddit-fueled trading frenzy*, Yahoo!Finance, Feb. 1, 2021, https://www.yahoo.com/news/game-stop-stores-are-still-empty-despite-redditfueled-trading-frenzy-172939409.html (observing that GameStop continued to struggle "with tepid mall traffic amidst the COVID-19 pandemic")

[28] Matthew Gault & Jason Koebler, *How Chaotic Redditors Made GameStop Stock Skyrocket (and Made Short Sellers Cry)*, Vice, Jan. 19, 2021, https://www.vice.com/en/article/qjpx8w/how-chaotic-redditors-made-gamestop-stock-skyrocket-and-made-short-sellers-cry

as early as 2019.[29] In August 2020 Gill publicly touted GameStop stock through a YouTube video that he posted.[30] Gill stated in the video that his interest in GameStop was based on several factors including a dedicated customer base for its legacy business and its potential to reinvent itself and capture a part of a "thriving $200 billion gaming industry."[31] In particular, Gill believed that GameStop could pursue new revenue streams by embracing the technology-driven digital economy.[32]

Gill decided to share his enthusiasm for GameStop on social media. In addition to YouTube, where he went by the name "Roaring Kitty", Gill, using the name "DeepF***ingValue" or "DFV," posted his views about GameStop to a chat forum hosted by Reddit, under the sub-community or subreddit "WallStreetBets."[33] Participants in WallStreetBets share an interest in stock and option trading. The r/wallstreetbets page was started in 2012 and gained millions of new followers during the pandemic lockdown and the related stock market volatility.[34]

Gill was not the only investor who viewed GameStop as an attractive investment. In August 2020, former Chewy co-founder Ryan Cohen publicly reported that he had purchased 9.6% of GameStop stock.[35] Cohen subsequently approached GameStop management and offered a plan to turn the company around. When his initial private overtures to the company were rebuffed, Cohen sent the GameStop board a public letter calling for a strategic review.[36] Cohen's efforts led the price of GameStop to increase from its August low.[37] However, GameStop reported "dismal" earnings on December 8, 2020, and the next day its stock price fell to $13.66/share.[38]

Some commentators anticipated that GameStop, like many other retailers, would file for bankruptcy as a result of the pandemic and the lockdown.[39] Despite Cohen's optimism, several hedge funds were skeptical that his plan would succeed in turning the company around and took substantial

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[29] Testimony of Keith Patrick Gill before the U.S. House Committee on Financial Services, Feb. 18, 2021, https://financialservices.house.gov/uploadedfiles/hhrg-117-ba00-wstate-gillk-20210218.pdf

[30] Keith Gill, *5 reasons GameStop stock (GME) is a roach not a cigar butt a la Warren Buffett & could short squeeze*, Youtube, Aug. 4, 2020, https://www.youtube.com/watch?v=JWdWCtLMoU0.

[31] Gill, *supra* note 29 at 3.

[32] *Id.*

[33] Julia-Ambra Verlaine & Gunjan Banerji, *Keith Gill Drove the GameStop Reddit Mania. He Talked to the Journal*, Wall St. J., Jan. 29, 2021, https://www.wsj.com/articles/keith-gill-drove-the-gamestop-reddit-mania-he-talked-to-the-journal-11611931696.

[34] See Catherine Thorbecke, *GameStop timeline: A closer look at the saga that upended Wall Street*, ABC News, Feb. 13, 2021, https://abcnews.go.com/Business/gamestop-timeline-closer-saga-upended-wall-street/story?id=75617315 (observing that r/wallstreetbets had 3 million members on Jan. 27, 2021 and more than 8 million by Feb. 3, 2021).

[35] See Schedule 13D filed by RC Ventures, LLC on Aug. 31, 2020, https://www.sec.gov/Archives/edgar/data/0001822844/000101359420000673/rc13da1-083120.htm.

[36] See Letter from RC Ventures LLC to GameStop Board of Directors dated Nov. 16, 2020, https://www.sec.gov/Archives/edgar/data/1326380/000101359420000821/rc13da3-111620.pdf.

[37] See Yahoo Finance, https://finance.yahoo.com/quote/GME/history?period1=1485907200&period2=1643673600&interval=1d&filter=history&frequency=1d&includeAdjustedClose=true (documenting a rise in GameStop's trading price to as high as $17.50/share.

[38] *Id.*

[39] See, e.g., Thomas S. Onder, *20 Retailers to Watch for a Bankruptcy Filing in the First Half of 2021*, Nat. L. Rev. Dec. 1, 2020, https://www.natlawreview.com/article/20-retailers-to-watch-bankruptcy-filing-first-half-2021 (including GameStop on list of 20 retailers to watch for a bankruptcy filing in the first half of 2021).

short positions.[40] By the end of the year, approximately 140% of GameStop's public float had been sold short.[41]

What followed was strange combination of events. Gill's postings excited an increasing number of retail investors who followed the r/wallstreetbets page, including many who sought to squeeze the short sellers by purchasing GameStop stock and driving up the price. New investors opened brokerage accounts to invest in GameStop, and investor interest expanded from GameStop to other meme stocks -- stocks that included AMC, Blackberry and Nokia (collectively BANG) as well as Koss, Tilray, Bed Bath & Beyond and Microvision.[42] These stocks saw their prices increase in response to interest on social media.[43] They also experienced substantial volatility.[44] According to one source, the GameStop frenzy led 28% of U.S. investors to invest in GameStop or other meme stocks in January 2021.

In January 2021, GameStop announced that it was receptive to Cohen's plan and agreed to add him and two other former Chewy executives to its board.[45] The combination of Cohen's activism and the pressure imposed on the short sellers led GameStop's price to increase dramatically and, in turn, those price increases fueled further purchases.[46] Social media posts encouraged investors to buy GameStop, contributing to the effort to drive prices higher.[47] Investor interest was also spurred by some high profile tweets, including posts by Elon Musk and Chamath Palihapitiya.[48] GameStop's relatively small market capitalization and the high level of short interest exacerbated the volatility of its stock price in response to these developments.[49]

Retail trading in GameStop was facilitated by the use of app-based brokers. Two of the most popular platforms were Robinhood and Webull.[50] Both were easy to use, allowed customers to open an account merely by downloading the app on their phone or mobile device, provided trading on the mobile platform, required no minimum account balance and did not charge account fees or

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[40] These included Melvin Capital and Citron Capital. Thorbecke, *supra* note 34.

[41] John McCrank, *Explainer: How were more than 100% of GameStop's shares shorted?,* Reuters, Feb. 18, 2021, https://www.reuters.com/article/us-retail-trading-shortselling-explainer/explainer-how-were-more-than-100-of-gamestops-shares-shorted-idUSKBN2AI2DD (reporting that "GameStop's peak short interest was 141.8% of its float on Jan. 4", 2021).

[42] Philip van Doorn, *We put AMC, GameStop and other meme stocks' numbers to the test — here's which ones came out on top*, MarketWatch, June 8, 2021, https://www.marketwatch.com/story/we-put-these-eight-meme-stocks-through-a-rugged-analytical-test-which-are-poised-for-growth-and-which-have-big-downsides-11622810160.

[43] Morningstar defines meme stocks as "stocks that see dramatic price increases, mostly fuelled [sic] by people on social media (primarily Reddit, Twitter and Tik Tok). These stocks rarely have company fundamentals that back the rise in price, and are often highly volatile" Ruth Saldanha, *What is a Meme Stock?,* Morningstar, June 15, 2021, https://www.morningstar.ca/ca/news/213048/what-is-a-meme-stock.aspx.

[44] van Doorn, *supra* note 42.

[45] Micah Maidenberg, *Chewy Co-Founder Joins GameStop's Board After Pushing Overhaul*, Wall St. J., Jan. 11, 2021, https://www.wsj.com/articles/chewy-co-founder-joins-gamestops-board-after-pushing-overhaul-11610378574.

[46] See *GameStop: Were The Short Sellers Routed? Does It Matter? (Beware The 'Gamma')*, Forbes.com, Mar. 19, 2021, https://www.forbes.com/sites/georgecalhoun/2021/03/19/gamestop-were-the-short-sellers-routed-does-it-matter-beware-the-gamma/?sh=4f76a30c4dae (explaining how stock price can respond to efforts by short sellers to cover their positions).

[47] Annabel Smith, *The Reddit revolt: GameStop and the impact of social media on institutional investors*, The Trade, Apr. 13, 2021, https://www.thetradenews.com/the-reddit-revolt-gamestop-and-the-impact-of-social-media-on-institutional-investors/.

[48] Thorbecke, *supra* note 34.

[49] Al Root, *GameStop Stock Volatility Could Get Even Worse. Here's Why*, Barron's Feb. 26, 2021, https://www.barrons.com/articles/gamestop-stock-volatility-could-get-even-worse-heres-why-51614360082.

[50] Others include Dough, Public and Firsttrade. Nikita Sheth, *How to get free stocks*, Finty, Dec. 15, 2021, https://finty.com/us/investing/free-stocks/.

commissions.[51] According to CNBC there were 3.7 million downloads of the Robinhood App in January 2021.[52] In addition to being easy to use, these trading apps courted investors by offering them free shares of stock for opening accounts or inviting friends to do so[53] and rewarding investors with confetti for actions like completing their first trade.[54] They also reinforced investor interest in GameStop and other meme stocks by providing investors with lists of popular and trending stocks.[55] The retail boon was not limited to platforms like Robinhood, however. Online broker Charles Schwab gained 4 million new investors in 2020, half of which were under 40.[56] Similarly Fidelity opened 12.7 new retail customer accounts.[57] Many investors opened brokerage accounts in response to the hype on r/wallStreetBets and looked to social media for guidance on their trading strategies.[58]

The unprecedented retail trading had systemic implications. On January 28, several retail trading platforms abruptly restricted transactions in GameStop and other meme stocks. Robinhood banned new purchases of thirteen stocks.[59] Webull imposed trading restrictions on three stocks.[60] TD Ameritrade announced that it was restricting trading in GameStop and AMC.[61] Schwab tightened its restrictions on investors' ability to purchase certain meme stocks on margin.[62] Interactive Brokers Group announced that investors could only unwind but not establish new options positions in five meme stocks.

Critics of the trading halts argued that the brokers were seeking to protect hedge fund short sellers from the impact of further price increases.[63] The brokers offered different but varying explanations.

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[51] Barbara Friedberg & Benjamin Curry, *Webull vs Robinhood: Which Is Better?,* Forbes Advisor, Jan. 20, 2022, https://www.forbes.com/advisor/investing/webull-vs-robinhood/#:~:text=Robinhood%20includes%20it%20with%20its,balance%20requirement%20to%20get%20started..

[52] Maggie Fitzgerald, *The GameStop mania might be over, but retail investors look here to stay*, CNBC, Feb. 13, 2021, https://www.cnbc.com/2021/02/13/why-retail-investors-are-here-to-stay.html.

[53] See Sheth, *supra* note 50 (describing details of free stock promotions on multiple trading platforms).

[54] See David Ingram, *Designed to distract: Stock app Robinhood nudges users to take risks*, NBC News, Sept. 12. 2019, https://www.nbcnews.com/tech/tech-news/confetti-push-notifications-stock-app-robinhood-nudges-investors-toward-risk-n1053071 (reporting concerns that Robinhood's platform design has "elements of fun" that may encourage users to "develop risky habits that will cost users money over time.").

[55] See, e.g., Roberto Stein, *The Top 5 predictable effects of new entries in Robinhood's "100 Most Popular" list*, Oct. 7, 2020, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3694588 (empirically analyzing the effect of inclusion in Robinhood's "100 most popular" list on the trading behavior of Robinhood users).

[56] Stephen McBride, *Millennials Will Propel Stocks Higher For Years*, Forbes, Feb. 8, 2021, https://www.forbes.com/sites/stephenmcbride1/2021/02/08/millennials-will-propel-stocks-higher-for-years/?sh=56856fff6e5d

[57] Justin Baer, *Fidelity, Once Stodgy and Adrift, Bets on the Reddit Crowd*, Wall St. J., Jan. 25, 2022, https://www.wsj.com/articles/fidelity-once-stodgy-and-adrift-bets-on-the-reddit-crowd-11643125668.

[58] Robinhood, for example, reported that the number of funded accounts increased from 7.2 million in March 2020 to 18 million in March 2021. Adelia Cellini Linecker, *Robinhood IPO To Tap Meme Stocks Crowd As Filing Reveals Soaring Growth*, Investor's Business Daily, July 1, 2021, https://www.investors.com/news/robinhood-ipo-to-tap-meme-stock-crowd-huge-share-for-retail-investors/.

[59] Brian Barrett, Robinhood Restricts GameStop Trading—in a Bid to Save Itself, Wired, Jan. 28, 2021, https://www.wired.com/story/robinhood-gamestop-stock/.

[60] James Crowley, *Webull Follows Robinhood in Blocking GameStop, AMC Trades After Being Suggested as Alternate Trading Platform*, Newsweek, Jan. 28, 2021, https://www.newsweek.com/webull-blocks-gamestop-amc-transactions-stock-market-robinhood-1565172.

[61] Mark DeCambre *GameStop and AMC trading restricted by TD Ameritrade, Schwab, Robinhood others*, MarketWatch, Jan. 28, 2021, https://www.marketwatch.com/story/gamestop-amc-trading-is-now-being-restricted-at-td-ameritrade-11611769804.

[62] *Id.*

[63] See, e.g., Barrett, *supra* note 59 ("Many of Robinhood's detractors accuse the company of acting in the interest of institutional short sellers rather than the individual retail investors that rely on it").

Schwab, Webull and TD Ameritrade, for example, cited volatility and market instability.[64] Robinhood, explained its actions as resulting from dramatically-increased capital requirements and costs associated with clearing the trades.[65] Most of the trading restrictions were removed within a single day. Robinhood announced that it had raised more than $1 billion of new capital to meet the capital requirements.[66] Despite the relatively short duration of the trading halts, they sparked outrage among investors and led some lawmakers to call for congressional hearings.[67] Dozens of lawsuits were filed against Robinhood and other companies.[68]

In subsequent months, Ryan Cohen succeeded in becoming chairman of GameStop and replaced its board of directors and executive team, an effort that including hiring a new CEO from Amazon.[69] Whether the new team will be successful in turning the company around remains to be seen. Although the stock price has not risen to anywhere near its January 2021 high, it has traded near or above $100/share consistently.[70]

Interest in meme stocks has declined since the winter of 2021, although retail investors have not dropped out of the market.[71] As pandemic-related restrictions are lifted and people return to offices and social interactions, the appeal of app-based stock trading and social media may fade, as will the liquidity provided by the pandemic stimulus checks. At the same time, the GameStop frenzy has left millions of new investors with brokerage accounts, making retail investor engagement in the capital markets an issue of ongoing concern.[72]

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[64] DeCambre, *supra* note 61; Crowley, *supra* note 60.

[65] See Testimony of Vladimir Tenev, Hearing before the US House of Representatives Committee on Financial Services, Feb. 18, 2021, at 2, https://context-cdn.washingtonpost.com/notes/prod/default/documents/68530c1f-5838-4653-9147-5a342335ea6e/note/a18d56f0-fd03-4dd9-b66b-988ebe166e9f.#page=1 ("the trading limits we put in place on GameStop and other stocks were necessary to allow us to continue to meet the clearinghouse deposit requirements that we pay to support customer trading on our platform.").

[66] Kate Kelly, Erin Griffith, Andrew Ross Sorkin & Nathaniel Popper, *Robinhood, in Need of Cash, Raises $1 Billion From Its Investors*, N.Y. Times, Jan. 29, 2021, https://www.nytimes.com/2021/01/29/technology/robinhood-fundraising.html

[67] Katherine Fung, *Alexandria Ocasio Cortex calls Robinhood's Block on Trading GameStop, Other Stocks, 'Unacceptable'*, Newsweek, Jan. 28, 2021, https://www.newsweek.com/alexandria-ocasio-cortez-calls-robinhoods-block-trading-gamestop-other-stocks-unacceptable-1565174 (citing AOC's tweet calling Robinhood's trading halt "unacceptable").

[68] Amanda Bronstad, *Lawsuits Over GameStop Trading Expand Beyond Robinhood, Alleging an Antitrust Conspiracy*, Nat. L J., Feb. 9, 2021, https://www.law.com/nationallawjournal/2021/02/09/lawsuits-over-gamestop-trading-expand-beyond-robinhood-alleging-an-antitrust-conspiracy/(describing 42 lawsuits against 35 defendants including Robinhood). To date, those lawsuits have not been successful. See, e.g., Alexander Osipovich, *Robinhood Meme-Stock Negligence Suit Is Rejected by Judge*, Wall St. J., Jan. 27, 2022, https://www.wsj.com/articles/robinhood-meme-stock-negligence-suit-is-rejected-by-judge-11643314436?cx_testId=3&cx_testVariant=cx_2&cx_artPos=1&mod=WTRN#cxrecs_s (describing dismissal of two lawsuits against Robinhood arising out of the trading halts).

[69] See Sarah E. Needleman, *GameStop's Power Player: How Outsider Ryan Cohen Wrested Control*, Wall St. J., Aug. 12, 2021, https://www.wsj.com/articles/gamestop-ryan-cohen-chewy-meme-stock-11628776861 (describing Cohen's acquisition of control over GameStop); Svea Herbst-Bayliss. *GameStop lures Amazon talent with grand plans and no frills*, Reuters, June 11, 2021, https://www.reuters.com/technology/gamestop-lures-amazon-talent-with-grand-plans-no-frills-2021-06-11/ (detailing Cohen's recruiting of former Amazon Australia chief Matt Furlong to serve as GameStop's new CEO).

[70] Yahoo! Finance, GameStop, Inc., *supra* note 19.

[71] Saqib Iqbal Ahmed, *Meme stock hangover: a year after GameStop, traders face gloomier markets*, Reuters, Jan. 28, 2022, https://www.reuters.com/business/finance/meme-stock-hangover-year-after-gamestop-traders-face-gloomier-markets-2022-01-28/.

[72] As of October 2021, Robinhood had more than 22 million funded accounts. Robinhood, *Robinhood Reports Third Quarter 2021 Results*, Oct. 26, 2021, https://investors.robinhood.com/news/news-details/2021/Robinhood-Reports-Third-Quarter-2021-Results/default.aspx#:~:text=Net%20Cumulative%20Funded%20Accounts%20increased,the%20third%20quarter%20of%202020

Some have called for regulatory intervention.[73] Senator Elizabeth Warren wrote to the SEC demanding that it respond to the GameStop frenzy.[74] Commonly-voiced concerns include that investors, either individually or collectively, used social media to manipulate the price of GameStop and that Robinhood violated securities laws by temporarily restricting investors from purchasing GameStop stock.[75] The SEC released a request for comment on digital engagement practices (DEP), citing the potential for DEP, including the gamification of stock trading through brokerage apps to lead to frequent or risky trading.[76] The SEC also announced that, in light of the GameStop frenzy, it would review payment for order flow[77] and existing rules governing short selling.[78] In addition, the SEC staff released a report on October 11, 2021 stating that [t]he extreme volatility in meme stocks in January 2021 tested the capacity and resiliency of our securities markets in a way that few could have anticipated" and identifying aspects of the regulatory framework that warranted further study.[79] To date, the SEC has not announced any findings of illegal manipulation; nor has it adopted new rules.

In December 2020, the Massachusetts Attorney General filed an administrative complaint against Robinhood accusing it of presenting stock trading as a game and taking advantage of inexperienced investors.[80] In April, 2021, regulators sought to amend the claim to revoke Robinhood's registration as a broker-dealer in Massachusetts.[81] In July 2021, Robinhood disclosed investigations by a variety of other regulators, including the states of New York and California as well as the Financial Industry Regulatory Authority.[82] The disclosure followed the announcement that Robinhood had agreed to pay

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73 See, e.g., James J. Angel, *Gamestonk: What Happened and What to Do about It* (March 1, 2021), https://ssrn.com/abstract=3782195 (advocating reforms to the regulation of short selling and broker dealer compensation practices); Written Testimony of Gina Gail Fletcher before the United States Senate Committee on Banking, Housing, and Urban Affairs, March 9, 2021, at 13 (urging regulators to be "more thoughtful about what financial products are available to retail investors."); Kyle Langvardt & James Fallows Tierney, *On "Confetti Regulation": The Wrong Way to Regulate Gamified Investing*, 131 Yale L.J. F. 717, 737 (2022) (advocating regulating app-based design features that encourage excessive trading through the concept of "behavioral churning"). See also Ryan Clements *Misaligned Incentives in Markets: Envisioning Finance That Benefits All of Society,* 19 DePaul Bus. & Comm. L.J. 1, 61 (2021) (citing a range of potential regulatory responses to the GameStop frenzy including "including changes to trading halts, increasing capital requirements on hedge funds, increasing transparency and limiting stock buybacks, consumer protection measures, and imposing disclosure requirements on social media platforms and forums like Reddit where sophisticated investors (like hedge funds) can exploit novice investors with the protection of anonymity").

74 Warren Letter*, supra* note 18.

75 Lucas Manfredi, *GameStop's big day as shares sit with 1,492% annual gain*, Fox Business, June 9, 2021, https://www.foxbusiness.com/markets/gamestop-stock-meme-earnings-ryan-cohen-chewy.

76 Request for Information and Comments on Broker-Dealer and Investment Adviser Digital Engagement Practices, Exchange Act Release No. 92766, 86 Fed. Reg. 49067, at 8-9 (Sept. 1, 2021) (Request for Comment on DEP).

77 Dave Michaels, *GameStop Saga Prompts SEC to Weigh Review of Payment for Order Flow*, Wall St. J., Mar. 9, 2021, https://www.wsj.com/articles/gamestop-saga-prompts-sec-to-weigh-review-of-payment-for-order-flow-11615316739

78 Katanga Johnson, *U.S. SEC chair says reviewing short-selling, swap rules after GameStop, Archegos sagas*, Reuters, May 5, 2021, https://www.reuters.com/business/us-sec-chief-plans-scrutinize-short-sellers-rein-gamification-following-gamestop-2021-05-05/.

79 U.S. Sec. & Exch. Comm'n, Staff Report on Equity and Options Market Structure Conditions in Early 2021, 43 (2021), https://www.sec.gov/files/staff-report-equity-options-market-struction-conditions-early-2021.pdf (hereafter SEC Staff Report).

80 Administrative Complaint, Robinhood Financial, LLC, No. E-2020-0047 (Mass. Sec. Div. Dec. 16, 2020), Administrative Complaint, Robinhood Financial, LLC, No. E-2020-0047 (Mass. Sec. Div. Apr. 15, 2021).

81 Nate Raymond*, Massachusetts regulators seek to revoke Robinhood's license; brokerage sues*, Reuters, Apr. 15, 2021, https://www.reuters.com/technology/robinhood-sues-invalidate-massachusetts-fiduciary-rule-2021-04-15/; Motion for Leave to File Amended Administrative Complaint, Robinhood Financial, LLC, No. E-2020-0047 (Mass. Sec. Div. Apr. 15, 2021).

82 Chris Prentice & Michelle Price, *Explainer: The regulatory and legal headwinds facing Robinhood*, Reuters, July 2, 2021, https://www.reuters.com/technology/regulatory-legal-headwinds-facing-robinhood-2021-07-02/.

the Financial Industry Regulatory Authority (FINRA) a $70 million penalty to settle allegations of wrongdoing.[83]

To date Congress has held four hearings to investigate the GameStop frenzy, three by the House Committee on Financial Services and one by the Senate Committee on Banking, Housing and Urban Affairs. The first House hearing featured testimony by Robinhood CEO Vlad Tenev, Keith Gill and representatives from Reddit, Citadel and Melvin Capital.[84] The second included testimony by academics and other experts.[85] SEC Chair Gary Gensler, CEO of the Depository Trust & Clearing Corporation and FINRA CEO Robert Cook testified at the third hearing.[86] Finally the Senate hearing featured various researchers on capital markets.[87] At the hearings, members of Congress and witnesses explored various potential concerns raised by the GameStop frenzy and debated a range of potential regulatory responses.[88]

II. Addressing the GameStop Frenzy

Commentators have identified two distinctive sets of regulatory concerns arising out of the GameStop frenzy. One set focuses on investor protection. Based on the premise that retail investors, particularly those who participated in the frenzy, are vulnerable, the concerns cite the potential that others, including other investors, social media platforms and brokerage firms, could exploit that vulnerability.[89] The core theme is a need to protect retail investors from the market.

A separate set of concerns focuses on the market impact of the GameStop frenzy rather than the impact on individual market participants.[90] These concerns are motivated less by paternalism than the prospect that price irrationality, volatility and heavy trading volume have systemic consequences. As a result, these commentators seek to protect the market from retail investors.

This part considers and evaluates both sets of concerns.

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[83] *Id.*

[84] Andrew Ross Sorkin, Jason Karaian, Michael J. de la Merced, Lauren Hirsch & Ephrat Livni, *'Something Very Wrong Happened Here'*, N.Y. Times Dealbook, Feb. 19, 2021, https://www.nytimes.com/2021/02/19/business/dealbook/robinhood-hearing-congress.html.

[85] Matt Phillips, *Congress hears testimony again on GameStop, focusing on the financial plumbing behind the frenzy*, N.Y. Times, Mar. 17, 2021, https://www.nytimes.com/2021/03/17/business/gamestop-hearing.html.

[86] SIFMA, *House Financial Services Committee GameStop Hearing Pt. 3*, May 6, 2021, https://www.sifma.org/resources/general/house-financial-services-committee-gamestop-hearing-pt-3/

[87] Who Wins on Wall Street? GameStop, Robinhood, and the State of Retail Investing, Hearing before the U.S. Senate Comm. On Banking, Housing and Urban Affairs, Mar. 9, 2021, https://www.banking.senate.gov/hearings/who-wins-on-wall-street-gamestop-robinhood-and-the-state-of-retail-investing.

[88] See, e.g., Cora Leeuwenburg, *An Update on the Gamestop Frenzy: Calls for Regulation and a Congressional Hearing, Inside Compliance*, March 19, 2021, http://blogs.luc.edu/compliance/?p=3770 (describing regulatory changes proposed during the Senate hearing).

[89] See, e.g., Bob Pisani, *Wall Street worries about regulatory fallout from the GameStop saga*, CNBC, Feb. 4, 2021, https://www.cnbc.com/2021/02/04/wall-street-worries-about-regulatory-fallout-from-the-gamestop-saga.html (describing concerns expressed by FINRA that "the gamification may have caused investors to trade excessively or make investments not suitable for them").

[90] See, e.g., Kevin Stankiewicz, *Massachusetts regulator says GameStop speculation is a danger to the whole market, as TD Ameritrade restricts trading*, CNBC (Jan. 27, 2021), https://www.cnbc.com/2021/01/27/gamestop-speculation-is-danger-to-whole-market-massachusetts-regulator.html; (describing statement by Massachusetts Secretary of the Commonwealth Williams Galvin that the GameStop frenzy "presents a broader threat to the U.S. equity market"); David Randall, *Analysis: A tulip by another name? 'Gamestonk' and the case for investor caution*, Reuters, (Jan. 30, 2021), https://www.reuters.com/article/us-retail-trading-bubbles-analysis-idUSKBN29Z0HG. (quoting finance professor Ronnie Sadka stating that "Retail investors are becoming a systemic risk").

A. Protecting Retail Investors from the Market

Commentators have written extensively about the retail investors who were caught up in the "meme" stock trading frenzy. As the articles note, a substantial number were inexperienced investors for whom the investment in GameStop and perhaps other meme stocks was their first venture into the capital markets.[91] The investors who use Robinhood and other app-based trading platforms such as Webull tend to be younger and to hold fewer assets than traditional retail investors. They also tend to be small investors. For example, the median account size at Robinhood is $240.[92] Survey evidence suggests that new traders are overly optimistic about the likelihood that they will make money through their trading.[93]

Critics warn that these investors are likely to lose money, money that they cannot not afford to lose.[94] As one put it, "fledgling investors, many of whom started trading on free trading apps like Robinhood during the pandemic, might not understand the intricacies of what is happening, leading to some incredibly risky bets with money they can't afford to lose."[95] Another observed that "for many [investors] who are younger and less experienced, meme investing ratchets the old idea of a stock tip up to a whole new level of virality and financial risk."[96]

The potential vulnerability of meme investors is increased by the mechanisms by which they are trading. Some of these new investors engage in substantial margin trading – trading with borrowed funds rather than using cash deposited in their accounts.[97] The allure of app-based trading and the hype associated with meme stocks may cause retail investors both to trade excessively and to incur excessive debt. Margin trading increases the risk associated with trades both by increasing an investor's exposure to the market and by creating the potential for an investor to lose more than he or she can afford.[98] As former TD Ameritrade CEO Joe Moglia explained "leverage . . . can rip your

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[91] See, e.g., Katie Martin & Robin Wigglesworth, *Rise of the retail army: the amateur traders transforming markets*, Fin. Times, March 9, 2021, https://www.ft.com/content/7a91e3ea-b9ec-4611-9a03-a8dd3b8bddb5 (reporting that "A Deutsche Bank survey found that almost half of US retail investors were completely new to the markets in the past year.").

[92] Keris Lahiff, *Robinhood debuts on Nasdaq – Jim Cramer and others share their take*, CNBC, July 29, 2021, https://www.cnbc.com/2021/07/29/robinhood-stock-nasdaq-ipo-jim-cramer-and-others-share-their-take.html#:~:text=The%20median%20Robinhood%20customer%20has,The%20average%20is%20about%20%245%2C000.

[93] Charles Schwab, Inc., *The Rise of the Investor Generation*, 2021, https://www.aboutschwab.com/generation-investor-study-2021 (reporting results of 2021 survey showing those who began investing in 2020 are more optimistic about the stock market).

[94] See Nathaniel Popper, *Robinhood Has Lured Young Traders, Sometimes With Devastating Results*, N.Y. Times, July 8, 2020, https://www.nytimes.com/2020/07/08/technology/robinhood-risky-trading.html (observing that the inexperience of Robinhood traders can lead them to experience "staggering losses").

[95] Alicia Adamczyk, '*You will lose your money very, very quickly': What investors need to know about GameStop's stock surge*, CNBC Make it, Jan. 27, 2021, https://www.cnbc.com/2021/01/27/what-to-know-about-gamestops-stock-spike.html.

[96] Rizwan Virk, *GameStop trades and meme investing turn stocks into a pump-and-dump scheme*, NBC News, Opinion, Feb. 14, 2021, https://www.nbcnews.com/think/opinion/gamestop-trades-meme-investing-make-stocks-ponzi-scheme-hurts-little-ncna1257680.

[97] Simon Constable, *Massive Margin Call Strikes Again In The Stock Market*, Forbes, Mar. 29, 2021, https://www.forbes.com/sites/simonconstable/2021/03/29/massive-leverage-strikes-again-in-the-stock-market/?sh=566f6c2a147f ("An army of individual investors used borrowed money to pile into the stock sending shares in the struggling company skyrocketing").

[98] See, e.g., U.S. Sec. & Exch. Comm'n, *Investor Bulletin: Understanding Margin Accounts* (June 10, 2021) https://www.sec.gov/oiea/investor-alerts-and-bulletins/ib_marginaccount (explaining that margin trading "exposes you to the potential for larger losses.");

arms off."[99] Indeed, data indicate that Robinhood customers were fourteen times more likely to default on their margin loans than the average investor.[100] Although the Federal Reserve limits the percentage of a securities purchase that can be financed through borrowing,[101] investors sometimes seek to circumvent these limits by using personal loans or credit card debt.[102] In addition, investors who purchase on margin bear the risk of a margin call which, if the customer lacks the cash to meet, could result in the broker automatically selling the customer's stock.[103]

Investor risk is further increased by the use of options. Options provide an alternative way to increase investor buying power and were cited as a substantial factor increasing the demand for GameStop stock.[104] Inexperienced traders are unlikely to understand how options work, however, or to evaluate the risk associated with their positions accurately. Although the brokerage industry imposes safeguards designed to limit the use of options by inexperienced investors, Robinhood has been criticized for failing to deploy these safeguards effectively and allowing inexperienced investors to access margin loans and options too easily.[105] One Robinhood investor, a 20-year-old student, committed suicide after his options trading through his Robinhood account led him to believe he had a negative $730,000 account balance.[106]

A related concern is that retail customers are not really investing in meme stocks bur rather are gambling.[107] To many, purchases of meme stocks appear irrational and untethered to fundamentals. Traders may be seduced by a combination of the trading apps they use and the social media platforms from which they obtain their trading information. Terming the apps on which these investors trade gamified and addictive, commentators chastise the platforms for pushing investors into inappropriate

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99 Carla Mozee, *Leverage 'can rip your arms off,' former TD Ameritrade boss says in warning to meme-stock retail traders*, Markets Insider, June 4, 2021, https://markets.businessinsider.com/news/stocks/meme-stock-leverage-warning-ex-td-ameritrade-boss-amc-reddit-2021-6.

100 Stephen Gandel, *Robinhood offers loans to buy stock — they were 14 times more likely to default*, CBS News, Feb. 5, 2021, https://www.cbsnews.com/news/robinhood-stock-loans-were-14-times-more-likely-to-default-than-rivals/. One possible explanation is that Robinhood was more aggressive in enabling its customers to borrow because of the interest that it earned on those margin loans. See *id* (describing stock lending as "one of Robinhood's few profit centers").

101 See *Understanding Margin Accounts*, *supra* note 98 (explaining that "According to Regulation T of the Federal Reserve Board, you may borrow up to 50 percent of the purchase price of margin securities).

102 Lance Roberts, *This Won't End Well – Gen Z'ers Take On Debt To Invest*, RIA Advice, Aug. 27, 2021, https://realinvestmentadvice.com/this-wont-end-well-gen-zers-take-on-debt-to-invest/ (reporting that many individual investors "took out personal loans or went into credit card debt" to fund their stock purchases).

103 Mozee, *supra* note 99.

104 David Borun, *How Options Trading is Fueling the GameStop Rally*. Nasdaq, Jan. 26, 2021, https://www.nasdaq.com/articles/how-options-trading-is-fueling-the-gamestop-rally-2021-01-26 (explaining how use of options increased GameStop demand and volatility).

105 See FINRA Press Release, FINRA Orders Record Financial Penalties Against Robinhood Financial LLC. June 30, 2021, https://www.finra.org/media-center/newsreleases/2021/finra-orders-record-financial-penalties-against-robinhood-financial (stating that Robinhood "failed to exercise due diligence before approving customers to trade options").

106 Sarah Jackson, *Robinhood has settled a lawsuit over the death of a 20-year-old who died by suicide last year thinking he lost $730,000 on the stock-trading app*, Insider, July 1, 2021, https://www.businessinsider.com/robinhood-settled-suit-suicide-20-year-old-trader-alex-kearns-2021-7. Robinhood settled a wrongful death lawsuit over the suicide for an undisclosed amount. *Id.*

107 See, e.g., Virk, *supra* note 96 ("most of the people putting money into the next big thing aren't really investing; they are truly just gambling online."); Madison Darbyshire, *Traders phone up gambling helplines as game-like broker apps spread*, Fin. Times, Oct. 7, 2021, https://www.ft.com/content/8f9bbc77-06b1-4fbd-8b7e-6e381ba038a7 (quoting Keith Whyte, the executive director of the National Council on Problem Gambling as stating that "the line between gambling and investing, which was already pretty fluid, has almost been completely erased").

trading decisions.[108] Trading platforms also increase herding by investors.[109] Sites such as Robinhood publish lists of stocks that are popular among their customers and push this information on the app.[110] Studies show that the inclusion of a stock in the list substantially increases customer trading of the stock.[111]

Critics also challenge brokerage firm conflicts of interest, observing that the business models of Robinhood and the other app-based brokers rely on trading to generate income.[112] Of particular concern is the fact that some trading apps earn a substantial amount of revenue from payment for order flow.[113] Payment for order flow occurs when brokers route their customer orders to wholesalers for execution rather than directly to an exchange. In turn, wholesalers pay the brokerage rebates in return for those orders.[114] In theory the rebate does not increase the cost of the trade to the customer, whose order must be executed at the best price available.[115] In reality, however, it is possible to generate price improvement for a customer in connection with a trade, and payment for order flow generally results in the broker rather than the customer receiving the benefit of any potential price improvement.[116]

Although payment for order flow has been around since the 1980s, it appears that Robinhood is the first trading platform to receive virtually all of its revenue from this source.[117] Robinhood earned an average of two-tenths of a penny for each share bought or sold.[118] Payment for order flow can create an incentive for a broker to encourage its customers to engage in more trading than is appropriate, given their investment objectives, a process that Kyle Langvardt and James Fallows

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[108] Darbyshire, *supra* note 107 (quoting the North American Securities Administrators Association as saying "By using features such as confetti, scratch-off style graphics and awards systems, certain firms are encouraging investors to make trades that may not be in their best interests and would conversely serve the interests of the broker-dealer,").

[109] See, e.g., Brad M. Barber, Xing Huang, Terrance Odean, & Christopher Schwarz, *Attention Induced Trading and Returns: Evidence from Robinhood Users* (October 12, 2021). __ J. Fin. __ (forthcoming), https://ssrn.com/abstract=3715077 (reporting that Robinhood focuses investor attention on certain stocks, encouraging herding and leading to lower investment returns).

[110] See Stein, *supra* note 55 (describing Robinhood's top 100 list).

[111] *Id.* (reporting that customers were 5 to 7 times likelier to buy stocks newly named to the top 100 list).

[112] See, e.g., Mark Schoeff Jr. & Nicole Casperson, *GameStop's saga: What the stock surge proves about financial (il)literacy*, Investment News, Apr. 12, 2021, https://www.investmentnews.com/gamestops-saga-what-the-stock-surge-proves-about-financial-literacy-205019. quoting William Galvin, secretary of the Commonwealth of Massachusetts ("Gamification strategies in the Robinhood app — like sending daily push notifications or displaying confetti raining down after each trade — are used to "lure customers" into consistent participation and long-term engagement with the platform, which, in turn, generates more revenue for the app.")

[113] See Avi Salzman, *SEC Chairman Says Banning Payment for Order Flow Is 'On the Table',* Barron's, Aug. 30, 2021, https://www.barrons.com/articles/sec-chairman-says-banning-payment-for-order-is-on-the-table-51630350595?mod=hp_LEAD_2 (reporting interview with SEC Chair Gary Gensler in which Gensler stated that banning payment for order flow is "on the table").

[114] *Id.*

[115] In reality, the requirement of best execution is somewhat lax. See, e.g., Robert P. Bartlett, *Modernizing Odd Lot Trading* (May 19, 2021). https://ssrn.com/abstract=3849763 (providing data demonstrating that odd lot trading rules reduce the impact of the best execution requirement for popular retail stocks on non-exchange trading venues).

[116] See Stanislav Dolgopolov, *Off-Exchange Market Makers and Their Best Execution Obligations: An Evolving Mixture of Market Reform, Regulatory Enforcement and Litigation*, 17 N.Y.U. J.L. & Bus. 477, 511 (2021) ("Robinhood explicitly offered to accept less price improvement for its customers than what the principal trading firms were offering, in exchange for receiving a higher rate of payment for order flow for itself.").

[117] John Mccrank, *Explainer: Robinhood makes most of its money from PFOF. What is it?,* Reuters, July 29, 2021, https://www.reuters.com/business/finance/robinhood-makes-most-its-money-pfof-what-is-it-2021-07-29/.

[118] Tomio Geron, *Data shows how Robinhood makes more money from its users than other brokers*, Protocol, July 5, 2021, https://www.protocol.com/fintech/payment-for-order-flow.

Tierney term behavioral churning.[119] As the SEC staff noted, payment for order flow "can create a conflict of interest for the retail broker-dealer" and that "payment for order flow and the incentives it creates may cause broker-dealers to find novel ways to increase customer trading, including through the use of digital engagement practices."[120]

Finally critics raise concern about the extent to which meme investors are influenced by social media.[121] Many investors opened brokerage accounts in response to the hype on the Reddit community known as WallStreetBets and look to social media (rather than trained investment professionals) for guidance on their trading strategies.[122] In particular, commentators warn that investors may simply be following a social trend rather than investing based on sound investment analysis.[123] The anonymity of these platforms also increases the potential for misinformation and even manipulation.[124] As the Washington Post observed: "With Reddit users cloaked in anonymity, there is no way of knowing whether messages touting GameStop come from average Joes — or scam artists executing a 'pump-and-dump' stock scheme."[125]

B. Protecting the Market from Retail Investors

The GameStop frenzy has also caused commentators to worry about the broader capital market impact of retail investing. Three related concerns dominate: volatility, systemic instability, and capital allocation.

As noted above, the price of GameStop and other meme stocks has been highly volatile. In a single day, GameStop's price swings led to six trading halts.[126] The level of short selling coupled with the use of margin trading and options to leverage demand, exacerbated these price swings.[127]

Volatility can exacerbate trading losses. It can generate higher levels of uninformed trading. And it can stress market mechanisms for pricing and clearing trades, lead to increased margin calls, and generate shortages in liquidity. The GameStop frenzy illustrated several of these concerns. The volatility of GameStop's price created pressure on the outstanding short positions, forcing short sellers to purchase stock, often at inflated prices, to cover mounting losses. Trading volatility led to concern by clearinghouses about the potential for failed trades, particularly when the trades were executed on margin. This in turn led those clearinghouses to demand higher deposits from retail brokerage firms

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119 Kyle Langvardt & James Fallows Tierney, *supra* note 73.

120 SEC Staff Report, *supra* note 79, at 12, 44.

121 See, e.g., Sue Guan, *Meme Investors*, Jan. 3, 2022 draft.

122 Investor Alert: *Thinking About Investing in the Latest Hot Stock? Understand the Significant Risks of Short-Term Trading Based on Social Media* (Jan. 29, 2021), available at https://www.investor.gov/introductioninvesting/general-resources/news-alerts/alerts-bulletins/investor-alerts/investor-62. One study demonstrated empirically that Reddit posts led to increased trading in GameStop shares. Andre Betzer & Jan Philipp Harries, *If he's still in, I'm still in! How Reddit posts affect GameStop retail trading*, May 10, 2021.

123 See, e.g., Reethu Ravi, *How Social Media Is Causing A Meme Stock Mania*, Jumpstart Mag., May 26, 2021, https://www.jumpstartmag.com/how-social-media-is-causing-a-meme-stock-mania/ ("meme stock investing often follow a social media trend rather than logical reasoning").

124 See, e.g., Brian O'Connell, *The Rise of Meme Stocks: How Viral Trading Hit High Gear in Early 2021*, FinMasters, Apr. 21, 2021, https://finmasters.com/the-rise-of-meme-stocks/ ("'Fraudsters may be emboldened to make false claims on anonymous internet forums.").

125 David J. Lynch, Hamza Shaban, Hannah Denham, & Tory Newmyer *Gamestop, AMC shares surge after Reddit users lead chaotic revolt against big Wall Street funds*, Wash. Post, Jan. 27, 2021, https://www.washingtonpost.com/business/2021/01/27/gamestop-amc-reddit-short-sellers-wallstreetbets/

126 Fox, *supra* note 21.

127 See SEC Staff Report, *supra* note 79.

such as Robinhood, which in turn led to the temporary halt, by many such firms in their customers' ability to trade meme stocks.[128]

One reason for these deposit requirements was the risk that failed trades impose on the system. If retail customers cannot pay for their trades, those losses may be passed on to brokerage firms and, in turn, affect the financial stability of counterparties to those trades or market intermediaries.[129] In the past, large losses suffered by a customer have had potentially significant marketwide impacts, as in the case of Long Term Capital Management.[130] The more recent Archegos case, in which a single family office's inability to meet margin calls triggered a $20 billion sell off in the market raised similar concerns.[131]

Although the GameStop frenzy does not appear to have had an impact on broader market stability,[132] commentators view retail trading as presenting a similar potential for systemic risk. Congressman Stephen Lynch warned about the potential of retail trading to fuel systemic risk.[133] Similarly Senator Elizabeth Warren noted that the GameStop frenzy and the level of speculation it involved could prompt broader market sell-offs.[134] She observed that the resulting market shift "also raises questions about broader instabilities in the market and financial system."[135]

Retail trading may also reduce liquidity.[136] Sue Guan demonstrates how coordinated retail trading could reduce liquidity by leader to wider spreads by liquidity suppliers and other market participants.[137] Reduced liquidity may lead to higher transaction costs and reduced market efficiency.[138]

The influx of retail market participants whose activities might be described as speculation rather than investing generates additional problems. Commentators warn that retail traders are "treating the stock market like a casino."[139] Market speculation both disrupts the link between prices and fundamental value[140] and reduces investor confidence. To the extent that prices are distorted, they affect issuers' costs of capital, enabling companies that do not have significant productive capacity to raise money more easily and raising the cost of capital for sound companies. AMC, for example, raised

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[128] See *infra* note _ and accompanying text.

[129] See SEC Staff Report, *supra* note 79 at 31 ("in highly volatile trading where share prices whipsaw by hundreds of dollars, NSCC may require more margin to guard against an increased risk of defaults").

[130] See, e.g., *President's Working Group on Financial Markets, Hedge Funds, Leverage, and the Lessons of Long-Term Capital Management* (1999), 17-19, https://www.treasury.gov/resource-center/fin-mkts/Documents/hedgfund.pdf (describing the potential market effect on counterparties if LTCM had failed).

[131] Will Daniel, *Retail trading was said to be a risk to markets during the GameStop saga, but the Archegos blowup has Reddit users pointing fingers back at Wall Street*, Markets Insider, Mar. 30, 2021, https://markets.businessinsider.com/news/stocks/reddit-retail-traders-systemic-risk-hedge-fund-archegos-liquidation-2021-3

[132] See Matt Phillips, Matthew Goldstein & Ephrat Livni, *S.E.C. Describes the GameStop Frenzy, but Not What to Do About It,* N.Y. Times, Oct. 18, 2021, https://www.nytimes.com/2021/10/18/business/sec-gamestop-meme-report.html (stating the SEC staff "found that everything worked largely the way it was supposed to").

[133] Daniel, *supra* note 131.

[134] Warren Letter*, supra* note 18.

[135] *Id.*

[136] Merritt B. Fox, Lawrence R. Glosten & Gabriel V. Rauterberg, *Stock Market Manipulation and Its Regulation*, 35 Yale J. on Reg. 67, 84 (2018) ("Liquidity is a multidimensional concept that relates to the size of a trade, the price at which it is accomplished, and the time it takes to accomplish the trade.")

[137] Guan, *supra* note 121 at 28.

[138] See Marcel Kahan, *Securities Regulations and the Social Costs of Inaccurate Stock Prices*, 41 Duke L.J. 977, 1019 (1992) (describing the costs resulting from reduced liquidity).

[139] Warren Letter*, supra* note 18.

[140] Alexander Kurov, *Wall Street isn't just a casino where traders can bet on GameStop and other stocks – it's essential to keeping capitalism from crashing*, The Conversation, Feb. 4, 2021, https://theconversation.com/wall-street-isnt-just-a-casino-where-traders-can-bet-on-gamestop-and-other-stocks-its-essential-to-keeping-capitalism-from-crashing-154154,

$1billion in capital while its stock price was buoyed by the meme stock boom, and GameStop raised $1.7 million.[141] Notably, in its prospectus, AMC cautioned investors that its current stock price reflect market dynamics unrelated to the company's fundamental value, stating that "we caution you against investing in our Class A common stock, unless you are prepared to incur the risk of losing all or a substantial portion of your investment."[142]

As one commentator observed,

> The capital markets exist to fund companies, create jobs, and drive our economy, while also helping millions of American families save for retirement, college, or to buy homes. Essential to the success of the markets is the notion that they are efficient, they reflect the allocation of capital to the most productive uses. Dramatic swings in share price, untethered from any rigorous economic analysis, and motivated by internet mob mentality, destroys this notion.[143]

III. Evaluating the Need for Reform

The foregoing concerns about the GameStop frenzy are legitimate. Many investors lost money, including some who lose money they could not afford to lose.[144] The price of GameStop stock fluctuated wildly, and the social media-fueled speculation spread from GameStop to a number of other companies. Social media-fueled trading sites present particular risks of fraud and manipulation, and app-based trading platforms challenge both existing broker-dealer practices and the manner in which those practices is regulated.

The link between these concerns and broadscale regulatory reform is, however, less compelling. While it is true that people can lose money through misguided stock purchases, people lose money in a variety of ways. People lose money by gambling, by spending too much on a trendy fashion item, or by incurring costly credit card debt. Although regulation seeks both to inform people about the consequences of these choices and to limit opportunism, a fundamental component of a free society requires people to be able to make choices with which others might disagree, and the proposition that unwise investing decisions should be prohibited reflects paternalism.

Paternalism seems particularly misplaced with respect to investments that, like the meme stocks involved here, were publicly-traded securities listed on national securities exchanges. [145]The extensive and expensive body of federal regulation was specifically designed to enable retail investors to purchase publicly-traded securities and to protect them when doing so. Federal securities regulation is premised on the idea, however, providing investors and the capital markets with full information is a

[141] Carleton English, *Taking Stock of Meme Mania Taking Stock of Meme Mania --- One year after it started, the Reddit-fueled trading boom is fizzling. Our reporter looks for answers*, Barron's Jan. 31, 2022.

[142] Steve Goldstein, *Here's AMC's blunt new warning to prospective buyers of its new stock offering*, MarketWatch, June 3, 2021, https://www.marketwatch.com/story/heres-amcs-blunt-new-warning-to-prospective-buyers-of-its-new-stock-offering-11622724514, quoting AMC Prospectus.

[143] Eric Wright, *Should the game stop with Gamestop?,* Colo. Tech. L.J., Feb. 2, 2021, https://ctlj.colorado.edu/?p=748.

[144] See Bailey Lipschultz, *Bed Bath & Beyond Tumble Shows the Risks of Chasing Meme Stocks*, Bloomberg, Sept. 30, 2021, https://www.bloomberg.com/news/articles/2021-09-30/bed-bath-beyond-tumble-shows-the-risks-of-chasing-meme-stocks (observing that many meme stocks have suffered substantial price declines since January 2021).

[145] For that reason, this Article focuses on meme stocks, and does not consider the extent to which its analysis extends to other financial instruments such as cryptocurrency or non-fungible tokens, which are not subject to the same regulatory scheme. See Victoria Chiu & Moin A. Yahya, *The Meme Stock Paradox*, 3 Corp. & Bus. L.J. 51, 61-62 (2022) (describing crashes in the price of Dogecoin and NFTs).

more desirable regulatory approach than having the federal government screen potential investments opportunities for safety or quality.[146]

In addition, the magnitude of harm to most individual investors associated with meme trading is quite small. A February 2021 poll found that, although 28% of survey respondent reported buying at least one meme stock, the median amount they invested was only $150.[147] Most investors did not buy stock on margin or to trade in options.[148] Of those who traded options, most used simple call options which enabled them to put down a smaller amount of money and profit if stock prices increased.[149] If stock prices fell, investors would simply lose the cost of the option. Significantly, investor losses were likely on the order of what they might have lost on a pre-pandemic trip to Las Vegas or Atlantic City.

Although meme trading might lead some to argue that retail investors are better off delegating their investment decisions to trained professionals,[150] commentators have long recognized that investing through intermediaries has flaws as well.[151] These include the sometimes significant fees charged by those intermediaries, problematic sales practices, conflicts of interest and simple incompetence – incompetence that retail investors may be poorly-positioned to identify.[152] There is also a curious sense of elitism reflected in the commentary. Only a small percentage of retail investors

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146 As Louis Brandeis put it, "Sunlight is said to be the best of disinfectants; electric light the most efficient policeman." LOUIS D. BRANDEIS, OTHER PEOPLE'S MONEY AND HOW THE BANKERS USE IT, 92 (1914).

147 Ethan Wolff-Mann, *28% of Americans bought GameStop or other viral stocks in January: Yahoo Finance-Harris Poll*, Yahoo!Finance, Feb. 9, 2021, https://www.yahoo.com/now/gamestop-amc-reddit-investing-213609595.html

148 See e.g., Testimony of Vlad Tenev, CEO of Robinhood: Hearing Before the H. Comm. on Fin. Serv., 117th Cong. (2021), https://context-cdn.washingtonpost.com/notes/prod/default/documents/68530c1f-5838-4653-9147-5a342335ea6e/note/a18d56f0-fd03-4dd9-b66b-988ebe166e9f.#page=1 (as of the end of 2020, only "about 13 percent of Robinhood customers traded basic options contracts (e.g., puts and calls), and only about two percent traded multi-leg options. Less than three percent of funded accounts were margin-enabled.").

149 See SEC Staff Report, supra note at 42 (reporting that the increased GameStop option trading "concentrated heavily in call options, a large percentage of which were short-dated"); Thyagaraju Adinarayan, *Retail trading fever drives U.S. equity option volumes to record monthly high*, Reuters, Feb. 3, 2021, https://www.reuters.com/article/us-retail-trading-options/retail-trading-fever-drives-u-s-equity-option-volumes-to-record-monthly-high-idUSKBN2A322R (observing that retail trading volume concentrated in call options which allowed investors to risk less money).

150 See SEC Chair Jay Clayton, *The Evolving Market for Retail Investment Services and Forward-Looking Regulation — Adding Clarity and Investor Protection while Ensuring Access and Choice*, May 2, 2018, https://www.sec.gov/news/speech/speech-clayton-2018-05-02 (observing that "markets can be intimidating and complex and … It is an investment professional's job to bridge this knowledge, information, and comfort gap.").

151 For a particularly colorful description of the extent to which securities firms have taken advantage of their retail customers see Robert Prentice, *Whither Securities Regulation? Some Behavioral Observations Regarding Proposals for its Future*, 51 Duke L.J. 1397, 1428-29 (2002).

152 See. e.g., Jerry W. Markham, *Regulating Broker-Dealer Investment Recommendations – Laying the Groundwork for the Next Financial Crisis,* 13 Drexel L. Rev. 377 (2021) (describing problematic broker dealer practices and regulatory efforts to combat those practices); Fisch, *supra* note 1, at 2000-2002 (describing abusive mutual fund sales practices by brokers); Council of Econ. Advisers, The Effects of Conflicted Investment Advice on Retirement Savings 26 (2015), https://www.whitehouse.gov/sites/default/files/docs/cea_ coi_report_final.pdf (stating that conflicted retirement advisors were costing Americans $17 billion/year).

own stock directly,[153] and that stock ownership is concentrated in rich white men.[154] For some, the prospect that app-based trading opens the capital markets to investors outside that narrow sphere suggests that something is wrong. But as SEC Commissioner Hester Peirce observes "telling investors they cannot make decisions for themselves only supports their suspicions that the capital markets are for the wealthy."[155]

The criticisms that have been leveled at app-based trading platforms like Robinhood's for gamifying stock trading are also problematic. As noted above, the SEC requested public comment on digital engagement practices, observing that game-like features and other design elements of the apps "may encourage investors to trade more often, invest in different products, or change their investment strategy."[156] The Massachusetts Attorney General brought an enforcement action against Robinhood for bringing gamification to investing.[157] Essentially, the complaint alleged that Robinhood's app, through devices such as displaying confetti after a customer traded, made investing in the stock market too attractive to young investors in an effort to generate greater engagement.[158] Better Markets describes the app as "incorporating addictive, endorphin-engendering game features."[159] Similarly, Healthy Markets argued to Congress that regulators should regulate the use of confetti and other "game-like features" in trading apps.[160]

It is unclear, however, why investing should not be fun. Gaming has become an increasing part of everyday life, and gamification has been used to promote user engagement across a variety of areas including healthcare, education and banking.[161] Gamification can help counteract some of the forces that lead people not to save and invest, such as the perception that investing is boring or complicated. In addition, gamification can have the positive effect of increasing people's motivation not just to invest but to invest successfully, leading to greater take-up of tools to increase financial literacy.[162] A 2021 Charles Schwab survey, for example, reported those who began investing in 2020 were "hungry for access to investing education and advice."[163]

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153 Ben Soppitt, *The Gamification Of Investing Brings Opportunity – And Risks*, Forbes, Jan. 8, 2021, https://www.forbes.com/sites/forbesbusinesscouncil/2021/01/08/the-gamification-of-investing-brings-opportunity--and-risks/?sh=5a96c02dc08e ("investing has historically been the preserve of a small but wealthy minority, with normal consumers excluded through a mixture of cost and lack of information, awareness and access due to the archaic nature of traditional investment methods").

154 Tim Smart, *Who Owns Stocks in America? Mostly, It's the Wealthy and White*, US News & World Report, Mar. 14, 2021, https://www.usnews.com/news/national-news/articles/2021-03-15/who-owns-stocks-in-america-mostly-its-the-wealthy-and-white.

155 SEC Commissioner Hester M. Peirce, *Remarks at Investor Advisory Committee Meeting*, Mar. 11, 2021, https://www.sec.gov/news/public-statement/peirce-statement-investor-advisory-committee-meeting-031121.

156 Request for Comment on DEP, *supra* note 76.

157 Administrative Complaint, *supra* note 80.

158 *Id.*

159 Letter from Better Markets to Janet Yellen, et al., Feb. 3, 2021, at 4, https://bettermarkets.org/sites/default/files/Better%20Markets%20Letter%20to%20FSOC%20Regarding%20Gamestop%202-3-2021.pdf.

160 Letter from Healthy Markets to HFSC Hearing, Feb. 17, 2021, at 19, https://healthymarkets.org/wp-content/uploads/2021/02/Letter-to-HFSC-Hearing-2-17-21.pdf.

161 *Gamification to stock fantasy - A new and eccentric idea for financial services to engage and educate customers*, Vinfotech, June 9, 2021, https://blog.vinfotech.com/fantasy-sports/gamification-and-stock-fantasy-a-new-idea-for-financial-services-to-boost-user-engagement

162 *Gamification to stock fantasy, supra* note 161.

163 Charles Schwab Inc., *supra* note 93.

Similarly, from a market impact perspective, concerns over the effect of the meme trading frenzy appear overstated.[164] Price volatility has been concentrated in a small number of stocks, primarily those with low prices and substantial short interest.[165] One reason is that retail money is still a relatively small percentage of the overall market meaning that, in liquid securities with broad-based ownership, retail trading, in most cases, lacks the capacity to move prices substantially. In addition, meme stock trading represents a very small percentage of the overall market.[166] As one article observes, citing industry experts, "it's a stretch to think that extreme market movement in a few, relatively low-capitalized companies will have any major effect on the broader market."[167]

In addition, retail trading can potentially increase market stability by offsetting the herding by institutional investors that has the potential to exacerbate price swings. Jonathan Macey observes, for example, that "Robinhood investors had a stabilizing effect on the market during the turbulence surrounding the early days of the Covid19 pandemic, when the market dropped in value by one-third."[168] Similarly Gideon Ozik et al. report that "while overall liquidity deteriorated during lockdown, the increase in retail trading activity improved it, lowering stock bid-ask spreads and price impact of trades."[169]

The characterization of trading in meme stocks as gambling also overstates the case. The capital markets include a wide range of investors with different motivations and time horizons and that use different sources of information. It is almost impossible to judge in advance whose analyses are likely to be correct.[170] The evidence suggests, however, that a substantial proportion of retail money was invested not in idiosyncratic companies but in conservative companies that performed well.[171]

Even investments in the more extreme meme stocks that generated herd-like behavior, can be defended on fundamentals, fundamentals that, at least in some cases appear to support the wisdom of the crowd. For example, activist Ryan Cohen's increasing involvement in GameStop and the prospect that his proposed revisions to the company's business strategy would result in a turnaround offered reasons to invest. Similarly, despite warning investors about the prospect that its stock price was inflated in 2021, AMC showed success in its holiday operations and beat analyst expectations for Q4 2021.[172] Although views on the street are mixed, analysts have also identified reasons to believe

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164 Testimony of Jennifer J. Schulp, Cato Institute, before the Committee on Financial Services, U.S. House of Representatives Hearing on "Game Stopped? Who Wins and Loses When Short Sellers, Social Media, and Retail Investors Collide", Feb. 18, 2021, https://www.congress.gov/117/meeting/house/111207/witnesses/HHRG-117-BA00-Wstate-SchulpJ-20210218.pdf (Schulp testimony) (observing that "the temporary volatility in GameStop and others did not present a systemic risk to the functioning of our markets").

165 But see Philippe van der Beck, & Coralie Jaunin, *The Equity Market Implications of the Retail Investment Boom* (Jan. 30, 2021) (finding that retail trading can move prices in both smaller stocks and those with substantial passive ownership).

166 See, e.g., *id.* (reporting that Robinhood investors had a "negligible market share of 0.2%,").

167 Jessica Mathews, *How much are meme stocks really moving the markets?* Fortune.com, June 13, 2021, https://fortune.com/2021/06/12/meme-stocks-moving-the-markets-gamestop-amc-clover/.

168 Jonathan R. Macey, *Securities Regulation as Class Warfare*, Feb. 20, 2021, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3789706.

169 Gideon Ozik, Ronnie Sadka & Siyi Shen., *Flattening the Illiquidity Curve: Retail Trading During the COVID-19 Lockdown*, J. OF FIN. & QUANT. ANAL. (May 13, 2021)

170 See SEC Staff Report, *supra* note 79 at 43 ("People may disagree about the prospects of GameStop and the other meme stocks, but those disagreements are what should lead to price discovery rather than disruptions.").

171 Ivo Welch, *The Wisdom of the Robinhood Crowd*, J. Fin. (forthcoming (2021); (reporting that Robinhood investors exhibited good timing and steadfastness and earned "good portfolio returns").

172 Will Feuer, *AMC Stock Jumps on Revenue Guidance for Holiday Quarter*, Wall St. J., Feb. 1, 2022, https://www.wsj.com/articles/amc-stock-jumps-on-revenue-guidance-for-holiday-quarter-11643730639.

that other meme stocks have the potential for continued growth based on fundamental analysis rather than hype.[173]

Hertz provides one of the best examples. Hertz was one of the original meme stocks in 2020, and commentators warned that it was an example of uninformed and irrational trading by retail investors as investors flocked into a company that was headed for bankruptcy.[174] As one commentator wrote in 2020:

> It is all pure gambling. There is no circumstance—zero—where Hertz shareholders will ever get a recovery once a plan of reorganization with creditors is agreed upon, probably months from now.[175]

Yet, as Matt Levine subsequently acknowledged, Cohan "turned out to be totally wrong."[176] Almost a year later, Hertz accepted a buyout bid that enabled it to emerge from bankruptcy and to pay its investors more than what any retail investor had paid for the stock.[177] Significantly the meme frenzy was not just about investors getting lucky. Retail support for the companies, and their stock prices, facilitated access by all three companies to capital that created new business opportunities that, in turn, arguably impacted their future prospects.[178]

Moreover, to the extent the concern is about speculation in the stock market, speculative trading is not limited to or even concentrated in retail investors. Many hedge funds use speculative trading strategies including the extensive use of options and derivatives.[179] Similarly, stock prices regularly depart from what some view to reflect fundamental value – bubbles and other examples of temporary misalignments are commonplace. Given the difficulty in determining when securities are under or overpriced, the claim that meme trading has distorted prices is problematic as a justification for regulatory intervention.[180]

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[173] See, e.g., *Bed, Bath & Beyond stronger than typical meme stocks: Analysts,* Capital.com, Aug. 19, 2021 https://capital.com/bed-bath-beyond-stronger-than-typical-meme-stocks-analysts (identifying reasons why Bed Bath and Beyond could increase in value independent of the meme stock movement); Seeking Alpha, *Beyond The Noise, AMC Does Have Fundamental Value*, Jan. 31, 2021, https://seekingalpha.com/article/4402349-beyond-noise-amc-fundamental-value (identifying potential growth for AMC based on fundamental value).

[174] Emily Graffeo, *Hertz: the original meme stock rises from the ashes of bankruptcy*, Markets Insider, Aug. 2, 2021, https://markets.businessinsider.com/news/currencies/hertz-original-reddit-wallstreetbets-meme-stock-exits-bankruptcy-2021-7.

[175] Matt Levine, *The Hertz Gamblers Were Right*, Bloomberg Law, Feb. 4, 2022, (quoting former Wall Street banker William Cohan). Most traditional analysts agreed. Neal Freyman, *Hertz Shareholders Win Big With Bankruptcy* Deal, Morning Brew, May 14, 2021, https://www.morningbrew.com/daily/stories/2021/05/14/hertz-shareholders-win-big-bankruptcy-deal.

[176] *Id.*

[177] Graffeo, *supra* note 174.

[178] As Chiu and Yahya ask "did [meme investors'] newfound faith in GameStop allow its management to discover new opportunities that did not exist prior to early 2021?" Chiu and Yahya, *supra* note 145 at 89. Levine explains that the SEC seemingly restricted Hertz's ability to obtain more capital through a public offering despite Hertz's warning to stockholders that "we expect that common stock holders would not receive a recovery through any plan"). Levine, *supra* note 175.

[179] See, e.g., Silla Brush, *Energy Speculation at Highest Levels on Record, CFTC's Bart Chilton Say*s, Bloomberg (Mar. 15, 2011, 11:45 AM), http://www.bloomberg.com/news/2011-03-15/hedge-fund-energy-speculation-highest-on-record-cftc-s-bart-chilton-says.html (describing hedge fund speculation in the energy markets).

[180] See, e.g., Troy A. Paredes, *On the Decision to Regulate Hedge Funds: The SEC's Regulatory Philosophy, Style and Mission,* 2006 U. Ill. L. Rev. 9751000, n. 100 (2006) ("Nor, for that matter, should the SEC be in the business of regulating to prevent bubbles in any particular type of asset class or investment vehicle or to discourage speculation (in any case, how does one decide when a bubble exists or that there is excessive speculation?)"); Schulp Testimony, *supra* note 164 ("Stock prices move in and out of alignment all the time, and markets are no strangers to bubbles.").

III. The Underrecognized Value of Retail Investing

The foregoing discussion summarizes and challenges the main concerns that commentators have raised over the GameStop frenzy. The call for regulatory intervention, and in particular for reforms that would introduce greater barriers to retail trading such as banning PFOF, limiting user interfaces that make app-based trading easy and accessible, and attempting to limit the use of social media to disseminate investing information, focuses excessively on the potential costs imposed by retail trading. In so doing, the debate over GameStop overlooks the benefits of the reemergence of the retail investor. I argue in this section that direct retail participation in the capital markets provides potential benefits to investors, corporations and society, benefits that have largely been unrecognized.

For investors, capital market participation offers the opportunity for increased wealth. Fin tech, through its lower costs and easy access, offers a tool by which a broader range of investors can engage with the markets, not just as passive investors but through the exercise of greater voice in corporate decisions. Direct retail ownership gives ordinary citizens both a connection to business and a stake in how business operates. Unlike efforts to increase the accountability of big corporations through external regulation, investment offers people the opportunity to influence businesses from within. Significantly, the GameStop frenzy highlights the new power of fin tech and social media to reduce the collective action problems associated with dispersed retail ownership. Retail ownership can also reduce the potentially skewed influence of large institutional intermediaries who may be subject to problematic agency costs. Engaging ordinary citizens is particularly valuable at a time in which the role of corporations in society is up for debate as commentators and policymakers debate the relative merits of shareholder versus stakeholder governance.

A. GameStop and Capital Market Participation

As SEC Commissioner Hester Peirce recently observed, "Our financial markets are among the greatest wealth-generating machines ever developed by any society," yet only about half of Americans participate in them through stock or mutual fund ownership.[181] In addition, retail participation in the markets is highly skewed. Women are less likely to own stock than men.[182] Minority households are far less likely to own stock than white households,[183] and this lower rate of capital market participation substantially contributes to wealth disparity.[184] Traditionally younger investors have been less likely to invest in the stock market. As recently as 2016, one study reported that almost 80% of millennials were not invested in the stock market at all.[185] A 2021 Nasdaq Foundation study pointed to the

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181 Hester M. Peirce, *Prosperity's Door,* July 21, 2021, https://www.sec.gov/news/speech/peirce-prosperity-door-072121?utm_medium=email&utm_source=govdelivery.

182 Erin El Issa, *Survey: Less Than Half of Women in U.S. Invest in the Stock Market*, NerdWallet, Sept. 1, 2021, https://www.nerdwallet.com/article/investing/survey-less-than-half-of-women-in-u-s-invest-in-the-stock-market#:~:text=Just%2048%25%20of%20women%20currently,according%20to%20a%20NerdWallet%20survey.&text=Women%20tend%20to%20live%20longer,your%20money%20grow%20over%20time. (reporting NerdWallet survey findings that "just 48% of women currently invest in the stock market, compared to 66% of men")

183 See Bo Evans, *Black Americans not investing in the stock market, and it's costing them*, The Denver Channel.com, Mar. 8, 2021, https://www.thedenverchannel.com/news/national/black-americans-not-investing-in-the-stock-market-and-its-costing-them (reporting that "61% of whites participate in the stock market whereas 28% of African Americans participate in the stock market").

184 Stan Choe, *Stocks are soaring, and most Black people are missing out*, ABC news, Oct. 12, 2020, https://abcnews.go.com/Business/wireStory/stocks-soaring-black-people-missing-73567655.

185 Josh Weiss, *Here's why millennials aren't investing*, CNBC, Apr. 1, 2016, https://www.cnbc.com/2016/04/01/heres-why-millennials-arent-investing.html.

ongoing underrepresentation of Black and Latinx women in the capital markets and highlighted the systemic factors that have contributed to the particular inability of this group to build wealth.[186]

Although a variety of factors contribute to the disparity in capital market participation, one contributing factor is the inability of young and diverse households to relate to the intermediaries that have historically served as gatekeepers to the capital markets through their role as brokers and financial advisors. Most financial advisors, for example, are over fifty.[187] Similarly most are male and white.[188] This leaves many people with the inability to relate to or trust stock market investing or the belief that their business will not be welcome.[189] As one commentator put it, "potential Black investors may feel that buying stocks is not for them."[190]

The cost of investing is another obstacle.[191] Historically brokerage accounts required a minimum investment, and the fees associated with maintaining an account and trading stock rapidly ate into the value of that investment. FINRA rules, for example, continue to require a minimum balance of $2000 in a margin account, although the minimum is not required for fully paid securities.[192] The entry into the market of app-based brokers like Robinhood has led to the elimination of commissions even among traditional brokers.[193] Commission-free trading makes it cost-effective for investors to purchase relatively small amounts of stock. The absence of account minimums and commissions makes it easier for new investors to start small, and to limit the risks that they take as they develop familiarity with the investment process. This flexibility is further enhanced by the sale of fractional shares or stock slices. As the dollar amount required to invest in a specific company is reduced, small investors can diversify their portfolios more easily, reducing the risks associated with direct stock ownership and reducing the need for investors to purchase mutual funds to achieve diversification.[194]

App-based trading platforms empower new, younger and more diverse investors by removing the obstacle of a person who does not look like them as a barrier to access. These new investors can participate on a small scale and develop a comfort level without concern about someone who views their account as too small or who is making judgments about whether they belong in the market., a process that one commentator terms "financial redlining."[195]

Traditionally, retail investors have participated in the capital markets through investments that are highly intermediated. Most investors own equities through mutual funds, in which a portfolio

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[186] Commonwealth, *A Framework for Inclusive Investing*, July 16, 2021, https://buildcommonwealth.org/wp-content/uploads/2021/08/CW-A_Framework_for_Inclusive_Investing.pdf.

[187] Weiss, *supra* note 185.

[188] Choe, *supra* note 184; Blair duQuesnay, Consider Firing Your Male Broker, N.Y. Times, Jan. 14, 2019, https://www.nytimes.com/2019/01/14/opinion/business-economics/new-year-resolution-investor-gende-gap.html (reporting that only about 20% of financial advisors are women).

[189] Evans, *supra* note 183 ("research shows that having someone who looks like you and has shared life experiences lead to more trust").

[190] Choe, *supra* note 184.

[191] See, e.g., Michael Reher & Stanislav Sokolinski, *Automation and Inequality in Wealth Management*, Aug. 2021, https://cpb-us-e2.wpmucdn.com/sites.utdallas.edu/dist/8/1090/files/2021/09/finance-conference-paper-automation-inequality-wealth-management.pdf (finding that a reduction in an investment adviser's account minimum increased participation by middle income households and led to increases in expected wealth).

[192] FINRA Rule 4210.

[193] See SEC Staff Report, *supra* note 79 at 7-8 (observing that, after Robinhood's policies of allowing investors to trade with no account minimums or commissions received "considerable attention" other brokers began to adopt similar policies).

[194] Schulp Testimony, *supra* note 164.

[195] Neal Freyman, *Black Investors Trade Their Way Through the Pandemic,* Morning Brew, May 15, 2021, https://www.morningbrew.com/daily/stories/2021/05/15/black-investors-trade-way-pandemic

manager chooses the individual securities. The asset manager also exercises the other aspects of stock ownership such as participating in annual meetings and voting the shares. In addition, retail investing occurs predominantly through employer-provided 401(k) plans in which the employer provides a menu of mutual fund options, and retail investors select among the choices provided in that menu. Because of the fiduciary obligations imposed on employers by ERISA, these choices typically involve highly diversified funds with a large number of portfolio securities. As a result, the connection between retail investors and the specific companies in which their money is invested is highly attenuated. ERISA also authorizes employers to cause plan participants to invest into a default investment option if they do not make an affirmative investment choice, and approximately 50% of plan assets are invested in the default option, meaning that a substantial number of retail investors may not even fully appreciate how their money is being invested.[196]

In contrast, low cost app-based trading facilitates direct stock ownership by retail investors. In addition to potentially reducing the investment costs associated with intermediation such as advisory fees and taxes,[197] direct ownership is likely to engage young retail investors. Simply put, app-based platforms make investing easier and more fun. They also give investors the opportunity to purchase companies that they are familiar with and that are affecting the world around them.[198] As one commentator puts it, "millennials aren't interested in owning boring bonds. This is a generation of stock pickers."[199] It is fair to believe that the enhanced opportunity for direct investing explains, in part, why millennials "piled into stocks like never before in 2020."[200] In addition, although meme stocks may initially draw new investors into the market, studies suggest that most go on to diversify their portfolios.[201]

These developments have contributed to a substantial shift in capital market participation. Research by FINRA and NORC at the University of Chicago found that investors who opened accounts for the first time in 2020 were younger, had lower incomes and were more diverse than traditional investors.[202] FINRA also found that these new accounts were smaller in size, suggesting that the increased participation reflected a more equitable approach to stock market participation.[203]

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[196] David Blanchett & Daniel Bruns, *Which Default Investment Is the Stickiest?*, Morningstar, May 1, 2018, https://www.fi360.com/uploads/media/wp_Sticky_Default_FINAL.pdf.

[197] Investors in mutual funds, for example, may pay taxes every year on the gains they realize in such funds, even if they do not take any distributions. See, e.g., T Rowe Price, *End-of-Year Tax Considerations for Capital Gains: Understanding Mutual Fund Distributions*, Oct. 11, 2021, https://www.troweprice.com/personal-investing/resources/insights/understanding-capital-gains-and-taxes-on-mutual-funds.html. In some cases, the fund may be managed in a way that exacerbates the tax consequences for small investors. See Jason Zwieg, *The Huge Tax Bills That Came Out of Nowhere at Vanguard*, Jan. 21, 2022, https://www.wsj.com/articles/vanguard-target-retirement-tax-bill-surprise-11642781228 (explaining how fund trading decisions resulted in unexpectedly large tax bills for retail investors).

[198] See Stephen McBride, *Millennials Will Propel Stocks Higher For Years*, Forbes, Feb. 8, 2021, https://www.forbes.com/sites/stephenmcbride1/2021/02/08/millennials-will-propel-stocks-higher-for-years/?sh=56856fff6e5d ("young folks LOVE investing in companies changing the world").

[199] *Id.*

[200] *Id.*

[201] See, e.g., Garnet Roach, *Meme stocks 'a gateway to serious investing,' says Public.com*, IR Magazine, Sept. 20, 2021, https://www.irmagazine.com/technology-social-media/meme-stocks-gateway-serious-investing-says-publiccom (reporting that 76% of "investors who first entered the markets via meme stocks have gone on to diversify their portfolios").

[202] FINRA, *"Investing 2020: New Accounts and the People Who Opened Them."* Consumer Insights: Money & Investing, February 2021, https://www.finrafoundation.org/sites/finrafoundation/files/investing-2020-new-accounts-and-the-people-who-opened-them_1_0.pdf

[203] Angelita Williams & Eric Young., *New Research: Global Pandemic Brings Surge of New and Experienced Retail Investors into the Stock Market.* FINRA Media Center, Feb. 2, 2021, https://www.finra.org/media-center/newsreleases/2021/new-research-global-pandemic-brings-surge-new-andexperienced-retail 17.

For Black investors in particular, GameStop and Robinhood have led, according to one survey, to "63% of Black Americans under 40 … participating in the stock market, the same share as white Americans" and a higher share than at any time in history.[204] Robinhood has released research showing that participation in the capital markets has also increased dramatically by Latinx investors.[205] As detailed below, this democratization of the shareholder class has important implications not just for investor wealth but for its impact on corporate America.

B. GameStop and Citizen-Capitalism

The increase in direct retail ownership has the potential to change the relationship between ordinary citizens and corporations. Almost a century ago, Louis Kelso, a political economist, identified the value in what he termed citizen-capitalism, the connection between ordinary citizens and businesses that could be achieved by making citizens into investors.[206] Kelso believed that facilitating the acquisition of capital by ordinary citizens – workers and consumers – would allow those citizens a greater share in the gains generated by the increasing productivity of that capital.[207]

Kelso invented the Employee Stock Ownership Plan or ESOP.[208] One key benefit to employee stock ownership, in Kelso's view, was that broader capital ownership could reduce the gap between the rich and the poor by enabling ordinary citizens a meaningful share in the growth of the economy.[209] The ESOP would increase the motivation of employees to make the company successful, because those efforts would redound to their benefit as stockholders.[210] Finally, employee stock ownership would unite the interests of management, employees, public stockholders and consumers.[211]

Kelso discussed General Motors as an example of how ESOPs could facilitate the connection between employees and the companies for which they work.[212] He highlighted the potential for using an ESOP to fuel corporate growth, which growth could then be shared with the employees through employee-owned stock. As he explained it, the ESOP would give workers "the ability to buy capital and pay for it out of what that capital produces, thus raising employees' incomes without raising the

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[204] Freyman, *supra* note 195.

[205] See, e.g., Gretchen Howard, *Latinx Investors Are Part of The New Wall Street*, Oct. 12, 2021, Robinhood, https://blog.robinhood.com/news/2021/10/12/latinx-investors-are-the-new-face-of-wall-street-and-crypto (reporting survey data on capital markets participation by Latinx investors through the Robinhood platform).

[206] Kelso was not the only person to advocate this approach. See, e.g., Joseph R. Blasi, Richard B. Freeman & Douglas L. Kruse, THE CITIZEN'S SHARE: PUTTING OWNERSHIP BACK INTO DEMOCRACY (2013) (arguing that allowing workers to share ownership and profits is a way to restore the middle class).

[207] Robert Hockett, *A Jeffersonian Republic by Hamiltonian Means: Values, Constraints and Finance in the Design of a Comprehensive and Contemporary American "Ownership Society,"* 79 S. Cal. L. Rev. 45, 127-28 (2005); see also Louis O. Kelso & Patricia Hetter Kelso, Could an ESOP Save General Motors?, The Kelso Institute, Nov. 11, 1981, http://kelsoinstitute.org/louiskelso/literary-legacy/could-an-esop-save-general-motors/ (describing the ESOP as an "enormous step toward the unification of the interests of management (who would be participants in the Kelso ESOP), employees, public stockholders, and consumers.")

[208] Burt A. Folkart, *Louis Kelso; Force Behind Employee Stock Ownership Plans*, L.A. Times, Feb. 21, 1991, https://www.latimes.com/archives/la-xpm-1991-02-21-mn-2330-story.html. Previously Kelso had advocated for government grants to enable ordinary citizens to invest in the stock market. Louis O. Kelso & Patricia Hetter, *Equality of Economic Opportunity Through Capital Ownership*, The Kelso Institute, originally published in Social Policies for America in the Seventies: Nine Divergent Views, 1968, http://kelsoinstitute.org/louiskelso/literary-legacy/equality-of-economic-opportunity-through-capital-ownership/ ("means need to be found to enable the poor man, who cannot afford belt-tightening, to finance the acquisition of newly formed capital in the same manner as the rich man, whose consumption is not necessarily restricted by his capital-acquiring activities.").

[209] Kelso & Kelso, *supra* note 207.

[210] Folkart, *supra* note 208.

[211] *Id.*

[212] Kelso & Kelso, *supra* note 207.

employer's labor costs."[213] In addition to incentivizing worker productivity, the ESOP would increase employee voice through their participation as shareholders.[214] Kelso's writings were influential in the getting Congress to include ESOPs in ERISA in 1974.[215] Although ESOPs have been controversial, a variety of studies demonstrate correlations between ESOPs and corporate profitability.[216]

Significantly, ESOPs increase a company's ownership by ordinary employees as opposed to either a wealthy investor class or institutional intermediaries. This change in ownership can affect a company in several ways. As Brett McDonnell has observed in connection with the standard ESOP:

> First, differences in ownership may change the objectives we can expect companies to pursue. Second, different ownership and control structures may affect the incentives and motivation of individual employees. Third, employee ownership and control may affect what information companies are able to use in making decisions.[217]

The downside of ESOPs is that they may cause worker-participants to be under-diversified as investors. A host of employees suffered substantial losses when the stock of their employers fell precipitously, whether due to economic events or fraud.[218] As Judge Posner observed: "[t]he time may have come to rethink the concept of an ESOP, a seemingly inefficient method of wealth accumulation by employees because of the under-diversification to which it conduces."[219]

The benefits that Kelso identified of citizen capitalism – providing ordinary citizens with a stake in the success of business operations, giving them a say in business decisions as corporate shareholders, and providing a communication mechanism between management and shareholders, employees, customers and other stakeholders – are not limited to the ESOP, however.[220] The same benefits can be realized through direct stock market participation. Direct ownership does not come with the baggage of the undiversified ESOP, in which a citizen's stake is primarily tied to a single business, particularly a business in which that citizen's human capital is also invested. Moreover, direct ownership similarly heightens the financial partnership between corporations and the stakeholders with whom the corporation deals, giving those stakeholders an interest in the corporation's success.

By including a greater percentage of ordinary people as owners of capital, citizen capitalism can reduce the economic inequality that can otherwise result from capitalist forces, providing a response to Thomas Piketty's famous criticism of capitalism.[221] Some have termed this approach "inclusive

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[213] *Id.*

[214] *Id.*

[215] Ezra S. Field, Note, *Money for Nothing and Leverage for Free: The Politics and History of the Leveraged ESOP Tax Subsidy*, 97 Colum. L. Rev. 740, 750 (1997) (observing that Kelso's "efforts were largely responsible for getting ESOPs included into ERISA in 1974").

[216] See, e.g., Jedidiah J. Kroncke, *ESOPs and the Limits of Fractionalized Ownership*, 2017 U Chi Legal F 287, 300-301 (2017) (discussing the literature on ESOP company profitability).

[217] Brett McDonnell, *ESOP's Failures: Fiduciary Duties when Managers of Employee-Owned Companies Vote to Entrench Themselves*, 2000 Colum. Bus. L. Rev. 199, 231.

[218] David Millon, *Enron and the Dark Side of Worker Ownership*, 1 Seattle J. Soc. Just. 113, 118 (2002) (observing that "When Enron's stock price collapsed— falling from a high of nearly $90 per share in 2000 to its current price of about $.25—employees lost up to 99% of the value of their retirement accounts").

[219] Summers v. State Street Bank & Trust Co., 453 F.3d 404, 411 (7th Cir. 2006), cert. denied, 127 S. Ct. 1249 (2007).

[220] Tamara Belinfanti, Sergio Alberto Gramitto Ricci & Lynn Stout offer a somewhat different view of citizen capitalism in their influential book, CITIZEN CAPITALISM: HOW A UNIVERSAL FUND CAN PROVIDE INFLUENCE AND INCOME TO ALL (Berrett-Koehler Press, 2019). As with the ESOP, Belinfanti et al, posit an intermediated form of ownership. As this Article explains below, direct ownership adds engagement and accountability to the economic participation offered by Belinfanti et al.'s proposed universal fund.

[221] Thomas Piketty, CAPITAL IN THE TWENTY-FIRST CENTURY (Arthur Goldhammer trans., Harvard Univ. Press 2014).

capitalism."[222] Inclusive capitalism can be understood as providing benefits to individuals by increasing their access to societal wealth and, in particular the wealth gains produced by corporations. It can also increase societal stability by reducing wealth and income inequality.[223]

Citizen capitalism can also enhance the voice of ordinary citizens in corporate decisions. Corporate law provides that the board of directors has the ultimate responsibility for determining the direction of a corporation. Shareholders play a role in corporate operations by electing that board. They play an indirect role through capital market discipline – allocating money to those companies whose business plans the market views as desirable. In addition, shareholders can raise issues of concern and seek to highlight problematic corporate practices – with respect corporate governance, ESG issues, and operational decisions – through the shareholder proposal rule. The power of shareholder action continues to increase. Tiny hedge fund Engine No. 1 dramatically spotlighted Exxon's refusal to address climate change through its successful 2021 proxy contest. Weeks later, Exxon announced its plan to achieve net zero greenhouse gas emission by 2050.[224] A recent study reports that the first three years of the Big Three's campaign to increase gender diversity on corporate boards has led to a "80% increase in the net flow of new female board members and an 11% increase in the overall proportion of female directors."[225]

Although recent examples of shareholder power focus on institutional investors, shareholder power is not limited to institutions; retail investors can also play a critical role. Retail investors are the source of a majority of shareholder proposals. Due to the conservatism of institutional investors, retail investors are typically the source of most innovation in such proposals although, for the proposals to impact corporate behavior they must ultimately command the support of institutions as well. Similarly, in issuers with significant retail ownership, the retail vote can influence the outcome of critical shareholder votes. DuPont's ability to earn the support of its retail shareholders was pivotal, for example, in its ability to ward off an activist challenge by hedge fund Trian.[226]

The GameStop frenzy has expanded retail influence. Retail investors in GameStop, AMC and other meme stocks demonstrated an unprecedented power to influence capital market pricing even in direct opposition to efforts by institutional investors such as hedge funds. The virtual shareholder meetings resulting from the pandemic lockdown provide a more accessible forum by which shareholders can participate in a dialogue with issuer management, and brokers such as Robinhood have developed mechanisms to facilitate the submission of questions at such meetings by retail

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[222] See, e.g., Stefan J. Padfield, *The Inclusive Capitalism Shareholder Proposal*, 17 U.C. Davis Bus. L.J. 147, 153 (2017) (defining inclusive capitalism as "the act of financing corporate operations via a broader distribution of capital paid for by the future earnings of the distributed capital"); Robert Ashford, *Why Working But Poor? The Need for Inclusive Capitalism*, 49 Akron L. Rev. 507, 508 (2016) ("We must establish a more inclusive capitalism by democratizing capital acquisition with the earnings of capital based on the principles of binary economics.")

[223] See, e.g., Sylvia Ostry, *When You Come to A Fork in the Road, Take It Reflections on North American Integration: Regional and Multilateral*, 1 J. Int'l L. & Int'l Rel. 239, 245 (2005) ("most experts agree that inequality and poverty...pose a serious threat to the sustainability of democracy.")

[224] ExxonMobil, *ExxonMobil announces ambition for net zero greenhouse gas emissions by 2050*, Jan. 18, 2022, https://corporate.exxonmobil.com/News/Newsroom/News-releases/2022/0118_ExxonMobil-announces-ambition-for-net-zero-greenhouse-gas-emissions-by-2050.

[225] Todd A. Gormley, Vishal K. Gupta, David A. Matsa, Sandra C. Mortal, & Lukai Yang, *The Big Three and Board Gender Diversity: The Effectiveness of Shareholder Voice* (Sept. 2021) at 9, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3724653.

[226] Jeff Mordock, *Retail shareholders cited as key to DuPont proxy win*, USA Today, May 13, 2015, https://www.usatoday.com/story/money/business/2015/05/13/dupont-proxy-fight/27224495/.

shareholders.[227] Sergio Ricci and Christina Sautter argue that the actions of retail investors at issuers like GameStop and AMC demonstrates their ability to use new technology such as social media to overcome traditional collective action problems.[228] They predict that this will cause them to engage not just with stock trading but with corporate governance.[229]

Significantly, retail participation in corporate governance offers a new tool for ordinary citizens to hold corporations accountable for their actions. As Joseph Blasi et al. observed in 2013, "the public has grown increasingly critical of corporations and suspicious of the relationship between big government and the big corporate sector."[230] In 2018, "[a] majority of Americans [viewed] large businesses as self-serving and self-dealing."[231] Both Democrats and Republicans increasingly believe that corporations wield too much power.[232] Data from interactive investors shows that efforts by retail shareholders to use their voting power to increase corporate accountability have grown dramatically.[233] Retail shareholders are also using ESG-oriented shareholder proposals to seek greater transparency on a variety of controversial corporate practices from political spending to human rights.[234] Greater disclosure subjects those practices to greater scrutiny, not just by shareholders but by regulators, other stakeholders and society at large.[235] Ricci and Sautter argue that retail engagement has the potential to reduce corporate externalities and cause issuers to embrace a broader public interest,[236] an issuer that will be explored in more detail below.

These developments have led issuers to pay growing attention to identifying the concerns of their retail shareholders and addressing those concerns. Following the outcome at DuPont, both Proctor & Gamble and activist hedge fund Trian paid substantial attention to cultivating the votes of retail investors, and those investors were ultimately pivotal in Trian's victory.[237] AMC CEO Adam Aron began using Twitter and Reddit to communicate with the company's retail shareholders, engaging in

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[227] See, e.g., Lewis Braham, *Robinhood's New Proxy Platform Battles Investor Apathy*, Barron's, Oct. 22, 2021, https://www.barrons.com/articles/robinhoods-has-created-a-new-online-proxy-platform-for-individual-investors-51634912806 (describing Robinhood's acquisition of Say Technology to create a platform enabling individual shareholders to ask questions of corporate management).

[228] Sergio Alberto Gramitto Ricci & Christina M. Sautter, *Corporate Governance Gaming: The Collective Power of Retail Investors*, 22 Nev. L.J. (forthcoming), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3815088.

[229] Sergio Alberto Gramitto Ricci & Christina Sautter report that "80% of Gen Z shareholders have already voted in annual shareholder meetings, exceeding every other generation of shareholders." Sergio Ricci & Christina Sautter, *The Wireless Investors Movement*, U. Chi. Bus. L. Rev., Jan. 28, 2022, https://businesslawreview.uchicago.edu/2022/01/28/the-wireless-investors-movement%EF%BF%BC/.

[230] Blasi et al., *supra* note 206 at 10.

[231] Robert D. Atkinson & Michael Lind, *Is Big Business Really That Bad?,* THE ATLANTIC, April 2018, https://www.theatlantic.com/magazine/archive/2018/04/learning-to-love-big-business/554096/

[232] Ben Casselman & Jim Tankersley, *Looking for Bipartisan Accord? Just Ask About Big Business,* N.Y. Times, May 14, 2021, https://www.nytimes.com/2021/05/14/business/economy/big-business-politics-economy.html

[233] Alex Rolandi, *Number of retail investors using vote to hold corporates accountable increases 110%,* Inv. Wk., Jan. 10, 2022, https://www.investmentweek.co.uk/news/4042985/retail-investors-vote-hold-corporates-accountable-increases-110 (reporting that one platform processed twice as money retail votes in 2021 as in 2020).

[234] See, e.g., Gabe Rissman, *New strategies help investors hold corporations accountable on human rights*, Open Global Rights, May 16, 2019, https://www.openglobalrights.org/new-strategies-help-investors-hold-corporations-accountable-on-human-rights/ (recounting how a retail investor used the shareholder proposal process to push for human rights improvements at ExxonMobil).

[235] See ICGN, Shareholder Proposals – An Essential Instrument for Ensuring Corporate Accountability, Dec. 2021, https://www.icgn.org/shareholder-proposals-%E2%80%93-essential-instrument-ensuring-corporate-accountability

[236] Ricci & Sautter, *supra* note 228.

[237] Michael Flaherty, *P&G, Peltz vie for small investor votes in biggest-ever proxy fight*, Reuters, Sept. 25, 2017, https://www.reuters.com/article/us-procter-gamble-trian-investors/pg-peltz-vie-for-small-investor-votes-in-biggest-ever-proxy-fight-idUSKCN1C01CW.

an unprecedented level of transparency in which Aron sought the views of his shareholder base on issues ranging from whether AMC should accept cryptocurrency to executives cashing in their stock options.[238] Aron also shifted the focus of the company's traditional quarter earnings calls to addressing the concerns of retail investors.[239] Investor relations specialists are counseling issuers not just to pay attention to retail investors but to develop strategies for doing so, including taking advantage of the company's website and making greater use of social media.[240] And corporate executives are using new tools to connect with retail investors and seeking to respond to their concerns.[241]

Direct investment is necessary, however, for retail shareholders to play an effective role in influencing corporate behavior.[242] Critically, capital ownership is not enough. Shareholders who own equity through intermediated investments such as mutual funds do not have the right to participate in corporate governance. They do not have the authority to introduce shareholder proposals. They do not even have the right to vote the shares reflecting their proportionate ownership interest in the portfolio companies held by the fund. In addition to depriving investors of say in their portfolio companies, intermediation deprives them of engagement. There is little reason for investors to pay attention to the 500 or 2000 portfolio companies held by their diversified index funds. Not only do investors have no connection to the choice to invest in those companies, but intermediation and diversification sever the connection between the investors' financial returns and individual firm behavior. Moreover, as detailed in the next section, there are reasons to question whether the interests of institutional investors and the issues on which they chose to engage are representative of the interests of retail investors.

C. GameStop and Intermediation

A key advantage of direct retail ownership is that it restores shareholder influence over corporate decisions to those who have an economic interest in those decisions. The growth of intermediated investing has resulted in a relatively small number of institutional investors exercising a substantial amount of control over corporate decisions. John Coates identified this concern, warning that "control of most public companies – that is, the wealthiest organizations in the world, with more revenue than most states -- will soon be concentrated in the hands of a dozen or fewer people."[243] Coates warned that a small number of people, through their control over the voting power in the portfolio companies held by index funds in particular, could wield "unsurpassed power" over corporate America.[244]

A particular area of concern involves the possibility that institutional investors will use this power to the detriment of other societal interests. The common ownership literature, for example, warns of

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[238] Alex Morrell, *How AMC CEO Adam Aron conquered Twitter, embraced the 'Apes' of Reddit, and won over a new generation of investors*, Insider, Dec. 14, 2021, https://www.businessinsider.com/amc-adam-aron-twitter-reddit-investors-meme-stock-2021-12.

[239] *Id.* ("AMC quarterly earnings calls, which used to cater to Wall Street research analysts, now revolve around retail investors and their ideas for the company, which involve questions about crypto, NFTs, AMC merch, eSports, and more.").

[240] Jeehae Linford, *Recent trends in retail investing: What does it mean for issuers?* IR Mag., Oct. 12, 2020, https://www.irmagazine.com/small-cap/recent-trends-retail-investing-what-does-it-mean-issuers.

[241] See, e.g., Nina Trentmann, *Connecting With Small Shareholders Remains a Challenge for Companies*, Wall St. J., Feb. 7, 2022, https://www.wsj.com/articles/connecting-with-small-shareholders-remains-a-challenge-for-companies-11644229801?mod=itp_wsj&mod=djemITP_h ("Executives are turning to new methods, such as tools that analyze reams of data and social-media platforms, to determine just who their small investors are and how to reach them, while also using traditional approaches like shareholder letters and meetings.").

[242] This is where direct ownership provides a form of citizen capitalism that extends beyond the Belinfanti, et al. proposal. See Belinfanti, et al., *supra* note 220 (proposing citizen capitalism through a universal fund through which all citizens can share in the economic proceeds from capitalism).

[243] Coates, *supra* note 12.

[244] *Id.* at 3.

the possible anticompetitive effects when large institutions own substantial stakes in competing firms, and offers empirical evidence in support of such effects.[245] The empirical findings have led regulators to initiate inquiries into these concerns.[246] In response, some commentators have sought to limit the size or holdings of large mutual funds.[247]

One man in particular, BlackRock's Larry Fink, was described in 2010 "as possibly the most important man in finance today."[248] Since 2010, Fink's influence has only increased. His annual letters to CEOs instruct corporate America with respect to issues ranging from ESG to whether corporations should get involved in voting rights legislation, and empirical research indicates that corporations respond to Fink's instructions.[249] That responsiveness likely results from the fact that Fink's instructions are backed up by BlackRock's substantial voting power and its ability to vote against director candidates or CEO compensation packages if Fink is displeased with management's actions.[250]

Coates recognized but did not highlight that the people who make decisions on behalf of the large institutional investors do not themselves hold the economic stakes in the companies that they controlled, but instead exercise that power on behalf of dispersed individual fund shareholders. I have described this exercise of shareholder power by asset managers as empty voting and argued that it has the potential to create agency costs because the interests of those who control fund voting decisions may not be aligned with the interests of the beneficiaries of those funds.[251]

A growing number of commentators have expressed concern over empty voting and the agency problems it creates.[252] As former acting SEC chair Allison Lee observed, mutual funds may not always reflect the preferences of their investors when they vote their proxies, and "[a]ddressing this agency cost is at the heart of corporate governance today."[253] The commentary identifies a variety of reasons

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245 See generally Jose Azar et al., *Anticompetitive Effects of Common Ownership*, 73 J. Fin. 1513 (2018); Martin C. Schmalz, *Common-Ownership Concentration and Corporate Conduct*, 10 Ann. Rev. Fin. Econ. 413 (2018).

246 See, e.g., C. Scott Hemphill & Marcel Kahan, *The Strategies of Anticompetitive Common Ownership*, 129 Yale L.J. 1392, 1395-1396 (2020) (describing inquiries by the Department of Justice, the Federal Trade Commission and the European Commission).

247 See, e.g., Eric A. Posner, Fiona M. Scott Morton & E. Glen Weyl, *A Proposal to Limit the Anti-Competitive Power of Institutional Investors*, 81 Antitrust L.J. 69, 74 (2017) (proposing that institutional investors be limited "to a stake of no more than 1 percent in more than a single firm in oligopolies").

248 Suzanna Andrews, *Larry Fink's $12 Trillion Shadow*, Vanity Fair, Mar. 2, 2010, https://www.vanityfair.com/news/2010/04/fink-201004?gclid=Cj0KCQiArt6PBhCoARIsAMF5wah4702rpJ2CeaegcxWOIG1kAJsKYufWOfOUIXnp1-Q7TVUN6FBPvo0aAjO3EALw_wcB.

249 Andrea Pawliczek, Ashley Nicole Skinner & Laura Wellman, *A New Take on Voice: The Influence of BlackRock's 'Dear CEO' Letters* (January 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3763042 (finding evidence that firms respond to BlackRock's "Dear CEO" letters).

250 Andrew Ross Sorkin & Michael J. de la Merced, *It's Not 'Woke' for Businesses to Think Beyond Profit, BlackRock Chief Says*, N.Y. Times Dealbook, Jan. 1, 2017, https://www.nytimes.com/2022/01/17/business/dealbook/larry-fink-blackrock-letter.html (explaining that BlackRock's $10 trillion in assets under management "gives Mr. Fink a huge amount of influence"

251 See Fisch, *supra*, note 9.

252 See, e.g., Jeff Schwartz, *'Public' Mutual Funds*, Cambridge Handbook on Inv. Prot. (forthcoming 2021), https://ssrn.com/abstract=3821388; Julia D. Mahoney & Paul G. Mahoney, *The New Separation of Ownership and Control: Institutional Investors and ESG*, 2021 Colum. Bus. L. Rev. 840 (2021), Sean Griffith & Dorothy Lund*, Conflicted Mutual Fund Voting in Corporate Law*, 99 B.U. L. Rev. 1151, 1155 (2019); Bernard S. Sharfman, *Opportunism in the Shareholder Voting of the "Big Three" Investment Advisers to Index Funds*, Feb. 1, 2022, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3995714.

253 Allison Herren Lee, *Every Vote Counts: The Importance of Fund Voting and Disclosure*, Mar. 17, 2021, https://www.sec.gov/news/speech/lee-every-vote-counts.

why the interests of institutional intermediaries may differ from those of retail investors.[254] These reasons include the business interests of the institutions such as enabling then to secure revenues from the administration of or inclusion in 401(k) plans,[255] the personal views[256] or the political aspirations of fund managers,[257] and a fear of regulation or public retribution in response to the asset managers' size and power.[258] Although empirical evidence on retail voting is limited, it supports these concerns – retail investors vote differently from institutional intermediaries.[259]

Scholars have identified possible ways to reduce the agency costs resulting from empty voting, including mechanisms to provide mutual fund beneficiaries with the power to influence how asset managers vote their shares.[260] These mechanisms are subject, however, to a variety of limitations. Most particularly, people who invest indirectly through mutual funds are unlikely to be aware of and informed about the portfolio companies owned by those funds. In addition, they are particularly likely to suffer from rational apathy, both because of their relatively small stakes and because, they have not made the affirmative decision to invest in the portfolio companies held through their funds.[261] Indeed, many mutual fund investors have not even made an affirmative decision to invest in the fund itself, because they are automatically invested into the default option in their employer's 401(k) plan.[262]

As the preceding sections have detailed, however, when retail investors invest directly, they are far more likely to be informed about the companies in which they invest. Early evidence since the GameStop frenzy suggests that this engagement is extending to participation in corporate governance as well. Reducing the extent to which retail investment is intermediated by increasing direct capital

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254 This discussion focuses on the divergence of interests related to funds' participation in the governance of their portfolio companies. The mutual fund structure itself creates a distinct set of conflicts and agency costs. See, e.g., Paul G. Mahoney, *Manager-Investor Conflicts in Mutual Funds*, 18 J. Econ. Persp. 161 (2004) (describing conflicts resulting from funds' compensation structures).

255 See Griffith & Lund, *supra* note 252, at 1176 (terming these "corporate client" conflicts).

256 Mahoney & Mahoney, *supra* note 252, at 866.

257 Robin Wigglesworth, *The ten trillion dollar man: how Larry Fink became king of Wall St, FT Magazine*, Oct. 7, 2021, https://www.ft.com/content/7dfd1e3d-e256-4656-a96d-1204538d75cd ("A host of former government officials work at BlackRock, and others have departed for plum jobs in the Biden administration.").

258 Schwartz, *supra* note 252, at 866.

259 Alon Brav, Matthew D. Cain & Jonathon Zytnick, *Retail Shareholder Participation in the Proxy Process: Monitoring, Engagement, and Voting* (May 25, 2021), https://ssrn.com/abstract=3387659 (documenting "substantial differences" between retail shareholders and institutional investors on various categories of shareholder proposals).

260 See, e.g., Jill E. Fisch, *The Uncertain Stewardship Potential of Index Funds*, *in* GLOBAL SHAREHOLDER STEWARDSHIP: COMPLEXITIES, CHALLENGES AND POSSIBILITIES (Dionysia Katelouzou & Dan W. Puchniak eds., Cambridge Univ. Press forthcoming 2021). See also Sharfman, *supra* note 252, at 28-29 (summarizing several feasible mechanisms by which retail investors could convey their voting preferences to fund managers); Caleb Griffin, *We Three Kings: Disintermediating Voting at the Index Fund Giants*, 79 MD. L. REV. 954, 983 (2020) (advocating pass-through voting).

261 See, e.g., Alicia Adamcyzk, *Your 401(k) might be invested in private prison companies. Here's how to find out*, CNBC.com, Aug. 12, 2020, https://www.cnbc.com/2020/08/12/new-tool-tells-you-if-your-401k-is-invested-in-private-prisons.html (quoting Andrew Behar, CEO of As You Sow as stating that many people are unaware that they are invested, through their 401(k) plan "in companies that don't align with their values.")

262 The assets of plan participants who are automatically enrolled in a 401(k) plan as well as those who have not selected another investment option are invested in the default investment option designated by the employer. Most 401k plans use target date funds as the default option. Stephen Miller, Number of 401(k) Funds Offered to Plan Participants Shrinks. SHRM, Dec. 1, 2020, https://www.shrm.org/resourcesandtools/hr-topics/benefits/pages/number-of-401k-funds-offered-to-plan-participants-shrinks.aspx (reporting data from Fidelity that 92% of 401(k) plans use target date funds as the default option and that among Millennials, 69 percent are invested exclusively in a target-date fund, due in part to being automatically enrolled in their 401(k) and defaulted into the option). Although a variety of demographic factors affect whether plan participants are likely to select the default option, studies suggest that most participants and assets remain in the default option. David Blanchett & Dan Bruns, *Default Investments: Made to Stick?,* Morningstar, Dec. 17, 2018, https://www.morningstar.com/articles/904924/default-investments-made-to-stick.

market participation by retail investors thus offers another potential vehicle for reducing both the power of institutional intermediaries and the agency costs resulting from intermediation.

D. GameStop and the Stakeholder Debate

The reemergence of the retail investor has particularly significant implications for the debate over stakeholder governance. Stakeholder governance shifts the objective of the corporation from maximizing shareholder economic value to delivering value to a variety of stakeholders, including employees, customers, suppliers, communities and the environment.[263] At its core, stakeholder governance is about using corporate governance to achieve societal objectives that cannot be addressed adequately through regulation.[264]

The debate over stakeholder governance has been extensive. A threshold question is whether stakeholder governance is an instrumental tool to enhance shareholder value or an alternative objective that can or should be pursued even when it is in tension with shareholder value. From a legal perspective, commentators debate corporate managers can pursue stakeholder value consistent with their fiduciary duty to shareholders. From a practical perspective, stakeholder governance requires corporate decisionmakers to decide which stakeholders' interests should be considered and how competing stakeholder interests should be prioritized.

A critical question is who decides whether a corporation should adopt stakeholder governance and to what degree. Do a corporation's managers or the board of directors have the authority to embrace stakeholder governance[265] or should that decision require shareholder input or even formal structural change?[266] Even if the question involves shareholder input, stakeholder governance presents distinctive agency problems because of the risk that institutional intermediaries will support objectives that differ from the interests of their beneficiaries.[267]

Because retail shareholders are, themselves, stakeholders, retail investing offers an end-run around these complex issues. Retail shareholders do not simply represent, they embody the interests of employees, customers, the community and society at large. A retail shareholder's interests reflect his or her overall role in society, and each shareholder's individual utility function reflects his or her preferences with respect to stakeholder issues that include safe products, fair treatment of employees, and harm to the environment, as well as economic profit. As a result, retail shareholders acting in their interests as shareholders, engage in what might be termed "automatic stakeholder governance."[268]

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[263] See, e.g., Lucian A. Bebchuk & Roberto Tallarita, *The Illusory Promise of Stakeholder Governance*, 106 Cornell L. Rev. 91, 94 (2020) (describing stakeholderism).

[264] See, e.g., Edward Rock, *For Whom Is the Corporation Managed in 2020? The Debate over Corporate Purpose,* 76 Bus. Law. 363, 367 (2021) (explaining the renewed debate over stakeholderism and corporate purpose as a response to "the political polarization of our electoral politics [that] has resulted in legislative deadlock.")

[265] In 2019, the Business Roundtable, a membership organization of chief executive officers, embraced stakeholder governance through its adoption of a "revised" statement of corporate purpose. Business Roundtable Redefines the Purpose of a Corporation to Promote 'An Economy That Serves All Americans', Bus. Roundtable (Aug. 19, 2019), https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-servesall-americans. Although some commentators have viewed that statement as a commitment by the employers of the signatories to the statement, as Bebchuk and Tallarita acknowledge, the boards of those companies did not appear to play a role in the CEOs' decision to sign it. 106 Cornell L. Rev. at 130-131.

[266] See Jill Fisch, *Purpose Proposals*, U. Chi. Bus. L. Rev. (forthcoming 2022) (describing shareholder efforts to cause corporations to adopt stakeholder governance by converting to public benefit corporations).

[267] See Mahoney & Mahoney, *supra* note 252 (arguing that institutions cannot sacrifice value for values consistent with their fiduciary duties).

[268] Oliver Hart and Luigi Zingales argue that corporate managers have the legal authority to respect shareholders' noneconomic preferences. See Oliver Hart & Luigi Zingales, *Companies Should Maximize Shareholder Welfare Not Market*

Of course shareholders are likely to hold differing views on these questions. Shareholders have heterogeneous preferences even with respect to economic issues – they likely differ in the time horizon of their investment, their risk preferences, the extent to which they favor cash dividends over growth, and their tax situations. Other stakeholders have heterogeneous preferences as well.[269] But heterogeneity does not prevent these stakeholder views from being raised and considered in a corporation's operating decisions. In addition, a variety of market mechanisms allow shareholders with different preferences to influence corporations. Shareholders can choose which companies to invest it. They can avoid companies whose policies they disagree with, or they can invest in those companies and push their fellow shareholders to support change. Finally, everyone does not have to agree. Unlike the institutional model of stakeholder governance which seeks to impose a one-size-fits all level of social policy on all businesses, direct ownership allows for variation among firms and practices.

To be fair, retail shareholders do not perfectly represent stakeholder interests. Roughly half of U.S. citizens are not invested in the markets at all, and even after the GameStop frenzy, those who invest are disproportionately white, wealthy and male. Shareholder votes are based on economic ownership, meaning that large shareholders have greater voice. Despite these concerns, a shareholder need not hold a substantial stake to influence corporate decisions. The shareholder proposal rule, SEC Rule 14a-8, enables shareholders with relatively small stakes to introduce shareholder proposals, thereby putting issues of concern on the corporate agenda.[270] Social media tools such as Reddit reduce the costs of publicizing a proposal and mobilizing support.

Historically a substantial proportion of shareholder proposals have addressed social policy issues and reflected stakeholder concerns.[271] Toward this end, they have been remarkably effective.[272] Recent shareholder proposals have focused on a variety of stakeholder concerns from workplace diversity and sexual harassment policies to food and product safety. The 2020-2021 proxy season saw retail investors sponsor new proposals at multiple companies seeking to have them convert to public benefit corporations in order to commit to stakeholder governance.[273] Moreover, because many proposals seek to have corporations provide greater disclosure of the negative externalities

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Value, 2 J.L. FIN. & ACCT. 247 (2017). Hart and Zingales do not, however, consider the agency problem discussed above resulting from the intermediation of most shares.

[269] See, e.g., Robert H. Mundheim, *What Is the Significance of the Business Roundtable Statement on the Purpose of a Corporation*?, Salzberg Glob. Sem. Newsletter (Oct. 22, 2019), https:// www.salzburgglobal.org/news/impact/article/robert-h-mundheim-what-is-the-significance-of-the-business-roundtable-statement-on-the-purpose-of-a-corporation [https://perma.cc/M864-F76P] (using hypothetical to illustrate potential conflicting interest among corporate employees).

[270] See Kobi Kastiel & Yaron Nili, *The Giant Shadow of Corporate Gadflies*, 94 S. Cal. L. Rev. 569, 604 (2021) (describing corporate gadflies as "setting the agenda for what is to be voted on by shareholders"); James D. Cox & Randall S. Thomas, *The SEC's Shareholder Proposal Rule: Creating a Corporate Public Square*, 3 Colum. Bus. L. Rev. 1147, 1197 (2022) (describing the shareholder proposal rule as the "corporate town square").

[271] See, e.g., Sarah C. Haan, *Shareholder Proposal Settlements and the Private Ordering of Public Elections*, 126 YALE L. J. 262, 272 (2016) ("The academic literature generally divides shareholder proposals into a corporate governance category and a social and environmental category").

[272] See, Neel Rane, Comment, *Twenty Years of Shareholder Proposals after Cracker Barrel: An Effective Tool for Implementing LGBT Employment Protections*, 162 U. Pa. L. Rev. 929, 932 (2014) ("shareholder proposals have been an extremely effective tool for activists and interested shareholders to effect employment protections for LGBT employees").

[273] See Fisch, *supra* note 266 (describing these purpose proposals).

they impose on stakeholders, they can have broader effects – increasing the transparency of corporate behavior and energizing stakeholders, regulators or the public at large to take action.[274]

Stakeholders can access this mechanism for focusing greater attention on their interests through the simple process of buying stock. Indeed, corporate law has a long history of stakeholders becoming shareholders and then using the corporate machinery in an effort to change the corporation's behavior. Harwell Wells details how two retail shareholders in the 1940s attempted to use the shareholder proposal rule to persuade Greyhound to eliminate its racially segregated buses.[275] In 2021, the SEC staff announced a change to its interpretation of Rule 14a-8 that opens the door to a more expansive use of shareholder proposals to address stakeholder interests. [276]

Finally, the prospect that retail shareholders will reflect stakeholder interests in their engagement with the corporations in which they invest is not mere speculation; there is increasing evidence that retail investors care about stakeholder considerations. One recent survey reported that "more than half (51%) of retail investors avoid investing in certain stocks due to moral or ethical concerns about a company's business pursuits."[277] For millennials and gen-X'ers, social justice issues, including climate change, racial justice, and inequality are increasingly important.[278] "Many millennials and Gen-X'ers make decisions about their careers and about where they shop based on their values."[279] Millennials and Gen-X investors, those who entered the market in the greatest numbers as part of the GameStop frenzy are "the driving force in the adoption of socially responsible investment strategies."[280] As David Webber, explain, millennial investors increasingly see a connection between investment activity and achieving broader societal goals, and they are calling for the companies in which they invest to give greater consideration to stakeholder interests.[281] Although the extent to which citizens will pursue stakeholder or societal goals in their role as investors remains unclear, as Ricci and Sautter explain, "Citizens who hold a small economic interest in a corporation would likely prioritize their interests as human beings living in a society and on a shared planet when voting their shares."[282]

IV. Some Cautionary Considerations

The preceding Part has identified the benefits that the reemergence of the retail investor can provide to corporations, the capital markets, and investors themselves. These benefits should not be overstated. There are costs of increased direct retail ownership. Investors will make mistakes such as

[274] Madison Condon details the use of shareholder proposals to address climate externalities, although her examples focus on proposals introduced by institutional investors. See Madison Condon, *Externalities and the Common Owner*, 95 Wash. L. Rev. 1 (2020).

[275] See Harwell Wells, *Shareholder Meetings and Freedom Rides: The Story of Peck v Greyhound*, June 21, 2021, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3873430.

[276] Shareholder Proposals, Staff Legal Bulletin No. 14L (CF) (Nov. 3, 2021).

[277] Sarah O'Brien, *While many investors want a portfolio with a purpose, not all put their money where their mouth is, survey finds*, CNBC, Aug. 2, 2021, https://www.cnbc.com/2021/08/02/not-all-investors-who-say-they-support-impact-investing-are-doing-it.html.

[278] Deloitte, *For Millennials And Gen Zs, Social Issues Are Top Of Mind—Here's How Organizations Can Drive Meaningful Change*, Forbes, July 22, 2021, https://www.forbes.com/sites/deloitte/2021/07/22/for-millennials-and-gen-zs-social-issues-are-top-of-mind-heres-how-organizations-can-drive-meaningful-change/?sh=6dccbdf450c6

[279] *Id.*

[280] Michal Barzuza, Quinn Curtis & David H. Webber, *Shareholder Value(s): Index Fund ESG Activism and the New Millennial Corporate Governance*, 93 S. Cal. L. Rev. 1243, 1294 (2020).

[281] *Id.* at 1285.

[282] Ricci & Sautter, *supra* note 228.

excessive trading, following the herd, inadequate diversification, and the use of financial products that they do not understand. Even if investors learn from their mistakes, some will lose money, perhaps more than they can afford to lose. Retail investors will affect the capital markets, and other market participants will have to adjust. New information sources will evolve and, as they do so, will raise new opportunities for manipulation and fraud.

For the reasons described above, this Article does not view the costs as sufficient to warrant regulatory intervention motivated by paternalism. A more difficult question is whether the retail investor mistakes will prevent issuers and the market from benefiting from citizen capitalism. Although at present this question is largely unanswerable, there are a few issues that warrant particular attention.

A. Social Media as a Source of Investment Information

The first issue is whether retail investing is sufficiently informed to confer the benefits described in this Article. Retail investors who purchase stock as a social movement or to be part of the crowd need not be interested in the corporation that issues the stock or engaged in its underlying business. Such investors are unlikely to make informed trades, to vote their shares, or to seek to hold managers accountable. In a sense, the governance role of frenzied retail investors might be closely analogous to that of algorithmic traders – that is, nonexistent.[283]

This position is likely exaggerated; empirical evidence to date suggests that a substantial proportion of retail trading is informed and that retail investors are increasingly engaging with the companies in which they invest.[284] Retail investors rely, however, on non-traditional sources of information. In particular, retail investors appear to be heavily influenced by postings on social media sites.[285] One study reported that a third of young investors rely on social media for investment advice.[286] The European Securities and Markets Authority warned investors to "be careful when taking investment decisions based exclusively on information from social media and other unregulated online platforms, if they cannot verify the reliability and quality of that information."[287]

To be sure, social media presents an ever-growing danger of misinformation, as well as the potential for that misinformation to manipulate the behavior of users, a danger that extends well beyond the capital markets. A collaborative study explored the role of social media in spreading both misinformation and mistrust in connection with the Covid-19 pandemic.[288] Commentators have

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[283] See, e.g., Yesha Yadav, *How Algorithmic Trading Undermines Efficiency in Capital Markets,* 68 Vand. L. Rev. 1607 (2015) (arguing that algorithmic trading undermines capital market efficiency).

[284] See notes __ through __ *infra* and accompanying text.

[285] See, e.g., SEC Staff Report, *supra* note 79, at 17 ("The price and volume movements in GME coincided with substantial interest expressed in certain online forums devoted to investing, including YouTube channels and the subreddit WallStreetBets."); Betzer & Harries, *supra* note 122 (showing empirically that "an increase in Reddit posts on GameStop is followed by an increase in the ratio of retail trading proportion of GameStop.").

[286] Emily Graffeo, *A third of young traders go to social media for investment advice — and 12% say they invest because it 'feels like a game', survey finds*, Markets Insider, Aug. 23, 2021, https://markets.businessinsider.com/news/stocks/retail-investing-trends-robinhood-gamification-survey-social-media-trading-2021-8.

[287] European Securities and Markets Authority, *Episodes of very high volatility in trading of certain stocks*, Feb. 17, 2021, https://www.esma.europa.eu/sites/default/files/library/esma70-155-1809_episodes_of_very_high_volatility_in_trading_of_certain_stocks_0.pdf.

[288] Ingrid Volkmer, *Social Media and Covid-19*, 2021, https://arts.unimelb.edu.au/__data/assets/pdf_file/0007/3958684/Volkmer-Social-Media-and-COVID.pdf

highlighted the role that social media platforms played in the January 6, 2021 capitol insurrection[289] and debated Facebook's use of algorithms to promote posts that are likely to generate outrage or other strong reactions.[290] Social media provides users with the potential to reach a greater audience than other communication mediums, and to do so with the limited accountability. The ability to post anonymously has been cited as creating the potential for lack of civility and other undesirable behaviors.[291] With respect to investing information, anonymous posting increases the potential for fraud.[292]

On the other hand, efforts to manipulate the market through online communications are not new,[293] traditional sources of investment information have proven similarly unreliable[294] and even professional investors are subject to manipulation and cognitive biases.[295] Perhaps most importantly, investors seem aware of the risks associated with the lack of accountability on social media. One empirical study found that investors rely less on information that is posted anonymously, and that such posting have limited price effects.[296] Another study suggests that social media users respond most to posts by people who develop a reputation for credibility.[297] Research also suggests that the analyst postings on social media are informative and that investors can trade profitably on those beliefs.[298] Although there is substantial heterogeneity in the quality of postings, investors have some ability to identify the high quality sources of information.[299] Similarly, it appears that issuers may benefit from social media as a source of information, gaining the ability, in some cases, to improve their operations as a result of the "collective wisdom of the Reddit chatroom."[300]

Although empirical studies of the GameStop frenzy are still in progress, early results do not indicate social media is distinctively problematic as an information source; rather investor use of these

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289 See, e.g., Tonya Mosley & Allison Hagan, *How Social Media Fueled The Insurrection At The U.S. Capitol*, WBUR, Jan. 7, 2021, https://www.wbur.org/hereandnow/2021/01/07/social-media-capitol-mob (noting that "Technology platforms make sensational, attention-grabbing content more visible through what's called maximizing user engagement").

290 Jon Evans, *Facebook isn't free speech, it's algorithmic amplification optimized for outrage*, TechCrunch, Oct. 20, 2019, https://techcrunch.com/2019/10/20/facebook-isnt-free-speech-its-algorithmic-amplification-optimized-for-outrage/.

291 Biju Dominic, *Anonymity on Social Media and its Ugly Consequences*, Mint, Feb. 10, 2021, https://www.livemint.com/opinion/columns/anonymity-on-social-media-and-its-ugly-consequences-11612977615856.html.

292 See, e.g., SEC. *Investor Alert: Beware of Stock Recommendations on Investment Research Websites*, Apr. 10, 2017, https://www.investor.gov/additional-resources/news-alerts/alerts-bulletins/investor-alert-beware-stock-recommendations (warning about the potential for fraud based on postings by authors using pseudonyms or false credentials).

293 For example, a student note details the widespread use of the internet in the 1999s, including through on-line chat rooms and discussion forums, to perpetrate securities fraud and manipulation. Nancy Toross, Notes and Comments *Double-Click on This: Keeping Pace with On-Line Market Manipulation*, 32 Loy. L.A. L. Rev. 1399, 1417-1429 (1999).

294 See. e.g., Jill E. Fisch & Hillary A. Sale, *The Securities Analyst as Agent: Rethinking the Regulation of Analysts*, 88 Iowa L. Rev. 1035, 1048-50 (2003) (describing the research analyst scandal and its impact on the information quality of analyst recommendations).

295 Prentice, *supra* note 151, at 1415-16 (observing that "Financial fraud and 'earnings management' . . . tend to fool even professional investors"); Donald C. L:angevoort, *Selling Hope, Selling Risk: Some Lessons for Law from Behavioral Economics About Stockbrokers and Sophisticated Customers*, 84 Calif. L. Rev. 627, 656-68 (1996) (explaining how brokers can use sales techniques to manipulate decisions by institutional investors).

296 Travis Dyer & Eunjee Kim, *Anonymous Equity Research*, 59 J. Acct'g Res. 575 (2021).

297 Michael Farrell, T. Clifton Green, Russell Jame & Stanimir Markov, *The democratization of investment research and the informativeness of retail investor trading*, __ J. Fin. Econ. __ (forthcoming).

298 Chukwuma Dim, *Should Retail Investors Listen to Social Media Analysts? Evidence from Text-Implied Beliefs*, Sept. 2021, draft at 28, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3813252.

299 *Id.*

300 Chiu & Yahya, *supra* note 145, at 86.

sources is consistent with their overall reliance on online sources of information including twitter, Reddit, TikTok and more. The likely message from the GameStop frenzy is that the SEC, similarly to other regulators, must pay continued attention to the use of social media platforms. Their use by securities professionals, corporate officials, and people who are trading the securities about which they post, warrant particular oversight. Notably, issuers are increasingly using social media to communicate with their investors and to combat misinformation.[301] The SEC might follow their lead and consider engaging directly with social media, to monitor ongoing developments, to play a role in educating investors about how to determine the reliability of posts, and even to flag posts that are particularly suspect. These developments also warrant consideration of greater collaboration between the SEC and other regulators that are confronting the challenges presented by social media platforms such as the Federal Trade Commission and the Federal Communications Commission.[302]

B. Digital Engagement Practices

A potentially bigger concern is when retail investing is the product of affirmative manipulation. Some commentators have warned that apps nudge investor behavior or seek to make certain stocks or trading activities more attractive.[303] The Massachusetts enforcement action against Robinhood is premised, in large part, on the allegedly manipulative aspects of its trading platform.[304] The SEC's request for public input on DEP requested information on how a variety of digital features, ranging from celebrations for trading such as "digital confetti" to games, leaderboards and curated lists, will influence investor behavior. [305]

While concerns over the ability of app-based platforms to influence investing behavior are undoubtedly true, the same can be said of most consumer-directed behavior, including product information, credit card offers and pharmaceutical advertising. Many businesses offer free products to induce consumers to make additional purchases, making it hard to distinguish Robinhood's free stock from Dunkin Donut's free coffee.[306] A paternalistic approach that regulates or limits business activity because of its capacity to influence behavior sweeps far more broadly than fin tech. Moreover, that the platform provider has a financial motive in encouraging the targeted behavior again does not distinguish trading platforms. Credit card companies encourage their customers to borrow, even to the point of incurring excessive debt, so they can make money from the high interest rates they charge

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301 See, e.g., Trentmann, supra note 241 (describing how one issuer "works with an external investor-relations firm that monitors popular online retail trading communities like Stocktwits, and corrects false statements if needed").

302 See, e.g., Devin Coldewey, *Who regulates social media?* TechCrunch, Oct. 19, 2020, https://techcrunch.com/2020/10/19/who-regulates-social-media/ (describing the FCC and FTC's roles in social media regulation).

303 Darbyshire, *supra* note 107; see also Written Testimony of Alexis Goldstein, Senior Policy Analyst, Americans for Financial Reform, Before the United States House Financial Services Committee, "Game Stopped? Who Wins and Loses When Short Sellers, Social Media, and Retail Investors Collide, Part II" Mar. 17, 2021, https://ourfinancialsecurity.org/wp-content/uploads/2021/03/hhrg-117-ba00-wstate-goldsteina-20210317.pdf (describing Robinhood as "using targeted advertising on social media").

304 See *infra* note __ and accompanying text.

305 Request for Comment on DEP, supra note 76, at 5-7.

306 See Dunkin, DD Perks, https://www.dunkindonuts.com/en/dd-perks (offering free coffee to customers who join DD Perks).

on that debt.[307] Pharmaceutical companies hope that people will demand costly prescription drugs from their doctors based on what they see on television.[308]

The power of platforms to gather customer specific information and then to use that information to exploit vulnerabilities presents a distinctive concern. A brokerage app can collect information on a customer's trading patterns – predicting which types of securities the customer is most likely to buy and targeting that customer with recommendations for more of those types of securities. Similarly an app can target investors who are likely to use derivatives or purchase securities on margin. This targeting can both generate additional revenues for the broker and enable the broker to target those investors who receptive to a particular pitch or trading strategy. Although app-based brokers would seem to distance a brokerage firm from the interpersonal interactions that generate this knowledge, and may leave a customer unaware that the information is being collected or used, the technology used by a brokerage platform may allow a firm to collect substantial information on customer preferences, trading patterns and response to nudges and cues. The platform can then use tools of artificial intelligence to respond to that information. In particular, while an app can then use the information to encourage behavior that is consistent with the customer's best interests, it can alternatively encourage behavior that is not consistent with its knowledge of the customer for its own financial benefit.

Again, this acquisition and use of customer data is not unique to trading apps. Amazon collects data on its customers and uses that data to "predictive suggestions for products and services that each user might be inclined to purchase."[309] Cambridge Analytica obtained user data from Facebook that it then used to create targeted messages to voters in the 2016 presidential election.[310] Target received negative publicity for collecting information that it used to predict when its customers were pregnant, which it then used to send them maternity advertisements.[311] The technology used in these examples is potentially powerful, and it may be a matter of algorithmic programming that is not visible in the same way as overt verbal or written actions.[312] As with other artificial intelligence type tools, platform regulation should be ensured that providers are held accountable for the impact of their design features without requiring proof that those features were deliberately designed to exploit or defraud.

Existing broker-dealer regulations limit brokers' ability to engage in this type of targeting. When brokers make recommendations or provide investment advice to customers, they must adhere to certain legal standards because of the potential influence on customer behavior. Brokers have an obligation to know their customers and to determine that the recommendations are suitable for the

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[307] See, e.g., Susan Block-Lieb & Edward J. Janger, *The Myth Of The Rational Borrower: Rationality, Behavioralism, and the Misguided "Reform" of Bankruptcy Law*, 84 Tex. L. Rev. 1481, 1540 (2006) (describing how credit card companies exploit consumer cognitive biases leading to excessive borrowing).

[308] The practice of allowing pharmaceutical companies to advertise their products directly to consumers has generated extensive controversy. See Victor E. Schwartz, Cary Silverman, Michael J. Hulka & Christopher E. Appel, *Marketing Pharmaceutical Products in the Twenty-First Century: An Analysis of the Continued Viability of Traditional Principles of law in the Age of Direct-to-Consumer Advertising*, 32 Harv. J.L. & Pub. Pol'y 333 (2009).

[309] Lauren Bass, *Note, The Concealed Cost of Convenience: Protecting Personal Data Privacy in the Age of Alexa*, 30 Fordham Intell. Prop. Media & Ent. L.J. 261, 278 (2019).

[310] Ido Kilovaty, *Legally Cognizable Manipulation*, 34 Berkeley Tech. L.J. 449, 466-67 (2019).

[311] Dacia Green, *Big Brother is Listening to you: Digital Eavesdropping in the Advertising Industry*, 16 Duke L. & Tech. Rev. 352 (2018).

[312] See, e.g., Cary Coglianese & David Lehr, Regulating by Robot: Administrative Decision Making in the Machine-Learning Era, 105 GEO. L.J. 1147, 1149 (2017) ("Many products and services, including email spam filters, medical diagnoses, product marketing, and self-driving cars, . . . depend on machine-learning algorithms and their ability to deliver astonishing forecasting power and speed." (footnotes omitted)).

targeted investors.[313] The SEC adopted Regulation Best Interest (Reg BI) in 2019 requiring brokers to comply with a "best interest" standard.[314] Reg BI also limits the manner in which brokers can be compensated for their recommendations.[315]

What constitutes a recommendation is not clear; in adopting Reg BI, the SEC stated that the definition is "not susceptible to a bright-line test" and depends on the specific "facts and circumstances." of a particular situation."[316] A recommendation need not be explicit; if a digital design or function suggests an investment or strategy, that design may constitute a recommendation.[317] A key issue in the determination of whether Reg BI applies is the degree to which a communication is individually tailored. As the SEC explained: "The more individually tailored the communication to a specific customer or a targeted group of customers about a security or group of securities, the greater the likelihood that the communication may be viewed as a 'recommendation.'"[318] One of the risks of manipulation lies in the potential for an app-based broker to use customer information to provide targeted recommendations without complying with Reg BI. Indeed, Robinhood has explicitly maintained that it does not use artificial intelligence to recommend securities or investment strategies, implicitly recognizing that, to do so, would warrant regulatory scrutiny concerning its compliance with these legal standards.[319]

Brokers obligations with respect to margin loans and options trading are even greater. FINRA rules require brokers affirmatively to approve customer accounts for options trading and, in doing so, to exercise due diligence to determine whether options trading is appropriate for that account.[320] FINRA rules provide that brokers must require customers to meet minimum deposit requirements to open a margin account, limit the extent of leverage associated with such an account in accordance with Regulation T, and maintain minimum margin requirements on an ongoing basis.[321] Brokers are also required to review the need to imposing higher margin requirements, if necessary, for individual accounts or securities.[322] The upshot of these rules is to require that brokers oversee the level of risk associated with their customers' trading activity. Automation should not be used as a tool for evading that oversight function.

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313 See, e.g., Nancy C. Libin & James S. Wrona, *The Securities Industry and the Internet: A Suitable Match?,* 2001 Colum. Bus. L. Rev. 601, 605 (explaining the suitability requirement); Robert H. Mundheim, *Professional Responsibilities of Broker-Dealers: The Suitability Doctrine*, 1965 Duke L.J. 445 (providing history of the suitability requirement).

314 Regulation Best Interest: The Broker-Dealer Standard of Conduct, Exchange Act Release No. 34-86031, 84 Fed. Reg. 33318 (July 12, 2019) (codified at 17 C.F.R. pt. 240); Neil S. Schadle, Note, *The Implications of "Regulation Best Interest: The Broker-Dealer Standard of Conduct" in an Increasingly Regulated Industry*, 46 Iowa J. Corp. L. 263, 272 (2020) (explaining Reg BI as imposing a "heightened standard of care for broker-dealers, raising a broker's obligation from a 'suitability' standard to a 'best interest' standard.").

315 Schadle, *supra* note 314.

316 Regulation Best Interest, *supra* note 314 at 79.

317 See Darbyshire, *supra* note 107 (explaining that "the SEC is looking at how digital design itself could be construed as giving investment advice").

318 Regulation Best Interest, *supra* note 314 at 80.

319 See Letter from David Dusseault, President, Robinhood Financial, LLC to Vanessa Coutryman, SEC, Oct. 1, 2021, https://www.sec.gov/comments/s7-10-21/s71021-9316498-260092.pdf, at 8-9 ("Robinhood does not recommend securities to particular investors or groups of investors using AI, ML (for example by sending or pushing specific investment recommendations or trade ideas tailored to specific customers), or any other method.")

320 FINRA Rule 2360(B).

321 FINRA rule 4210.

322 FINRA rule 4210(d); See also FINRA, Regulatory Notice 21-15, FINRA Reminds Members About Options Account Approval, Supervision and Margin Requirements, https://www.finra.org/rules-guidance/notices/21-15 (reminding brokers that "members must perform due diligence on the customer and collect information about the customer to support a determination that options trading is appropriate for the customer").

C. Financial Literacy

A final concern is that retail investors will be particularly vulnerable to exploitation both by fraudsters on social media and app-based brokerage firms, because of their lack of financial literacy. Investor financial literacy is an ongoing challenge.[323] Retail investors lack the basic skills necessary to manage their money, use credit cards, handle mortgages and retirement savings. Policymakers and researchers have struggled to identify tools for improving financial literacy, but many education and outreach efforts have shown limited success.[324]

One of the challenges with app-based trading is that investors tend to have limited understanding even of the products they are using. FINRA's survey reported, for example, that a substantial number of investors surveyed did not know whether their investment account charged commissions, whether they had ever purchased fractional shares, or whether their account allowed them to purchase securities on margin.[325]

App-based brokers see themselves not as the problem, but as the solution. Robinhood explains that many of its "digital features are designed to promote financial literacy and investment awareness," features that include Robinhood Learn, In-App Education, and Robinhood Snacks.[326] Webull describes its in-app community platforms as enabling its customers to learn from each other.[327] As one commentator explains, these platforms that are designed for self-directed investors are increasingly including "embedded education" tools that provide such investors with direction, research and analysis to assist the decisionmaking process.[328] These tools can dramatically increase the practical accessibility of capital market participation for retail investors.

But Fintech can do more. App-based platforms have the capability of providing just-in-time information – information that is provided to an investor at the time the investor enters a trade, seeks a quote on an option, or inquires into the ability to fund a trade through margin lending. Just-in-time education has been shown to improve the effectiveness of financial education because investors have access to the educational material when it is decision-relevant.[329] Apps could encourage investors to reconsider risky or unusual investment decisions with a pop-up asking "are you sure?" An investor who indicated uncertainty could then be directed to a source of additional information. Apps could use the same features that have been criticized as overly engaging – bright colors, confetti, easy-to-use designs – to reward customers for accessing educational material or demonstrating their mastery of financial concepts. App-based platforms also have the ability to make financial education interactive.

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323 See, e.g., Jill E. Fisch, Andrea Hasler, Annamaria Lusardi & Gary Mottola, *New Evidence on the Financial Knowledge and Characteristics of Investors*, at 2, FINRA Investor Education Foundation, Oct. 2019 ("Data from the 2018 National Financial Capability Study (NFCS) show that only 30% of the general population demonstrates understanding of basic financial concepts such as the workings of interest rates, inflation, and risk diversification.").

324 See Jill E. Fisch, Annamaria Lusardi & Andrea Hasler, *Defined Contribution Plans and the Challenge of Financial Illiteracy*, 105 Cornell L. Rev. 741, 783-85 (2020) (highlighting the importance of financial education and recounting studies showing mixed success of education efforts).

325 FINRA*, supra* note 202.

326 Dusseault, *supra* note 319 at 9-10.

327 Benzinga, *Webull's CEO On Empowering Traders Through Education And Community*, Sept. 26, 2019. https://www.webull.com/news/21495543. A commentator describes Webull has having a "relative dearth of educational materials" however. Emily Guy Birken & Benjamin Curry, *Webull Review 2022*, Forbes Advisor, Jan. 13, 2022, https://www.forbes.com/advisor/investing/webull-review/.

328 Rebecca Fu, *How embedded education is disrupting fintech*, UX Collective, Medium, Jan. 5, 2022, https://uxdesign.cc/how-embedded-education-is-disrupting-fintech-275cc6f85507.

329 See, e.g., Michael Kitces, *Financial Literacy Effectiveness & Providing Just-In-Time Training By Financial Advisors*, Sept. 21, 2016, https://www.kitces.com/blog/financial-literacy-program-effectiveness-just-in-time-training-by-financial-advisors/ (describing the importance of providing financial education on a "just-in-time" basis).

An ongoing challenge with disclosure-based regulation is that, even if regulations mandate valuable disclosures, many investors do not read them. Apps could provide questions or tools that require investors to demonstrate their familiarity with the disclosures before being approved for trading certain types of instruments or increasing their level of risk exposure.[330]

Regulators could "nudge" fintech in this direction. Rather than seeking to constrain innovation through new regulations or enforcement actions, regulators could encourage the development of greater educational tools, and perhaps a demonstration that those tools are being used and are effective in increasing customer financial literacy. Investor education requirements could be imposed as an alternative sanction to fines or license revocations. Demonstrated effectiveness in financial education could also provide brokers with safe harbor protection with respect to requirements such as suitability or Reg BI.

In sum, the GameStop frenzy offers new reasons to think carefully about what motivates retail investing decisions and how to motivate investors to make better ones. By engaging with the tools provided by social media and trading apps, regulators can encourage retail investors to reemerge in the capital markets and to serve as a mechanism for constructive change.

Conclusion

The GameStop frenzy is very much a product of new developments in the capital markets, particularly the role of fintech and social media. These developments show considerable promise in reducing barriers to retail participation in those markets. The reemergence of the retail investor, moreover, has the promise of affecting not just capital market behavior, but the way public corporations are run.

Whether this promise will be realized remains to be seen and depends in part on developments in retail engagement not just in trading but in voting their shares. It also depends on the extent to which regulators take action to restrict the innovations that have led to broader market participation. This Article has argued that the rationale for such restrictions is unconvincing and motivated largely by a misplaced skepticism about retail trading. At the same time, the Article identifies potential opportunities for regulators to improve the retail investor experience and to learn from the costs as well as the benefits of retail ownership.

[330] Stephen Choi suggested the idea that investors could demonstrate sufficient sophistication to be qualified for a higher level of independent trading. See Stephen Choi, *Regulating Investors Not Issuers: A Market-Based Proposal*, 88 Cal. L. Rev. 279 (2000).