
ARTICLE

GAMESTOP AND THE REEMERGENCE OF THE RETAIL INVESTOR

JILL E. FISCH*

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, critics argue that the stock market, in turn, needs protection from retail investors.

This Article challenges calls for broad regulatory reform. It reasons 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 clamp 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.

This Article defends the reemergence of the retail investor and its potential promise in enabling citizen capitalism—providing ordinary citizens with a stake

* Saul A. Fox Distinguished Professor of Business Law, University of Pennsylvania Law School. I am grateful for helpful comments from Dorothy Lund, Sergio Alberto Gramitto Ricci, Christina Sauter, Jeff Schwartz, and the participants in the Penn Law Faculty Ad Hoc workshop, the Southeastern Association of Law Professors Annual Meeting, the University of Southern California's Center for Law and Social Science Workshop, the Bocconi-Oxford Junior Scholars Network Workshops in Corporate Law, the National Business Law Scholars Conference, *The 21st Century Berle & Means Corporation: A Revolution in Retail Investing* at Monash University, *Law and Business of the Contemporary Corporation* at the University of Milan, and *New Frontiers of Shareholder Engagement* at Bocconi University.

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 increasingly 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, the frenzy drew retail investors to the market, and there is evidence that retail investment and engagement will both continue and evolve. This Article identifies opportunities to improve the retail investing experience, including greater oversight of sources of investment information, limits on 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.

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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 Entertainment Holdings, Inc. (“AMC”), and Express.² Interest in these stocks—interest that critics argued was divorced from fundamentals—was fueled by posts 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 and at least one retail-oriented brokerage firm faced dramatically increased capital requirements, forcing it to

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 those individuals (men, women, and joint accounts) held a combined average of 59% of outstanding issues.” Sarah C. Haan, *Corporate Governance and the Feminization of Capital*, 74 STAN. L. REV. 515, 526 n.45 (2022) (citing *Who Owns “Big Business”? Analysis of Stockholdings in Largest Corporations* (pt. 1), 87 TRS. & ESTS. 5, 6 (1948)). 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, 1962-63 (2010) [hereinafter Fisch, *Securities Intermediaries*] (“The ownership of public equity has shifted substantially from retail to institutional investors since Congress enacted the federal securities laws in the 1930s.”); Jill E. Fisch, *Mutual Fund Stewardship and the Empty Voting Problem*, 16 BROOK. J. CORP. FIN. & COM. L. 71, 72 (2021) [hereinafter Fisch, *The Empty Voting Problem*].

² See, e.g., Drew Harwell, ‘*Holding the Line*’ Gets Harder as GameStop Tanks, WASH. POST, Feb. 3, 2021, at A1 (describing “newbie” investors who “plowed billions of dollars through Robinhood and other online brokerages into GameStop”); Caitlin McCabe & Caitlin Ostroff, *Meme Stock Rally Resumes*, WALL ST. J., May 27, 2021, at B1 (characterizing GameStop, AMC, and Express as meme stocks).

³ See, e.g., Reuters, *How ‘Dank Memes’ Changed Wall Street: Understanding Crazy Gamestop-Reddit Phenomenon*, FIN. EXPRESS (Jan. 30, 2021, 4:58 PM), <https://www.financialexpress.com/investing-abroad/featured-stories/how-dank-memes-changed-wall-street-understanding-crazy-gamestop-reddit-phenomenon/2182611/> [<https://perma.cc/8MYP-7LJS>] (describing role of Reddit and other social media platforms in GameStop stock trading).

⁴ See, e.g., Dave Michaels, *GameStop Frenzy Prompts Criminal DOJ Probe—Investigation to Look for Any Evidence of Market Manipulation in Recent Price Swings*, WALL ST. J., Feb. 12, 2021, at A1 (“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> [<https://perma.cc/R6LH-LMSM>] (reporting “big losses” for Melvin Capital and Light Street Capital).

limit trading temporarily.⁶ Regulators demanded information,⁷ and in 2021, Congress held four hearings.⁸

The GameStop frenzy may have been 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 move on with their lives 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,

⁶ See, e.g., Avi Salzman, *GameStop's January Trading Halt—and the Search for a Fix*, BARRON'S (Feb. 24, 2021, 4:36 PM), <https://www.barrons.com/articles/gamestop-trading-was-halted-by-a-plumbing-problem-there-could-be-a-fix-51614193956> (observing that Robinhood and “[o]ther brokers . . . placed limits on some transactions”).

⁷ The Securities and Exchange Commission (“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, 5:32 PM), <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 SEC’s report following its nine-month investigation into GameStop frenzy); Request for Information and Comments on Broker-Dealer and Investment Adviser Digital Engagement Practices, Exchange Act Release No. 92766, Investment Advisers Act Release No. 5833, 86 Fed. Reg. 49067 (Sept. 1, 2021) [hereinafter Request for Comment on Digital Engagement Practices] (seeking information on 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: Virtual Hearing Before the H. Comm. on Fin. Servs.*, 117th Cong. (2021) [hereinafter *Game Stopped? Part I*]; *Game Stopped? Who Wins and Loses When Short Sellers, Social Media, and Retail Investors Collide, Part II: Virtual Hearing Before the H. Comm. on Fin. Servs.*, 117th Cong. (2021) [hereinafter *Game Stopped? Part II*]; *Game Stopped? Who Wins and Loses When Short Sellers, Social Media, and Retail Investors Collide, Part III: Virtual Hearing Before the H. Comm. on Fin. Servs.*, 117th Cong. (2021) [hereinafter *Game Stopped? Part III*]; *Who Wins on Wall Street? GameStop, Robinhood, and the State of Retail Investing: Hearing Before the S. Comm. on Banking, Hous., & Urb. Affs.*, 117th Cong. (2021) [hereinafter *Who Wins on Wall Street?*]. On June 24, 2022, the House Financial Services Committee released a report on the GameStop frenzy. MAJORITY STAFF OF H. COMM. ON FIN. SERVS., 117TH CONG., *GAME STOPPED: HOW THE MEME STOCK MARKET EVENT EXPOSED TROUBLING BUSINESS PRACTICES, INADEQUATE RISK MANAGEMENT, AND THE NEED FOR LEGISLATIVE AND REGULATORY REFORM* (2022), https://financialservices.house.gov/uploadedfiles/6.22_hfsc_gs.report_hmsmeetbp.irm.nlrf.pdf [<https://perma.cc/B8K6-ETA6>].

retirement plans, and professional advisors.⁹ The role of these intermediaries was to shelter retail investors from the risks associated with direct investing, including 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 environmental, social, and governance (“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 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 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 These critics 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

⁹ See, e.g., Fisch, *The Empty Voting Problem*, *supra* note 1, at 72 (“[I]nstitutional investors in the United States own 70-80% of the stock in large publicly-traded companies.”); Fisch, *Securities Intermediaries*, *supra* note 1, at 1963 (reporting that, at the end of 2008, 92% of the money in the mutual fund industry was contributed by the household sector).

¹⁰ See, e.g., Jill E. Fisch, Tess Wilkinson-Ryan & Kristin Firth, *The Knowledge Gap in Workplace Retirement Investing and the Role of Professional Advisors*, 66 DUKE L.J. 633, 638-42 (2016) (reporting “dramatic knowledge gap” in financial literacy between ordinary people and investment professionals).

¹¹ See Fisch, *Securities Intermediaries*, *supra* note 1, at 1965 (discussing 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* 13-14 (Harvard Pub. L. Working Paper No. 19-07, 2018), <https://ssrn.com/abstract=3247337> [<https://perma.cc/593Q-9L26>].

¹³ See, e.g., John C. Coffee, Jr., *Liquidity Versus Control: The Institutional Investor as Corporate Monitor*, 91 COLUM. L. REV. 1277, 1288-89 (1991) (evaluating institutions’ use of exit and voice in monitoring their portfolio companies).

¹⁴ See Fisch, *The Empty Voting Problem*, *supra* note 1, at 77-78 (describing BlackRock and Vanguard’s support for shareholder proposals addressing climate change).

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 common ownership literature).

¹⁶ See *infra* Section II.A.

efficiency.¹⁷ Congress and the Securities and Exchange Commission (“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, limits on the use of social media in connection with 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, this 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 and are issued by 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. This Article explains that retail investing has the potential to increase the involvement of ordinary citizens in the country’s economic development. The current trend has engaged a population that has not traditionally participated in the capital markets and offers them the opportunity 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

¹⁷ See *infra* Section II.B.

¹⁸ See, e.g., Letter from Elizabeth Warren, Sen., U.S. Senate, to Allison Herren Lee, Acting Chair, U.S. Sec. & Exch. Comm’n (Jan. 29, 2021), <https://www.warren.senate.gov/imo/media/doc/01.29.2021%20Letter%20from%20Senator%20Warren%20to%20Acting%20Chair%20Lee.pdf> [https://perma.cc/S7D3-ZUEA] (asking SEC to explain steps it will take to (1) “ensure that securities markets better reflect prices that are in line with the intrinsic and fundamental value of underlying companies” and (2) “update and implement rules defining market manipulation”); Gary Gensler, Chair, U.S. Sec. & Exch. Comm’n, 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> [https://perma.cc/NEB2-SZJL] (“I’ve asked staff to make recommendations for the Commission’s consideration on best execution, Regulation [National Market System], payment for order flow (both on-exchange and off-exchange), minimum pricing increments, and the [National Best Bid and Offer], with the aim of continuing to make our markets as efficient as possible.”).

market, however, this Article argues that the lesson for regulators from the GameStop frenzy is the need to understand the new drivers of retail investing and to ensure that those drivers promote informed and efficient investing behavior. Toward that end, this Article focuses 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.

Beginning with a brief overview of the GameStop trading frenzy and its extension to broader direct retail participation in the capital markets, this Article then 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. Part III 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.

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

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. *GameStop Corp. (GME): Historical Data*, YAHOO! FIN. [hereinafter *GameStop Historical Data*], <https://finance.yahoo.com/quote/GME/history?period1=1485907200&period2=1643673600&interval=1d&filter=history&frequency=1d&includeAdjustedClose=true> [https://perma.cc/GFA9-RM9E] (last visited Oct. 25, 2022). GameStop stock split four-for-one effective July 21, 2022. *Stock Split*, GAMESTOP, <https://news.gamestop.com/stock-split> (last visited Oct. 25, 2022).

²⁰ Mark DeCambre, *GameStop's Surge Is Making It One of the Most Traded Stocks in the U.S.*, MARKETWATCH (Jan. 27, 2021, 12:56 PM), <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*, INSIDER: MKTS. INSIDER (Mar. 10, 2021, 3:28 PM), <https://markets.businessinsider.com/news/stocks/gamestop-stock-price-trading-halts-volatility-spike-176-trading-range-2021-3> [https://perma.cc/GRV4-89G6].

²² A “meme” stock has been described as “a stock, popular with millennial-aged retail traders, that trades more on hype than its underlying fundamentals.” Thomas Niel, *9 Meme Stocks that Social Media Won't Shut Up About*, NASDAQ (Feb. 12, 2021, 1:54 PM), <https://www.nasdaq.com/articles/9-meme-stocks-that-social-media-wont-shut-up-about->

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 and conducted its initial public offering in 2002.²⁴ Its shares are listed on the New York Stock Exchange.²⁵ 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.²⁶

Over time, GameStop lost market share to competitors that relied on digitalized sales of downloadable games. It has failed to earn a profit since 2017.²⁷ GameStop's poor financial condition was exacerbated when the COVID-19 lockdown in March 2020 forced it to close its retail stores, many of which were in empty shopping malls.²⁸ In August 2020, GameStop stock was trading at around \$4/share.²⁹

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 as early as 2019.³⁰ In August 2020,

2021-02-12. Social media platforms often generate the hype behind meme stocks. *Id.* The term comes from the word “meme,” which the Merriam-Webster dictionary defines as “an idea, behavior, style, or usage that spreads from person to person within a culture.” *Meme*, MERRIAM-WEBSTER DICTIONARY, <https://www.merriam-webster.com/dictionary/meme> [<https://perma.cc/8E5H-EMFD>] (last visited Oct. 25, 2022). Meme stocks are often highly volatile. *See* Derek Horstmeyer & Valerie Mayer, *Meme Stocks and Systematic Risk*, ENTERPRISING INV. (Aug. 9, 2021), <https://blogs.cfainstitute.org/investor/2021/08/09/meme-stocks-and-systematic-risk/> [<https://perma.cc/L5SR-Q4LS>] (describing increased volatility associated with meme stocks).

²³ GAMESTOP, CORPORATE FACT SHEET (2019), <https://news.gamestop.com/static-files/a07563a1-de5d-43d0-bb11-d6bfd309dacd> [<https://perma.cc/S4WF-7S27>].

²⁴ *Id.*

²⁵ *Id.*

²⁶ Abha Bhattarai & Taylor Telford, *Despite Record Stock Surge, GameStop Is Still Struggling to Stay Afloat*, WASH. POST, Feb. 3, 2021, at A22.

²⁷ *Id.*

²⁸ Shannon Liao, *GameStop Closes All Stores*, CNN BUS. (Mar. 22, 2020, 9:28 AM), <https://www.cnn.com/2020/03/20/tech/gamestop-open-essential-business/index.html> [<https://perma.cc/FPH2-JQSE>] (reporting GameStop's decision to close all its stores as part of March 2020 lockdown); Brian Sozzi, *GameStop Stores Are Still Empty Despite Reddit-Fueled Trading Frenzy*, YAHOO! FIN. (Feb. 1, 2021), <https://www.yahoo.com/news/game-stop-stores-are-still-empty-despite-redditfueled-trading-frenzy-172939409.html> [<https://perma.cc/NF5H-9JYN>] (observing that GameStop continued to struggle “with tepid mall traffic amidst the COVID-19 pandemic”).

²⁹ Matthew Gault & Jason Koebler, *How Chaotic Redditors Made GameStop Stock Skyrocket (and Made Short Sellers Cry)*, VICE: MOTHERBOARD (Jan. 19, 2021, 3:20 PM), <https://www.vice.com/en/article/qjpx8w/how-chaotic-redditors-made-gamestop-stock-skyrocket-and-made-short-sellers-cry> [<https://perma.cc/BF5D-UUCE>].

³⁰ *Game Stopped? Part I*, *supra* note 8, at 13 (statement of Keith Patrick Gill, GameStop Investor).

Gill posted a YouTube video in which he publicly touted the company's stock.³¹ 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 as "an established, uniquely positioned player in a thriving \$150 billion gaming industry . . . to reinvent itself as a premier gaming hub."³² In particular, Gill believed that GameStop could pursue new revenue streams by embracing the technology-driven digital economy.³³

Gill decided to share his enthusiasm for GameStop on social media. In addition to YouTube, where he went by the name "Roaring Kitty,"³⁴ 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."³⁵ 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.³⁶

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.³⁷ Cohen subsequently approached GameStop management and offered a vision to turn the company around.³⁸ When his initial private overtures to the company were rebuffed,

³¹ 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>.

³² *Id.*

³³ *Game Stopped? Part I*, *supra* note 8, at 14 (statement of Keith Patrick Gill, GameStop Investor) (arguing that "GameStop may be able to find new revenue streams" through its "unique opportunity to pivot toward a technology-driven business").

³⁴ Michelle Price, *A Year on, GameStop Champion Roaring Kitty Is Quiet—Yet Much Richer*, REUTERS (Feb. 2, 2022, 2:24 PM), <https://www.reuters.com/technology/year-gamestop-champion-roaring-kitty-is-quiet-yet-much-richer-2022-02-02/>.

³⁵ Julia-Ambra Verlaine & Gunjan Banerji, *The Man Who Drove GameStop Mania*, WALL ST. J., Jan. 30, 2021, at A1.

³⁶ See Catherine Thorbecke, *GameStop Timeline: A Closer Look at the Saga That Upended Wall Street*, ABC NEWS (Feb. 13, 2021, 6:00 AM), <https://abcnews.go.com/Business/gamestop-timeline-closer-saga-upended-wall-street/story?id=75617315> [<https://perma.cc/W52C-RSZJ>] (observing that r/wallstreetbets had 3 million members on January 27, 2021, and more than 8 million by February 3, 2021).

³⁷ See RC Ventures LLC (Schedule 13D) (Aug. 31, 2020), <https://www.sec.gov/Archives/edgar/data/0001822844/000101359420000673/rc13da1-083120.htm> [<https://perma.cc/3TWW-WC3Y>].

³⁸ See Letter from Ryan Cohen, Managing Member, RC Ventures LLC, to GameStop Board of Directors (Nov. 16, 2020), <https://www.sec.gov/Archives/edgar/data/1326380/000101359420000821/rc13da3-111620.pdf> [<https://perma.cc/2UCP-HNXX>] (noting RC Ventures' private outreach to GameStop's Board of Directors).

Cohen sent the GameStop board a public letter calling for a strategic review.³⁹ Cohen's efforts led the price of GameStop to increase from its August low.⁴⁰ However, GameStop reported dismal earnings on December 8, 2020, and the next day its stock price fell to \$13.66/share.⁴¹

Some commentators anticipated that GameStop, like many other retailers, would file for bankruptcy because of the pandemic and the lockdown.⁴² Despite Cohen's optimism, several hedge funds were skeptical that his plan would succeed in turning the company around and took substantial short positions.⁴³ By the end of the year, approximately 140% of GameStop's public float had been sold short.⁴⁴

What followed was a strange combination of events. Gill's postings excited a 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.⁴⁵ New investors opened brokerage accounts to invest in GameStop, and investor interest expanded to other meme stocks, including AMC, Blackberry, and Nokia (collectively BANG), as well as Koss, Tilray, Bed Bath & Beyond, and MicroVision.⁴⁶ These stocks saw their prices rise in response to interest on social media.⁴⁷ They also experienced substantial volatility.⁴⁸ According to one source, the GameStop frenzy led 28% of U.S. investors to invest in GameStop or other meme stocks in January 2021.⁴⁹

³⁹ *See id.*

⁴⁰ *See GameStop Historical Data*, *supra* note 19 (documenting rise in GameStop's trading price to as high as \$17.50/share).

⁴¹ *Id.*

⁴² *See, e.g.*, Thomas S. Onder, *20 Retailers to Watch for a Bankruptcy Filing in the First Half of 2021*, NAT'L L. REV. (Dec. 1, 2020), <https://www.natlawreview.com/article/20-retailers-to-watch-bankruptcy-filing-first-half-2021> [<https://perma.cc/S65K-8QWY>] (including GameStop on list of twenty retailers to watch for bankruptcy filing in first half of 2021).

⁴³ These included Melvin Capital and Citron Capital. Thorbecke, *supra* note 36.

⁴⁴ John McCrank, *Explainer: How Were More than 100% of GameStop's Shares Shorted?*, REUTERS (Feb. 18, 2021, 11:15 AM), <https://www.reuters.com/article/us-retail-trading-shortselling-explainer/explainer-how-were-more-than-100-of-gamestops-shares-shorted-idUSKBN2AI2DD> [<https://perma.cc/XW6D-745Y>] (reporting that "GameStop's peak short interest was 141.8% of its float on Jan. 4[, 2021]").

⁴⁵ 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, 2:02 PM), <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>.

⁴⁶ *Id.*

⁴⁷ *See id.*

⁴⁸ *See id.*

⁴⁹ Ethan Wolff-Mann, *28% of Americans Bought GameStop or Other Viral Stocks in January: Yahoo Finance-Harris Poll*, YAHOO! FIN. (Feb. 9, 2021), <https://www.yahoo.com/now/gamestop-amc-reddit-investing-213609595.html> [<https://perma.cc/H4LU-WSN3>].

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.⁵⁰ The combination of Cohen's activism and the pressure on the short sellers led GameStop's price to increase dramatically, and, in turn, those price increases fueled further purchases.⁵¹ Social media posts encouraged investors to buy GameStop, contributing to the effort to drive prices higher.⁵² Investor interest was also spurred by some high-profile tweets, including posts by Elon Musk and Chamath Palihapitiya.⁵³ 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.⁵⁴

App-based trading platforms facilitated retail trading in GameStop.⁵⁵ Robinhood and Webull were two of the most popular platforms.⁵⁶ 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 commissions.⁵⁷ According to CNBC, there were 3.7 million downloads of the Robinhood App in January 2021.⁵⁸ In addition to being easy to use, these trading apps courted investors by offering them free shares of stock for opening accounts

⁵⁰ Micah Maidenberg, *GameStop Adds Cohen to Board*, WALL ST. J., Jan. 12, 2021, at B4.

⁵¹ See George Calhoun, *GameStop: Were the Short Sellers Routed? Does It Matter? Beware the 'Gamma'*, FORBES (Mar. 19, 2021, 4:37 PM), <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).

⁵² Annabel Smith, *The Reddit Revolt: GameStop and the Impact of Social Media on Institutional Investors*, TRADE (Apr. 13, 2021, 9:50 AM), <https://www.thetradenews.com/the-reddit-revolt-gamestop-and-the-impact-of-social-media-on-institutional-investors/> [<https://perma.cc/DYX8-KNMJ>] (describing social media's role in GameStop's share price rising over 1,000% in two weeks).

⁵³ Thorbecke, *supra* note 36; see Elon Musk, @elonmusk, TWITTER (Jan. 26, 2021, 4:08 PM), <https://twitter.com/elonmusk/status/1354174279894642703>.

⁵⁴ Al Root, *GameStop Stock Volatility Could Get Even Worse. Here's Why.*, BARRON'S (Feb. 26, 2021, 12:21 PM), <https://www.barrons.com/articles/gamestop-stock-volatility-could-get-even-worse-heres-why-51614360082>.

⁵⁵ Jennifer J. Schulp, *GameStop and the Rise of Retail Trading*, 41 CATO J. 511, 514-15 (2021) (discussing rise of retail participation in equity markets and role of trading apps).

⁵⁶ Other platforms include Dough, Public, and Firsttrade. Nikita Sheth, *How to Get Free Stocks*, FINTY (Aug. 22, 2022), <https://finty.com/us/investing/free-stocks/> [<https://perma.cc/Y8QY-JSDS>] (listing app-based brokers and discussing their marketing tactics).

⁵⁷ Barbara Friedberg & Benjamin Curry, *Webull vs Robinhood: Which Is Better?*, FORBES ADVISOR (Aug. 4, 2022, 11:01 AM), <https://www.forbes.com/advisor/investing/webull-vs-robinhood/> [<https://perma.cc/W7WB-SXN7>].

⁵⁸ Maggie Fitzgerald, *The GameStop Mania Might Be Over, but Retail Investors Look Here to Stay*, CNBC (Feb. 13, 2021, 9:53 AM), <https://www.cnbc.com/2021/02/13/why-retail-investors-are-here-to-stay.html> [<https://perma.cc/6PUZ-ZJCR>].

or inviting friends to do so⁵⁹ and by rewarding investors with confetti for actions like completing their first trade.⁶⁰ They also reinforced investor interest in GameStop and other meme stocks by providing investors with lists of popular and trending stocks.⁶¹ The retail boom was not limited to platforms like Robinhood, however. In 2020, online broker Charles Schwab gained 4 million new investors, over half of whom were under 40.⁶² Similarly, Fidelity has opened 12.7 million new retail customer accounts since March 2020.⁶³ Many investors opened brokerage accounts in response to the hype on r/wallstreetbets and looked to social media for guidance on their trading strategies.⁶⁴

The unprecedented retail trading had systemic implications. On January 28, 2021, several retail trading platforms abruptly restricted transactions in GameStop and other meme stocks. Robinhood banned new purchases of thirteen stocks.⁶⁵ Webull imposed trading restrictions on three stocks.⁶⁶ TD Ameritrade announced that it was restricting trading in GameStop and AMC.⁶⁷ Schwab

⁵⁹ See Sheth, *supra* note 56 (describing details of free stock promotions on multiple trading platforms).

⁶⁰ See David Ingram, *Designed to Distract: Stock App Robinhood Nudges Users to Take Risks*, NBC NEWS (Sept. 12, 2019, 2:59 PM), <https://www.nbcnews.com/tech/tech-news/confetti-push-notifications-stock-app-robinhood-nudges-investors-toward-risk-n1053071> [<https://perma.cc/MW6L-AUWN>] (reporting concerns that Robinhood's platform design has "elements of fun" that may encourage users to "develop risky habits that will cost [them] money over time").

⁶¹ See, e.g., Roberto Stein, *The Top 5 Predictable Effects of New Entries in Robinhood's "100 Most Popular" List* 4 (Sept. 17, 2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3694588 [<https://perma.cc/9W5R-4XD4>] (empirically analyzing effect of inclusion in Robinhood's "100 most popular" list on trading behavior of Robinhood users).

⁶² Stephen McBride, *Millennials Will Propel Stocks Higher for Years*, FORBES (Feb. 8, 2021, 9:33 AM), <https://www.forbes.com/sites/stephenmcbride1/2021/02/08/millennials-will-propel-stocks-higher-for-years/?sh=56856fff6e5d>.

⁶³ Justin Baer, *Fidelity, Once Stodgy, Bets on the Reddit Crowd*, WALL ST. J., Jan. 26, 2022, at A1.

⁶⁴ 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*, INV.'S BUS. DAILY (July 1, 2021, 4:04 PM), <https://www.investors.com/news/robinhood-ipo-to-tap-meme-stock-crowd-huge-share-for-retail-investors/> [<https://perma.cc/89EV-NEQX>].

⁶⁵ Brian Barrett, *Robinhood Restricts GameStop Trading—In a Bid to Save Itself*, WIRED (Jan. 29, 2021, 6:45 AM), <https://www.wired.com/story/robinhood-gamestop-stock/>.

⁶⁶ James Crowley, *Webull Follows Robinhood in Blocking GameStop, AMC Trades After Being Suggested as Alternate Trading Platform*, NEWSWEEK (Jan. 28, 2021, 11:52 AM), <https://www.newsweek.com/webull-blocks-gamestop-amc-transactions-stock-market-robinhood-1565172> [<https://perma.cc/D4AC-NRSR>].

⁶⁷ Mark DeCambre, *GameStop and AMC Trading Restricted by TD Ameritrade, Schwab, Robinhood Others*, MARKETWATCH (Jan. 28, 2021, 10:40 AM), <https://www.marketwatch.com/story/gamestop-amc-trading-is-now-being-restricted-at-td-ameritrade-11611769804>.

tightened its restrictions on investors' ability to purchase certain meme stocks on margin.⁶⁸ Interactive Brokers Group announced that investors could unwind but not establish new options positions in five meme stocks.⁶⁹

Critics of the trading halts argued that the brokers were seeking to protect hedge fund short sellers from the impact of further price increases.⁷⁰ The brokers offered different but varying explanations. Schwab, Webull, and TD Ameritrade, for example, cited volatility and market instability.⁷¹ Robinhood pointed to dramatically increased capital requirements and costs associated with clearing the trades.⁷² Most of the trading restrictions were removed within a single day.⁷³ Robinhood announced that it had raised more than \$1 billion of new capital to meet the capital requirements.⁷⁴ Despite their relatively short duration, the trading halts sparked outrage among investors and led some lawmakers to call for congressional hearings.⁷⁵ Dozens of lawsuits were filed against Robinhood and other companies.⁷⁶

⁶⁸ *Id.*

⁶⁹ *Id.*

⁷⁰ See, e.g., Barrett, *supra* note 65 (“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.”).

⁷¹ DeCambre, *supra* note 67; Crowley, *supra* note 66.

⁷² See *Game Stopped? Part I*, *supra* note 8, at 115 (written testimony of Vladimir Tenev, CEO, Robinhood Markets, Inc.) (“[T]he 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.”).

⁷³ Tara Siegel Bernard & Gillian Friedman, *After an Outcry, Robinhood Says It Will Allow Users to Trade GameStop Again on Friday*, N.Y. TIMES (Jan. 30, 2021), <https://www.nytimes.com/2021/01/28/business/robinhood-gamestop-restrictions.html> (“Several retail stockbrokers, including Robinhood, said they would allow trades of GameStop and other volatile companies after restricting customers’ ability to purchase securities earlier in the day.”).

⁷⁴ Kate Kelly, Erin Griffith, Andrew Ross Sorkin & Nathaniel Popper, *Needing Cash, Robinhood Raises \$1 Billion from Existing Investors*, N.Y. TIMES, Jan. 30, 2021, at B4.

⁷⁵ Katherine Fung, *Alexandria Ocasio Cortez Calls Robinhood’s Block on Trading GameStop, Other Stocks ‘Unacceptable,’* NEWSWEEK (Jan. 28, 2021, 12:54 PM), <https://www.newsweek.com/alexandria-ocasio-cortez-calls-robinhoods-block-trading-gamestop-other-stocks-unacceptable-1565174> [<https://perma.cc/AV6U-M8P4>] (noting Representative Alexandria Ocasio Cortez’s tweet calling Robinhood’s trading halt “unacceptable”).

⁷⁶ Amanda Bronstad, *Lawsuits over GameStop Trading Expand Beyond Robinhood, Alleging an Antitrust Conspiracy*, NAT’L L.J. (Feb. 9, 2021, 10:56 AM), <https://www.law.com/nationallawjournal/2021/02/09/lawsuits-over-gamestop-trading-expand-beyond-robinhood-alleging-an-antitrust-conspiracy/> [<https://perma.cc/4UGY-22LN>] (describing forty-two lawsuits against thirty-five defendants including Robinhood). To date, those lawsuits have not been successful. See, e.g., Alexander Osipovich, *Judge Rejects Suit Against Robinhood*, WALL ST. J., Jan. 28, 2022, at B11 (describing dismissal of two lawsuits against Robinhood arising out of trading halts).

In subsequent months, Ryan Cohen succeeded in becoming chairman of GameStop and replaced its board of directors and executive team, an effort that included hiring a new Chief Executive Officer (“CEO”) from Amazon.⁷⁷ Whether the new team will be successful in turning the company around remains to be seen.⁷⁸ Although the stock price has not risen to anywhere near its January 2021 high, it has traded near or above \$100/share consistently.⁷⁹

Although interest in meme stocks declined after the winter of 2021, retail investors have not dropped out of the market.⁸⁰ 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. Similarly, the broad market decline in the spring of 2022 has led to reduced retail trading activity and could cause some new investors to exit from the markets entirely.⁸¹ 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.⁸²

⁷⁷ See Sarah E. Needleman, *Ryan Cohen’s Power Play at GameStop—36-Year-Old Ousted Executives in Overhaul*, WALL ST. J., Aug. 13, 2021, at A1 (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, 9:43 AM), <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).

⁷⁸ See, e.g., Bernard Zambonin, *GameStop Stock: Here’s What You Should Know About GME’s Bold Turnaround Plan*, THE STREET (July 11, 2022, 6:56 AM), <https://www.thestreet.com/memestocks/gme/gamestop-stock-what-you-should-know-bold-turnaround-plan> [<https://perma.cc/2ZSQ-DKFB>] (providing update on GameStop’s turnaround plan after one year under new leadership).

⁷⁹ *GameStop Historical Data*, *supra* note 19.

⁸⁰ Saqib Iqbal Ahmed, *Meme Stock Hangover: A Year After GameStop, Traders Face Gloomier Markets*, REUTERS (Jan. 28, 2022, 12:12 PM), <https://www.reuters.com/business/finance/meme-stock-hangover-year-after-gamestop-traders-face-gloomier-markets-2022-01-28/>.

⁸¹ See, e.g., Tara Siegel Bernard, *Amateur Investors Rode the Bull, but Now the Bear Is Near*, N.Y. TIMES, May 20, 2022, at B1 (reporting declines in retail trading activity and describing various retail responses to market decline); Jacob Sonenshine, *Retail Investors Are Dropping Out of the Stock Market*, BARRON’S (Mar. 16, 2022, 3:15 AM), <https://www.barrons.com/articles/retail-investors-trading-activity-stocks-51647382939> (citing evidence that retail investors may be getting “scared away from the market”).

⁸² As of October 2021, Robinhood had more than 22 million funded accounts. *Robinhood Reports Third Quarter 2021 Results*, ROBINHOOD (Oct. 26, 2021), <https://investors.robinhood.com/news/news-details/2021/Robinhood-Reports-Third-Quarter-2021-Results/> [<https://perma.cc/VTH3-R7NV>] (noting number of funded accounts increased 97% from 11.4 million in third quarter of 2020).

Some have called for regulatory intervention.⁸³ Senator Elizabeth Warren wrote to the SEC demanding that it respond to the GameStop frenzy.⁸⁴ 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.⁸⁵ 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.⁸⁶ The SEC also announced that, in light of the GameStop frenzy, it would review payment for order flow⁸⁷ and existing rules governing short selling.⁸⁸ In addition, the SEC staff released a report on October 14, 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

⁸³ See, e.g., James J. Angel, *Gamestonk: What Happened and What to Do About It* 14, 34-36 (Georgetown McDonough Sch. of Bus., Working Paper No. 3782195, 2021), <https://ssrn.com/abstract=3782195> [<https://perma.cc/KPY4-SFXW>] (advocating reforms to regulation of short selling and broker dealer compensation practices); *Who Wins on Wall Street?*, *supra* note 8, at 13 (written testimony of Gina-Gail S. Fletcher, Professor of Law, Duke University School of Law) (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 concept of “behavioral churning”); see also Ryan Clements, *Misaligned Incentives in Markets: Envisioning Finance that Benefits All of Society*, 19 *DEPAUL BUS. & COM. L.J.* 1, 60-61 (2021) (citing range of potential regulatory responses to GameStop frenzy, “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”).

⁸⁴ Letter from Elizabeth Warren, *supra* note 18.

⁸⁵ Lucas Manfredi, *GameStop’s Big Day as Shares Sit with 1,492% Annual Gain*, *FOX BUS.* (June 9, 2021, 7:46 AM), <https://www.foxbusiness.com/markets/gamestop-stock-meme-earnings-ryan-cohen-chewy> [<https://perma.cc/R24J-WXW9>].

⁸⁶ Request for Comment on Digital Engagement Practices, *supra* note 7, at 49067-69 (“DEPs can potentially harm retail investors if they prompt them to engage in trading activities that may not be consistent with their investment goals or risk tolerance.”).

⁸⁷ Dave Michaels, *GameStop Saga Prompts SEC to Weigh Review of Payment for Order Flow*, *WALL ST. J.* (Mar. 9, 2021, 2:05 PM), <https://www.wsj.com/articles/gamestop-saga-prompts-sec-to-weigh-review-of-payment-for-order-flow-11615316739> (explaining that rise of commission-free trading has put more focus on controversy surrounding payment for order flow, “a practice that funnels many small investors’ stock orders to be filled by high-speed trading firms”).

⁸⁸ Katanga Johnson, *U.S. SEC Chair Says Reviewing Short-Selling, Swap Rules After GameStop, Archegos Sagas*, *REUTERS* (May 5, 2021, 2:40 PM), <https://www.reuters.com/business/us-sec-chief-plans-scrutinize-short-sellers-rein-gamification-following-gamestop-2021-05-05/>.

study.⁸⁹ To date, the SEC has not announced any findings of illegal manipulation or adopted new rules.⁹⁰

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.⁹¹ In April 2021, regulators sought to amend the claim to revoke Robinhood's registration as a broker-dealer in Massachusetts.⁹² In July 2021, Robinhood disclosed investigations by a variety of other regulators, including the Financial Industry Regulatory Authority ("FINRA") and the states of New York and California.⁹³ The disclosure followed the announcement that Robinhood had agreed to pay FINRA a \$70 million penalty to settle allegations of wrongdoing.⁹⁴

Congress 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.⁹⁵ The second hearing included testimony

⁸⁹ U.S. SEC. & EXCH. COMM'N, STAFF REPORT ON EQUITY AND OPTIONS MARKET STRUCTURE CONDITIONS IN EARLY 2021, at 43 (2021) [hereinafter SEC STAFF REPORT], <https://www.sec.gov/files/staff-report-equity-options-market-structure-conditions-early-2021.pdf> [https://perma.cc/SCL9-2JPY].

⁹⁰ SEC Chair Gary Gensler has signaled his intention to update the SEC's rules to "drive greater efficiencies in our equity markets, particularly for retail investors." See Gary Gensler, Chair, Sec. & Exch. Comm'n, "Market Structure and the Retail Investor:" Remarks Before the Piper Sandler Global Exchange Conference (June 8, 2022), <https://www.sec.gov/news/speech/gensler-remarks-piper-sandler-global-exchange-conference-060822> [https://perma.cc/QF4C-M943].

⁹¹ Administrative Complaint at 3, Robinhood Financial, LLC, No. E-2020-0047 (Mass. Sec. Div. Dec. 16, 2020), <https://www.sec.state.ma.us/sct/current/sctrobinhood/MSD-Robinhood-Financial-LLC-Complaint-E-2020-0047.pdf> [https://perma.cc/WK5J-7RFY] ("Robinhood used advertising and marketing techniques that targeted younger individuals, including Massachusetts residents, with little, if any, investment experience.").

⁹² Nate Raymond, *Massachusetts Regulators Seek to Revoke Robinhood's License; Brokerage Sues*, REUTERS (Apr. 15, 2021, 2:13 PM), <https://www.reuters.com/technology/robinhood-sues-invalidate-massachusetts-fiduciary-rule-2021-04-15/>; Motion for Leave to File Amended Administrative Complaint at 1-2, Robinhood Financial, LLC, No. E-2020-0047 (Mass. Sec. Div. Apr. 15, 2021), https://static.reuters.com/resources/media/editorial/20210415/04142021robinhood_amend.pdf [https://perma.cc/232A-CSLR] (arguing that Robinhood's failure to change its behavior since initial filing is grounds for revocation of registration as broker-dealer in Massachusetts).

⁹³ Chris Prentice & Michelle Price, *Explainer: The Regulatory and Legal Headwinds Facing Robinhood*, REUTERS (July 2, 2021, 6:28 AM), <https://www.reuters.com/technology/regulatory-legal-headwinds-facing-robinhood-2021-07-02/>.

⁹⁴ *Id.*

⁹⁵ Andrew Ross Sorkin, Jason Karaian, Michael J. de la Merced, Lauren Hirsch & Ephrat Livni, "Something Very Wrong Happened Here," N.Y. TIMES: DEALBOOK (Mar. 12, 2021), <https://www.nytimes.com/2021/02/19/business/dealbook/robinhood-hearing-congress.html>.

by academics and other experts.⁹⁶ SEC Chair Gary Gensler, CEO of the Depository Trust & Clearing Corporation Michael C. Bodson, and FINRA CEO Robert Cook testified at the third hearing.⁹⁷ Finally, the Senate hearing featured various researchers on capital markets.⁹⁸ 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.⁹⁹

II. ADDRESSING THE GAMESTOP FRENZY

Commentators have identified two distinct 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.¹⁰⁰ The core theme is a need to protect retail investors from the market.¹⁰¹

A separate set of concerns focuses on the market impact of the GameStop frenzy rather than the impact on individual market participants.¹⁰² These

⁹⁶ 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>.

⁹⁷ *Game Stopped? Part III*, *supra* note 8, at 5-6, 8.

⁹⁸ *Who Wins on Wall Street?*, *supra* note 8, at 6-14.

⁹⁹ See, e.g., Cora Leeuwenburg, *An Update on the Gamestop Frenzy: Calls for Regulation and a Congressional Hearing*, LOY. UNIV. CHI. SCH. OF L.: INSIDE COMPLIANCE (Mar. 19, 2021), <http://blogs.luc.edu/compliance/?p=3770> [<https://perma.cc/7U6L-MFVV>] (describing regulatory changes proposed during Senate hearing).

¹⁰⁰ See, e.g., Bob Pisani, *Wall Street Worries About Regulatory Fallout from the GameStop Saga*, CNBC (Feb. 4, 2021, 10:03 AM), <https://www.cnbc.com/2021/02/04/wall-street-worries-about-regulatory-fallout-from-the-gamestop-saga.html> [<https://perma.cc/5ELN-KRP6>] (describing concerns expressed by FINRA that “gamification may have caused investors to trade excessively or make investments not suitable for them”).

¹⁰¹ As Abe Cable explains, the concept of investor protection encompasses three distinct rationales—paternalistic investor protection, protection of investor choice, and protection of investor access. See Abraham J.B. Cable, *Regulating Democratized Investing*, OHIO ST. L.J. (forthcoming 2022) (manuscript at 8-10), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4136828 [<https://perma.cc/2RQ8-GN83>]. Calls for regulatory reform in response to the GameStop frenzy are driven largely by paternalistic concerns and, as Cable explains, are likely to sacrifice investor choice and access. *Id.* (manuscript at 29, 33-34).

¹⁰² 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, 4:13 PM), <https://www.cnbc.com/2021/01/27/gamestop-speculation-is-danger-to-whole-market-massachusetts-regulator.html> [<https://perma.cc/X5XU-EM2W>] (describing statement by Massachusetts Secretary of the Commonwealth William Galvin that 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,

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.

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.¹⁰³ 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.¹⁰⁴ They also tend to be small investors. For example, the median account size at Robinhood is \$240.¹⁰⁵ Survey evidence suggests that new traders are overly optimistic about the likelihood that they will make money through their trading.¹⁰⁶

Critics warn that these investors are likely to lose money—money they cannot afford to lose.¹⁰⁷ As one commentator 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.”¹⁰⁸ Another observed that “for

7:16 AM), <https://www.reuters.com/article/us-retail-trading-bubbles-analysis-idUSKBN29Z0HG> (quoting Boston College finance professor Ronnie Sadka’s statement that “[r]etail investors are becoming a systemic risk”).

¹⁰³ See, e.g., Katie Martin & Robin Wigglesworth, *Rise of the Retail Army: The Amateur Traders Transforming Markets*, FIN. TIMES (Mar. 9, 2021), <https://www.ft.com/content/7a91e3ea-b9ec-4611-9a03-a8dd3b8bddb5> [<https://perma.cc/DN3L-5NBV>] (“A Deutsche Bank survey found that almost half of US retail investors were completely new to the markets in the past year.”).

¹⁰⁴ See *id.*; Nathaniel Popper, *Robinhood Has Lured Young Traders, Sometimes with Devastating Results*, N.Y. TIMES, Sept. 25, 2021, at B1 (noting that average age of Robinhood investors is thirty-one and half of Robinhood investors have never invested before).

¹⁰⁵ Keris Lahiff, *Robinhood Debuts on Nasdaq—Jim Cramer and Others Share Their Take*, CNBC: TRADING NATION (July 29, 2021, 5:42 PM), <https://www.cnbc.com/2021/07/29/robinhood-stock-nasdaq-ipo-jim-cramer-and-others-share-their-take.html> [<https://perma.cc/CU96-V485>].

¹⁰⁶ *The Rise of the Investor Generation: 15% of U.S. Stock Market Investors Got Their Start in 2020, Schwab Study Shows*, CHARLES SCHWAB CORP., <https://www.abouschwab.com/generation-investor-study-2021> [<https://perma.cc/K4A3-NAWY>] (last visited Oct. 25, 2022) (reporting results of 2021 survey showing those who began investing in 2020 are more optimistic about stock market).

¹⁰⁷ See Popper, *supra* note 104 (observing that inexperience of Robinhood traders can lead to “staggering losses”).

¹⁰⁸ 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, 5:28 PM), <https://www.cnbc.com/2021/01/27/what-to-know-about-gamestops-stock-spike.html> [<https://perma.cc/TC28-9F7B>].

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.”¹⁰⁹

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.¹¹⁰ 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 investors’ exposure to the market and by creating the potential for investors to lose more than they can afford.¹¹¹ As former TD Ameritrade CEO Joe Moglia explained, “leverage . . . can rip your arms off.”¹¹² Indeed, data indicate that Robinhood customers were fourteen times more likely to default on their margin loans than the average investor.¹¹³ Although the Federal Reserve limits the percentage of a securities purchase that can be financed through borrowing,¹¹⁴ investors sometimes seek to circumvent these limits by using personal loans or credit card debt.¹¹⁵ In addition, investors who purchase on

¹⁰⁹ Rizwan Virk, *GameStop Trades and Meme Investing Turn Stocks into a Pump-and-Dump Scheme*, NBC NEWS: THINK (Feb. 19, 2021, 5:20 PM), <https://www.nbcnews.com/think/opinion/gamestop-trades-meme-investing-make-stocks-ponzi-scheme-hurts-little-ncna1257680> [<https://perma.cc/2GHT-E3MN>].

¹¹⁰ Simon Constable, *Massive Margin Call Strikes Again in the Stock Market*, FORBES (Mar. 29, 2021, 11:52 AM), <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.”).

¹¹¹ See, e.g., *Investor Bulletin: Understanding Margin Accounts*, U.S. SEC. & EXCH. COMM’N (June 10, 2021), https://www.sec.gov/oiea/investor-alerts-and-bulletins/ib_marginaccount [<https://perma.cc/7FU9-983Y>] (explaining that margin trading “exposes you to the potential for larger losses”).

¹¹² Carla Mozée, *Leverage “Can Rip Your Arms Off,” Former TD Ameritrade Boss Says in Warning to Meme-Stock Retail Traders*, INSIDER: MKTS. INSIDER (June 4, 2021, 8:48 AM), <https://markets.businessinsider.com/news/stocks/meme-stock-leverage-warning-ex-td-ameritrade-boss-amc-reddit-2021-6> [<https://perma.cc/2DPY-QVNQ>].

¹¹³ Stephen Gandel, *Robinhood Offers Loans to Buy Stock—They Were 14 Times More Likely to Default*, CBS NEWS (Feb. 5, 2021, 6:09 PM), <https://www.cbsnews.com/news/robinhood-stock-loans-were-14-times-more-likely-to-default-than-rivals/> [<https://perma.cc/JF9Q-SAKY>]. 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”).

¹¹⁴ See *Investor Bulletin: Understanding Margin Accounts*, *supra* note 111 (“According to Regulation T of the Federal Reserve Board, you may borrow up to 50 percent of the purchase price of margin securities.”).

¹¹⁵ Lance Roberts, *This Won’t End Well—Gen Z’ers Take on Debt to Invest*, ADVISOR PERSPS. (Sept. 3, 2021),

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.¹¹⁶

Options further increase investor risk. Options provide an alternative way to increase investor buying power and were cited as a substantial factor boosting the demand for GameStop stock.¹¹⁷ 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 for allowing inexperienced investors to access margin loans and options too easily.¹¹⁸ One Robinhood investor, a 20-year-old student, committed suicide after his options trading through his Robinhood account led him to incorrectly believe he had a negative \$730,000 account balance.¹¹⁹

A related concern is that retail customers are not really investing in meme stocks but are instead gambling.¹²⁰ To many critics, 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

<https://www.advisorperspectives.com/commentaries/2021/09/03/this-wont-end-well-geners-take-on-debt-to-invest> [<https://perma.cc/V23T-DGSV>] (reporting that many individual investors “took out personal loans or went into credit card debt” to fund their stock purchases).

¹¹⁶ Mozée, *supra* note 112.

¹¹⁷ David Borun, *How Options Trading Is Fueling the GameStop Rally*, NASDAQ (Jan. 26, 2021, 4:50 PM), <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).

¹¹⁸ See News Release, Michelle Ong, Ray Pellicchia, Angelita Plemmer Williams & Andrew DeSouza, Fin. Indus. Regul. Auth., 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> [<https://perma.cc/Z54J-SJTJ>] (stating that Robinhood “failed to exercise due diligence before approving customers to place options trades”).

¹¹⁹ 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, 5:59 PM), <https://www.businessinsider.com/robinhood-settled-suit-suicide-20-year-old-trader-alex-kearns-2021-7> [<https://perma.cc/5C85-SSJL>]. Robinhood settled a wrongful death lawsuit over the suicide for an undisclosed amount. *Id.*

¹²⁰ See, e.g., Virk, *supra* note 109 (“[M]ost 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. 6, 2021), <https://www.ft.com/content/8f9bbc77-06b1-4fbd-8b7e-6e381ba038a7> [<https://perma.cc/D37S-ADC2>] (quoting statement of Keith Whyte, executive director of National Council on Problem Gambling, that “line between gambling and investing, which was already pretty fluid, has almost been completely erased”).

for pushing investors into inappropriate trading decisions.¹²¹ Trading platforms also increase herding by investors.¹²² Sites such as Robinhood publish lists of stocks that are popular among their customers and push this information on the app.¹²³ Studies show that the inclusion of a stock on the list substantially increases customer trading of the stock.¹²⁴

Critics also challenge brokerage firms' conflicts of interest, observing that the business models of Robinhood and the other app-based brokers rely on trading to generate income.¹²⁵ Of particular concern is the fact that some trading apps earn a substantial amount of revenue from payment for order flow.¹²⁶ 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 exchange for those orders.¹²⁷ 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.¹²⁸ In reality, however, it is possible to generate price improvement for a customer in connection with a trade, and payment for order

¹²¹ See Darbyshire, *supra* note 120 (quoting North American Securities Administrators Association as saying, “[b]y 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”).

¹²² See, e.g., Brad M. Barber, Xing Huang, Terrance Odean & Christopher Schwarz, *Attention-Induced Trading and Returns: Evidence from Robinhood Users*, J. FIN. (forthcoming 2022) (manuscript at 28-29), <https://ssrn.com/abstract=3715077> [<https://perma.cc/JZ8D-CN9Z>] (reporting that Robinhood focuses investor attention on certain stocks, encouraging herding and leading to lower investment returns).

¹²³ See Stein, *supra* note 61 (describing Robinhood's top 100 list).

¹²⁴ *Id.* (reporting that customers were five to seven times more likely to buy stocks newly named to top 100 list).

¹²⁵ See, e.g., Mark Schoeff Jr. & Nicole Casperson, *GameStop's Saga: What the Stock Surge Proves About Financial (Il)lteracy*, INV. NEWS (Apr. 12, 2021), <https://www.investmentnews.com/gamestops-saga-what-the-stock-surge-proves-about-financial-literacy-205019> [<https://perma.cc/9W8V-HZ4F>] (quoting William Galvin, Secretary of the Commonwealth of Massachusetts, as saying, “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”).

¹²⁶ See Avi Salzman, *SEC Chairman Says Banning Payment for Order Flow Is “On the Table,”* BARRON'S (Aug. 30, 2021, 4:46 PM), https://www.barrons.com/articles/sec-chairman-says-banning-payment-for-order-is-on-the-table-51630350595?mod=hp_LEAD_2 (reporting SEC Chair Gary Gensler's statement that banning payment for order flow is “on the table”).

¹²⁷ *Id.*

¹²⁸ The requirement of best execution is somewhat lax. See, e.g., Robert P. Bartlett, III, *Modernizing Odd Lot Trading*, 2021 COLUM. BUS. L. REV. 520, 525 (providing data demonstrating that odd lot trading rules reduce impact of best execution requirement for popular retail stocks on nonexchange trading venues).

flow generally results in the broker, rather than the customer, receiving the benefit of any potential price improvement.¹²⁹

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.¹³⁰ Robinhood earned an average of two-tenths of a penny for each share bought or sold.¹³¹ Payment for order flow can create an incentive for a broker to encourage its customers to engage in more trading than is appropriate for their investment objectives, a process that Kyle Langvardt and James Fallows Tierney term “behavioral churning.”¹³² As 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.”¹³³

Critics also raise concerns about the extent to which meme investors are influenced by social media.¹³⁴ Many investors opened brokerage accounts in response to the hype in the Reddit community known as WallStreetBets and then looked to social media (rather than trained investment professionals) for guidance on their trading strategies.¹³⁵ In particular, commentators warn that investors may simply be following a social trend rather than investing based on

¹²⁹ See Stanislav Dolgoplov, *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, 512 (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.”).

¹³⁰ John McCrank, *Explainer: Robinhood Makes Most of Its Money from PFOF. What Is It?*, REUTERS (July 29, 2021, 11:59 AM), <https://www.reuters.com/business/finance/robinhood-makes-most-its-money-pfof-what-is-it-2021-07-29/>.

¹³¹ Tomio Geron, *Data Shows How Robinhood Makes More Money from Its Users than Other Brokers*, PROTOCOL (July 15, 2021), <https://www.protocol.com/fintech/payment-for-order-flow> [https://perma.cc/NP6G-HZY8].

¹³² Langvardt & Fallows Tierney, *supra* note 83, at 737.

¹³³ SEC STAFF REPORT, *supra* note 89, at 12, 44.

¹³⁴ See, e.g., Sue S. Guan, *Meme Investors and Retail Risk*, 63 B.C. L. Rev. (forthcoming 2022) (manuscript at 11-12), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4002708 [https://perma.cc/K5A8-L6T9].

¹³⁵ *Thinking About Investing in the Latest Hot Stock? Understand the Significant Risks of Short-Term Trading Based on Social Media*, U.S. SEC. & EXCH. COMM’N: INV. ALERTS BULL. (Jan. 30, 2021), <https://www.sec.gov/oiea/investor-alerts-and-bulletins/risks-short-term-trading-based-social-media-investor-alert> [https://perma.cc/2BMA-HXKU]. One study empirically demonstrated that Reddit posts led to increased trading in GameStop shares. André Betzer & Jan Philipp Harries, *How Online Discussion Board Activity Affects Stock Trading: The Case of GameStop*, FIN. MKTS. & PORTFOLIO MGMT. (Mar. 30, 2022), <https://link.springer.com/content/pdf/10.1007/s11408-022-00407-w.pdf> [https://perma.cc/SJ32-FPQS].

sound investment analysis.¹³⁶ The anonymity of these platforms also increases the potential for misinformation and even manipulation.¹³⁷ 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.”¹³⁸

Finally, as this Article goes to press, the capital markets have suffered a substantial decline, with stocks falling more than 20 percent since the start of 2022.¹³⁹ As a result, many retail investors who began investing during 2021 have suffered significant losses.¹⁴⁰

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.¹⁴¹ The level of short selling, coupled with the use of margin trading and options to leverage demand, fueled these price swings.¹⁴²

Volatility can exacerbate trading losses and generate higher levels of uninformed trading. It can also 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.

¹³⁶ See, e.g., Reethu Ravi, *How Social Media Is Causing a Meme Stock Mania*, JUMPSTART (May 26, 2021), <https://www.jumpstartmag.com/how-social-media-is-causing-a-meme-stock-mania/> [<https://perma.cc/B4EK-68HB>] (“[M]eme stock investing often follow [sic] a social media trend rather than logical reasoning.”).

¹³⁷ See, e.g., Brian O’Connell, *The Rise of Meme Stocks: How Viral Trading Hit High Gear in Early 2021*, FINMASTERS, <https://finmasters.com/the-rise-of-meme-stocks/> [<https://perma.cc/VG3R-9RH2>] (last updated Aug. 9, 2022) (quoting Asher Rogovy, Chief Investment Officer at Magnifina, as saying, “Fraudsters may be emboldened to make false claims on anonymous internet forums”).

¹³⁸ David J. Lynch, Hamza Shaban, Hannah Denham & Tory Newmyer, *Unlikely Shares Surge in Wall Street Revolt*, WASH. POST, Jan. 28, 2021, at A1.

¹³⁹ Conrad de Aenlle, *Recession Worries and Bear Markets*, N.Y. TIMES, July 17, 2022, at BU7.

¹⁴⁰ See, e.g., Lu Wang, *Day Trader Army Loses All the Money It Made in Meme-Stock Era*, BLOOMBERG (May 8, 2022, 5:55 PM), <https://www.bloomberg.com/news/articles/2022-05-08/day-trader-army-loses-all-the-money-it-made-in-meme-stock-era#xj4y7vzkg> (citing Morgan Stanley estimate finding “amateur investors who jumped in when the [COVID-19] lockdown began have now given back all of their once-prodigious gains”).

¹⁴¹ Fox, *supra* note 21.

¹⁴² See SEC STAFF REPORT, *supra* note 89, at 17-22.

This, in turn, led those clearinghouses to demand higher deposits from retail brokerage firms such as Robinhood, which caused many such firms temporarily to halt trading in meme stocks.¹⁴³

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.¹⁴⁴ In the past, large losses suffered by a customer have had potentially significant market-wide impacts, as in the case of Long Term Capital Management.¹⁴⁵ 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.¹⁴⁶

Although the GameStop frenzy does not appear to have had an impact on broader market stability,¹⁴⁷ commentators view retail trading as presenting a similar potential for systemic risk. Congressman Stephen Lynch warned of retail trading's potential to fuel systemic risk.¹⁴⁸ Similarly, Senator Elizabeth Warren noted that the GameStop frenzy and the level of speculation it involved could prompt broader market sell-offs.¹⁴⁹ She observed that the resulting market shift "also raises questions about broader instabilities in the market and financial system."¹⁵⁰

¹⁴³ See *supra* notes 65-69 and accompanying text.

¹⁴⁴ See SEC STAFF REPORT, *supra* note 89, at 31 ("[I]n highly volatile trading where share prices whipsaw by hundreds of dollars, NSCC may require more margin to guard against an increased risk of defaults.").

¹⁴⁵ See, e.g., PRESIDENT'S WORKING GRP. ON FIN. MKTS., HEDGE FUNDS, LEVERAGE, AND THE LESSONS OF LONG-TERM CAPITAL MANAGEMENT 17-19 (1999), [https://ypfsresourcelibrary.blob.core.windows.net/fcic/fcic-docs/1999-04-00%20Hedge%20Funds,%20Leverage,%20and%20the%20Lessons%20of%20Long-Term%20Capital%20Management%20\(PWG%20on%20Financial%20Markets\).pdf](https://ypfsresourcelibrary.blob.core.windows.net/fcic/fcic-docs/1999-04-00%20Hedge%20Funds,%20Leverage,%20and%20the%20Lessons%20of%20Long-Term%20Capital%20Management%20(PWG%20on%20Financial%20Markets).pdf) [<https://perma.cc/VNU2-4KSW>] (describing potential market effect on counterparties if LTCM had failed).

¹⁴⁶ 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*, INSIDER: MKTS. INSIDER (Mar. 30, 2021, 7:56 AM), <https://markets.businessinsider.com/news/stocks/reddit-retail-traders-systemic-risk-hedge-fund-archegos-liquidation-2021-3> [<https://perma.cc/WW96-9UUS>].

¹⁴⁷ See Matt Phillips, Matthew Goldstein & Ephrat Livni, *S.E.C. Suggests No Policy Changes in Response to Meme Stock Frenzy*, N.Y. TIMES, Oct. 19, 2021, at B4 (stating SEC staff "found that everything worked largely the way it was supposed to").

¹⁴⁸ See Daniel, *supra* note 146.

¹⁴⁹ Letter from Elizabeth Warren, *supra* note 18.

¹⁵⁰ *Id.*

Retail trading may also reduce liquidity,¹⁵¹ which can raise transaction costs and reduce market efficiency.¹⁵² Sue Guan demonstrates how coordinated retail trading could reduce liquidity by leading to wider spreads by liquidity suppliers and other market participants.¹⁵³

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.”¹⁵⁴ Market speculation both disrupts the link between prices and fundamental value¹⁵⁵ 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 \$1 billion in capital while its stock price was buoyed by the meme stock boom, and GameStop raised \$1.7 million.¹⁵⁶ Notably, in its prospectus, AMC cautioned investors that its current stock price reflected 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.”¹⁵⁷

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.”¹⁵⁸ Another reasoned,

¹⁵¹ 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.”).

¹⁵² See Marcel Kahan, *Securities Laws and the Social Costs of “Inaccurate” Stock Prices*, 41 DUKE L.J. 977, 1019 (1992) (describing costs resulting from reduced liquidity).

¹⁵³ Guan, *supra* note 134 (manuscript at 28).

¹⁵⁴ Letter from Elizabeth Warren, *supra* note 18.

¹⁵⁵ See 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*, CONVERSATION (Feb. 4, 2021, 6:46 PM), <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> [<https://perma.cc/EG9N-QLP2>].

¹⁵⁶ 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, at 26.

¹⁵⁷ AMC Ent. Holdings, Prospectus Supplement (Form 424B5) (June 3, 2021), https://www.sec.gov/Archives/edgar/data/0001411579/000110465921076090/tm2118373-1_424b5.htm [<https://perma.cc/CU8U-P6BZ>].

¹⁵⁸ Letter from Tyler Gellash, Exec. Dir., Healthy Mkts., to Maxine Waters, Chairwoman, House Comm. on Fin. Servs.; Patrick McHenry, Ranking Member, House Comm. on Fin. Servs.; Brad Sherman, Chairman, House Comm. on Fin. Servs.; Bill Huizenga, Ranking Member, House Comm. on Fin. Servs. 1 (Feb. 17, 2021), <https://healthymarkets.org/wp-content/uploads/2021/02/Letter-to-HFSC-Hearing-2-17-21.pdf> [<https://perma.cc/SF9A-NMZH>].

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.¹⁵⁹

III. EVALUATING THE NEED FOR REFORM

The foregoing concerns about the GameStop frenzy are legitimate. Many investors lost money, including some who lost more than they could afford to lose.¹⁶⁰ The price of GameStop stock fluctuated wildly, and the social media-fueled speculation spread to 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 are 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: by gambling, spending too much on a trendy fashion item, or 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 is that people can make choices with which others might disagree. Regulating with the objective of preventing unwise investing decisions is 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.¹⁶¹ The extensive and expansive 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, that providing investors and the capital markets with full information is a more desirable regulatory approach

¹⁵⁹ Eric Wright, *Should the Game Stop with Gamestop*, COLO. TECH. L.J.: BLOG (Feb. 2, 2021), <https://ctlj.colorado.edu/?p=748> [<https://perma.cc/3LM5-FA6L>].

¹⁶⁰ See Bailey Lipschultz, *Bed Bath & Beyond Tumble Shows Risks of Chasing Meme Stocks*, BLOOMBERG (Sept. 30, 2021, 4:09 PM), <https://www.bloomberg.com/news/articles/2021-09-30/bed-bath-beyond-tumble-shows-the-risks-of-chasing-meme-stocks> (observing many meme stocks have suffered substantial price declines since January 2021).

¹⁶¹ 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 nonfungible tokens, which are not subject to the same regulatory scheme. See David Yaffe-Bellany, Erin Griffith & Ephrat Livni, *As Cryptocurrencies Melt Down, \$300 Billion Evaporates in Days*, N.Y. TIMES, May 13, 2022, at A1 (reporting \$300 billion losses in “experimental and unregulated digital currencies”).

than having the federal government screen potential investment opportunities for safety or quality.¹⁶²

Additionally, 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 respondents reported buying at least one meme stock, the median amount they invested was only \$150.¹⁶³ Most investors did not buy stock on margin or to trade in options.¹⁶⁴ 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.¹⁶⁵ 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 prepandemic 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,¹⁶⁶ commentators have long recognized that investing through intermediaries has flaws as well.¹⁶⁷ 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

¹⁶² 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).

¹⁶³ Wolff-Mann, *supra* note 49.

¹⁶⁴ See, e.g., *Game Stopped? Part I*, *supra* note 8, at 116 (written testimony of Vladimir Tenev, CEO, Robinhood Markets, Inc.) (stating as of 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”).

¹⁶⁵ See SEC STAFF REPORT, *supra* note 89, at 42 (reporting that 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, 11:54 AM), <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).

¹⁶⁶ See Jay Clayton, Chair, U.S. Sec. & Exch. Comm’n, *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> [<https://perma.cc/JP45-JAKY>] (“Markets can be intimidating and complex It is an investment professional’s job to bridge this knowledge, information, and comfort gap.”).

¹⁶⁷ 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).

identify.¹⁶⁸ There is also a curious sense of elitism reflected in the commentary. Only a small percentage of retail investors own stock directly,¹⁶⁹ and that stock ownership is concentrated in rich white men.¹⁷⁰ 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.”¹⁷¹

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.”¹⁷² The Massachusetts Attorney General brought an enforcement action against Robinhood for bringing gamification to investing.¹⁷³ Essentially, the complaint alleged that Robinhood’s app, through features such as displaying confetti after a customer traded, made investing in the stock market entertaining for young investors in an effort to generate greater engagement.¹⁷⁴

¹⁶⁸ See, e.g., Jerry W. Markham, *Regulating Broker-Dealer Investment Recommendations—Laying the Groundwork for the Next Financial Crisis*, 13 DREXEL L. REV. 377, 383-96 (2021) (describing problematic broker dealer practices and regulatory efforts to combat those practices); Fisch, *Securities Intermediaries*, *supra* note 1, at 2000-02 (describing abusive mutual fund sales practices by brokers); COUNCIL OF ECON. ADVISERS, THE EFFECTS OF CONFLICTED INVESTMENT ADVICE ON RETIREMENT SAVINGS 26 (2015), https://obamawhitehouse.archives.gov/sites/default/files/docs/cea_coi_report_final.pdf [<https://perma.cc/CP3H-DKLH>] (stating that conflicted retirement advisors cost Americans \$17 billion per year).

¹⁶⁹ Ben Soppitt, *The Gamification of Investing Brings Opportunity—and Risks*, FORBES (Jan. 8, 2021, 7:00 AM), <https://www.forbes.com/sites/forbesbusinesscouncil/2021/01/08/the-gamification-of-investing-brings-opportunity--and-risks/> (“[I]nvesting 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.”).

¹⁷⁰ Tim Smart, *Who Owns Stocks in America? Mostly, It’s the Wealthy and White*, U.S. NEWS & WORLD REP. (Mar. 15, 2021, 10:58 AM), <https://www.usnews.com/news/national-news/articles/2021-03-15/who-owns-stocks-in-america-mostly-its-the-wealthy-and-white>.

¹⁷¹ Hester M. Peirce, Comm’r, U.S. Sec. & Exch. Comm’n, Remarks at Investor Advisory Committee Meeting (Mar. 11, 2021), <https://www.sec.gov/news/public-statement/peirce-statement-investor-advisory-committee-meeting-031121> [<https://perma.cc/Z5R9-NQB7>].

¹⁷² Gary Gensler, *Statement on Request for Information and Comments on Broker-Dealer and Investment Advisor Digital Engagement Practices, Related Tools and Methods, and Regulatory Considerations and Potential Approaches*, U.S. SEC. & EXCH. COMM’N (Aug. 27, 2021), <https://www.sec.gov/news/public-statement/gensler-dep-request-comment> [<https://perma.cc/H2CZ-QACJ>]; see Request for Comment on Digital Engagement Practices, *supra* note 7, at 49067-69.

¹⁷³ See Administrative Complaint, *supra* note 91, at 1.

¹⁷⁴ *Id.* at 3.

Better Markets describes the app as “incorporating addictive, endorphin-engendering game features.”¹⁷⁵ Similarly, Healthy Markets argued to Congress that regulators should regulate the use of confetti and other “game-like features” in trading apps.¹⁷⁶

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.¹⁷⁷ 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.¹⁷⁸ A 2021 Charles Schwab survey, for example, reported those who began investing in 2020 were “hungry for access to investing education and advice.”¹⁷⁹

Similarly, from a market impact perspective, concerns over the effect of the meme trading frenzy appear overstated.¹⁸⁰ Price volatility has been concentrated in a small number of stocks, primarily those with low prices and substantial short interest.¹⁸¹ 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

¹⁷⁵ Letter from Dennis M. Kelleher, President & Chief Exec. Officer, Better Mkts.; Lev Bagramian, Senior Sec. Pol’y Advisor, Better Mkts.; Stephen Hall, Legal Dir. & Sec. Specialist, Better Mkts.; to Janet Yellen, Sec’y, Dep’t of the Treasury; Jerome H. Powell, Chariman, Bd. of Governors of the Fed. Rsrv. Sys.; Allison Herren Lee, Acting Chairperson, Sec. & Exch. Comm’n; Rostin Benham, Acting Chairperson, Commodity Futures Trading Comm’n; John C. Williams, President & Chief Exec. Officer, Fed. Rsrv. Bank of New York 4 (Feb. 3, 2021), <https://bettermarkets.org/sites/default/files/Better%20Markets%20Letter%20to%20FSOC%20Regarding%20Gamestop%202-3-2021.pdf> [<https://perma.cc/YJ54-V4GU>].

¹⁷⁶ Letter from Tyler Gellasch, *supra* note 158, at 19.

¹⁷⁷ *Gamification to Stock Fantasy—A New and Eccentric Idea for Financial Services to Engage and Educate Customers*, VINFO TECH: BLOG (June 9, 2021), <https://blog.vinfotech.com/fantasy-sports/gamification-and-stock-fantasy-a-new-idea-for-financial-services-to-boost-user-engagement> [<https://perma.cc/NC5C-2K2M>].

¹⁷⁸ *Id.*; see *infra* Section V.C.

¹⁷⁹ *The Rise of the Investor Generation*, *supra* note 106.

¹⁸⁰ *Game Stopped? Part I*, *supra* note 8, at 112 (written testimony of Jennifer J. Schulp, Director, Financial Regulation Studies, Cato Institute) (“[T]emporary volatility in GameStop and others did not present a systemic risk to the functioning of our markets.”).

¹⁸¹ *But see* Philippe van der Beck & Coralie Jaunin, *The Equity Market Implications of the Retail Investment Boom 24-25* (Swiss Fin. Inst. Rsch. Paper No. 21-12, 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3776421 [<https://perma.cc/FDM3-JQZE>] (finding retail trading can move prices in both smaller stocks and those with substantial passive ownership).

of the overall market.¹⁸² 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.”¹⁸³

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 Covid-19 pandemic, when the market dropped in value by one-third.”¹⁸⁴ Similarly Gideon Ozik, Ronnie Sadka, and Siyi Shen report that “while overall liquidity deteriorated during lockdown, the increase in retail trading activity improved it, lowering stock bid-ask spreads and the price impact of trades.”¹⁸⁵

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.¹⁸⁶ The evidence suggests, however, that a substantial proportion of retail money was invested not in idiosyncratic companies but in conservative companies that performed well.¹⁸⁷

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.¹⁸⁸ Similarly, despite warning investors about the prospect that its stock price was inflated in 2021, AMC showed success in its

¹⁸² See, e.g., *id.* at 32 (reporting that Robinhood investors had 0.2% market share).

¹⁸³ Jessica Mathews, *How Much Are Meme Stocks Really Moving the Markets?*, FORTUNE (June 12, 2021, 8:30 AM), <https://fortune.com/2021/06/12/meme-stocks-moving-the-markets-gamestop-amc-clover/>.

¹⁸⁴ Jonathan R. Macey, *Securities Regulation and Class Warfare*, 2021 COLUM. BUS. L. REV. 796, 819.

¹⁸⁵ Gideon Ozik, Ronnie Sadka & Siyi Shen, *Flattening the Illiquidity Curve: Retail Trading During the COVID-19 Lockdown*, 56 J. FIN. & QUANTITATIVE ANALYSIS 2356, 2358 (2021).

¹⁸⁶ See SEC STAFF REPORT, *supra* note 89, 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.”).

¹⁸⁷ Ivo Welch, *The Wisdom of the Robinhood Crowd*, 77 J. FIN. 1489, 1523 (2022) (reporting that Robinhood investors exhibited good timing and steadfastness and earned “good portfolio returns”).

¹⁸⁸ See *supra* notes 37-40, 50, 77 and accompanying text (discussing Cohen’s involvement in GameStop).

holiday operations and beat analyst expectations for Q4 2021.¹⁸⁹ Although views on the street are mixed, analysts have also identified reasons to believe that other meme stocks have the potential for continued growth based on fundamental analysis rather than hype.¹⁹⁰

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 flocking into a company that was headed for bankruptcy.¹⁹¹ As commentator William Cohan 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.”¹⁹²

Yet, as Matt Levine subsequently acknowledged, Cohan “turned out to be totally wrong.”¹⁹³ 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.¹⁹⁴ Significantly, the meme frenzy was not just about investors getting lucky. Retail support for the companies, and their stock

¹⁸⁹ Will Feuer, *AMC Revenue Guidance Beats Forecasts, Sending Stock Up*, WALL ST. J., Feb. 2, 2022, at B7 (“Shares of AMC Entertainment Holdings Inc. jumped as much as 13% in premarket trading after the company posted preliminary fourth-quarter results that showed revenue topping analyst expectations.”).

¹⁹⁰ See, e.g., *Bed, Bath & Beyond Stronger than Typical Meme Stocks: Analysts*, CAPITAL.COM (Aug. 19, 2021, 7:00 PM), <https://capital.com/bed-bath-beyond-stronger-than-typical-meme-stocks-analysts> [<https://perma.cc/L9HV-RPQS>] (identifying reasons why Bed Bath & Beyond could increase in value independent of meme stock movement); Mercury Rsch., *Beyond The Noise, AMC Does Have Fundamental Value*, SEEKING ALPHA (Jan. 31, 2021, 11:03 PM), <https://seekingalpha.com/article/4402349-beyond-noise-amc-fundamental-value> (identifying potential growth for AMC based on fundamental value).

¹⁹¹ Emily Graffeo, *Hertz: The Original Meme Stock Rises from the Ashes of Bankruptcy*, INSIDER: MKTS. INSIDER (Aug. 2, 2021, 12:00 PM), <https://markets.businessinsider.com/news/currencies/hertz-original-reddit-wallstreetbets-meme-stock-exits-bankruptcy-2021-7> [<https://perma.cc/2KYJ-EZ6Q>] (“In a matter of weeks after the bankruptcy announcement, traders bid up shares of Hertz by 825% percent while Wall Street onlookers scratched their heads and wondered why retail investors were scooping up shares of a company that couldn’t meet its debt obligations.”).

¹⁹² Matt Levine, *Money Stuff: The Hertz Gamblers Were Right*, BLOOMBERG (May 12, 2021, 12:51 PM), <https://www.bloomberg.com/news/newsletters/2021-05-12/money-stuff-the-hertz-gamblers-were-right> (quoting former Wall Street banker William Cohan). Most traditional analysts agreed. See 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> [<https://perma.cc/B83V-3CFE>].

¹⁹³ Levine, *supra* note 192.

¹⁹⁴ Graffeo, *supra* note 191.

prices, facilitated access by all three companies to capital that created new business opportunities that, in turn, arguably impacted their future prospects.¹⁹⁵

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.¹⁹⁶ 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 a problematic justification for regulatory intervention.¹⁹⁷

IV. 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 payment for order flow, 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 Part that direct retail participation in the capital markets provides potential benefits to investors, corporations, and society—benefits that have largely been unrecognized. As Abe Cable has observed, current regulatory proposals are likely to “stamp out ultra-retail investing” thereby sacrificing these benefits.¹⁹⁸

For investors, capital market participation offers the opportunity for increased wealth. Fintech, through its lower costs and easy access, allows a broader range

¹⁹⁵ 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?” Victoria Chiu & Moin A. Yahya, *The Meme Stock Paradox*, 3 CORP. & BUS. L.J. 51, 89 (2022). 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 192.

¹⁹⁶ See, e.g., Silla Brush, *Energy Speculation Highest on Record, CFTC’s Chilton Says*, 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 widespread hedge fund speculation in energy markets).

¹⁹⁷ 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. 975, 1000 n.100 (“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?).”); *Game Stopped? Part I*, *supra* note 8, at 112 (written testimony of Jennifer J. Schulp, Director, Financial Regulation Studies, Cato Institute) (“Stock prices move in and out of alignment all the time, and markets are no strangers to bubbles.”).

¹⁹⁸ Cable, *supra* note 101 (manuscript at 6).

of investors to 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 fintech 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 when the role of corporations in society is up for debate as commentators and policymakers question 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.¹⁹⁹ In addition, retail participation in the markets is highly skewed. Women are less likely to own stock than men.²⁰⁰ Minority households are far less likely to own stock than white households,²⁰¹ and this lower rate of capital market participation substantially contributes to wealth disparity.²⁰² Traditionally, younger investors have been less likely to invest in the stock market. As recently as 2016, one study reported that almost 80% of

¹⁹⁹ Hester M. Peirce, Comm’r, U.S. Sec. & Exch. Comm’n, *Prosperity’s Door* (July 21, 2021), <https://www.sec.gov/news/speech/peirce-prosperity-door-072121> [<https://perma.cc/95RE-GAQ2>].

²⁰⁰ 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> [<https://perma.cc/68WG-8ME2>] (reporting NerdWallet survey findings that only “48% of women, compared to 66% of men” invest in stock market).

²⁰¹ See Bo Evans, *Black Americans Not Investing in the Stock Market, and It’s Costing Them*, DENVER CHANNEL (Mar. 8, 2021, 7:02 PM), <https://www.thedenverchannel.com/news/national/black-americans-not-investing-in-the-stock-market-and-its-costing-them> [<https://perma.cc/QN98-UFSB>] (quoting Yosef Bonaparte, Economics Professor at University of Colorado Denver, as saying, “61% of whites participate in the stock market whereas 28% of African Americans participate in the stock market”).

²⁰² Stan Choe, *Stocks Are Soaring, and Most Black People Are Missing Out*, ABC NEWS (Oct. 12, 2020, 8:01 PM), <https://abcnews.go.com/Business/wireStory/stocks-soaring-black-people-missing-73567655> [<https://perma.cc/Y2UX-9Q46>] (“Researchers say increased investment by racial minorities in the stock market, carried through future generations, could help narrow the wealth gap.”).

millennials were not invested in the stock market at all.²⁰³ A 2021 Nasdaq Foundation study pointed to the 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.²⁰⁴

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 white, male, and over the age of fifty.²⁰⁵ This leaves many people with the inability to relate to or trust stock market investing, or with the belief that their business will not be welcome.²⁰⁶ As one commentator put it, “potential Black investors may feel that buying stocks is not for them.”²⁰⁷

The cost of investing is another obstacle.²⁰⁸ 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

²⁰³ Josh Weiss, *Here’s why Millennials Aren’t Investing*, CNBC (Apr. 1, 2016, 1:15 PM), <https://www.cnn.com/2016/04/01/heres-why-millennials-arent-investing.html> [https://perma.cc/8UMR-395T].

²⁰⁴ STEVE HOLT, TIM FLACKE & GOSIA TOMASZEWSKA, COMMONWEALTH, A FRAMEWORK FOR INCLUSIVE INVESTING: DRIVING STOCK MARKET PARTICIPATION TO CLOSE THE WEALTH GAP FOR WOMEN OF COLOR 3-4 (2021), https://buildcommonwealth.org/wp-content/uploads/2021/08/CW-A_Framework_for_Inclusive_Investing.pdf [https://perma.cc/2EZ2-36E4].

²⁰⁵ See Press Release, J.D. Power, Technology, Social Media Critical to Bridging Financial Advisor Age Gap, J.D. Power Finds (July 9, 2019), <https://www.jdpower.com/business/press-releases/2019-us-financial-advisor-satisfaction-study> [https://perma.cc/QVV5-6FVV] (reporting “average age of financial advisors is about 55, and approximately one-fifth of advisors are 65 or older”); Greg Iacurci, *Diversity Among Financial Planners Improved in 2021—But It Still Remains Overwhelmingly White and Male*, CNBC (Jan. 26, 2022, 2:11 PM), <https://www.cnn.com/2022/01/26/diversity-among-financial-planners-improved-in-2021-but-it-still-lags.html> [https://perma.cc/H6VW-BQ68] (reporting that, of 92,055 certified financial planners in 2021, 83% were white, 76.6% were male, and 71.5% were forty or older); Blair duQuesnay, *Consider Firing Your Male Broker*, N.Y. TIMES, Jan. 16, 2019, at A23 (reporting that fewer than 20% of financial advisors are women).

²⁰⁶ See Evans, *supra* note 201 (“Research shows that having someone who looks like you and has shared life experiences lead [sic] to more trust.”).

²⁰⁷ Choe, *supra* note 202.

²⁰⁸ See, e.g., Michael Reher & Stanislav Sokolinski, Automation and Inequality in Wealth Management 2-3 (Sept. 1, 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3515707 [https://perma.cc/3HMN-VXCC] (finding reduction in investment adviser’s account minimum increased participation by middle income households and led to increases in expected wealth).

account, although the minimum is not required for fully paid securities.²⁰⁹ The entry into the market of app-based brokers like Robinhood has led to the elimination of commissions even among traditional brokers.²¹⁰ 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 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 decreases, 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.²¹¹

App-based trading platforms empower new, younger, and more diverse investors by removing the obstacle of a person who does not look like them. 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 makes judgments about whether they belong in the market, a process that one commentator terms “financial redlining.”²¹²

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 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.²¹³ In addition, retail investing occurs largely 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.²¹⁴ Because of the fiduciary obligations

²⁰⁹ FINRA Rule 4210(b). Margin Requirements, FIN. INDUS. REGUL. AUTH., <https://www.finra.org/rules-guidance/rulebooks/finra-rules/4210> (last visited Oct. 25, 2022) [<https://perma.cc/8KEU-K2U5>].

²¹⁰ See SEC STAFF REPORT, *supra* note 89, 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).

²¹¹ See *Game Stopped? Part I*, *supra* note 8, at 110 (written testimony of Jennifer Schulp, Director, Financial Regulation Studies, Cato Institute) (noting rise in retail investors and research showing that “the ability to invest with a small amount of money was a commonly cited reason for opening an account for the first time in 2020”).

²¹² 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> [<https://perma.cc/9S58-7D6K>] (quoting Tyrone Ross, financial consultant and CEO of investment platform Onramp Invest).

²¹³ See Fisch, *The Empty Voting Problem*, *supra* note 1, at 83 (terming this practice “empty voting”).

²¹⁴ See Irina Ivanova, *Stock Market’s Fall Has Wiped Out \$3 Trillion in Retirement Savings This Year*, CBS NEWS: MONEYWATCH (June 17, 2022, 8:00 AM), <https://www.cbsnews.com/news/stocks-drop-recession-retirement-savings-401k-ira-3->

imposed on employers by the Employee Retirement Income Security Act (“ERISA”), these choices typically involve highly diversified funds with a large number of portfolio securities.²¹⁵ 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,²¹⁶ 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.²¹⁷

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,²¹⁸ 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 affect the world around them.²¹⁹ As one commentator puts it, “millennials aren’t interested in owning boring bonds. This is a generation of stock pickers.”²²⁰ 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.”²²¹ In addition, although

trillion-2022/ [https://perma.cc/88XQ-S5G7] (“Retirement accounts are the main channel through which most Americans are exposed to the ups and downs of the stock market.”).

²¹⁵ See Fisch, *Securities Intermediaries*, *supra* note 1, at 1984 (explaining “employers must offer their employees a range of diversified investment options” to qualify for ERISA’s liability exemption for investment losses).

²¹⁶ See DAVID BLANCHETT & DANIEL BRUNS, MORNINGSTAR, WHICH DEFAULT INVESTMENT IS THE STICKEST? 1-2 (2019), https://www.fi360.com/uploads/media/wp_Sticky_Default_FINAL.pdf [https://perma.cc/UQ2P-CP42].

²¹⁷ See *id.*

²¹⁸ 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., Roger Young, *End-of-Year Tax Considerations for Capital Gains: Understanding Mutual Fund Distributions*, T. ROWE PRICE (Aug. 23, 2022), <https://www.troweprice.com/personal-investing/resources/insights/understanding-capital-gains-and-taxes-on-mutual-funds.html> [https://perma.cc/XE2K-ACG2]. In some cases, the fund may be managed in a way that exacerbates the tax consequences for small investors. See Jason Zwiag, *Vanguard Forgets the Little Guy*, WALL ST. J., Jan. 22, 2022, at B5 (explaining how fund trading decisions resulted in unexpectedly large tax bills for retail investors).

²¹⁹ See Stephen McBride, *Millennials Will Propel Stocks Higher for Years*, FORBES (Feb. 8, 2021, 9:33 AM), <https://www.forbes.com/sites/stephenmcbride1/2021/02/08/millennials-will-propel-stocks-higher-for-years/?sh=56856fff6e5d> (“[Y]oung folks LOVE investing in companies changing the world.”).

²²⁰ *Id.*

²²¹ *Id.*

meme stocks may initially draw new investors into the market, studies suggest that most go on to diversify their portfolios.²²²

These developments have contributed to a substantial shift in capital market participation. Research by FINRA and the National Opinion Research Center (“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.²²³ 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.²²⁴ 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.²²⁵ Robinhood has also released research showing a dramatic increase in Latinx investors’ participation in the capital markets.²²⁶ 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.²²⁷ Kelso believed that

²²² See, e.g., Garnet Roach, *Meme Stocks “a Gateway to Serious Investing,” Says Public.com*, IR MAG. (Sept. 20, 2021), <https://www.irmagazine.com/technology-social-media/meme-stocks-gateway-serious-investing-says-publiccom> [https://perma.cc/7ZSR-86RS] (reporting that 76% of “investors who first entered the markets via meme stocks have gone on to diversify their portfolios”).

²²³ MARK LUSH, ANGELA FONTES, MEIMEIZI ZHU, OLIVIA VALDES & GARY MOTTOLA, *INVESTING 2020: NEW ACCOUNTS AND THE PEOPLE WHO OPENED THEM 2* (2021), https://www.finrafoundation.org/sites/finrafoundation/files/investing-2020-new-accounts-and-the-people-who-opened-them_1_0.pdf [https://perma.cc/KD5J-B65D].

²²⁴ News Release, Angelita Williams & Eric Young, FINRA, *New Research: Global Pandemic Brings Surge of New and Experienced Retail Investors into the Stock Market* (Feb. 2, 2021), <https://www.finra.org/media-center/newsreleases/2021/new-research-global-pandemic-brings-surge-new-and-experienced-retail> [https://perma.cc/8LNV-ZKV2].

²²⁵ Freyman, *supra* note 212.

²²⁶ See, e.g., Gretchen Howard, *Latinx Investors Are Part of the New Wall Street*, ROBINHOOD (Oct. 12, 2021), <https://blog.robinhood.com/news/2021/10/12/latinx-investors-are-the-new-face-of-wall-street-and-crypto> [https://perma.cc/3UWB-FQYE] (reporting survey data on capital markets participation by Latinx investors through Robinhood platform).

²²⁷ See LOUIS O. KELSO & MORTIMER J. ADLER, *THE CAPITALIST MANIFESTO* 40, 99 (1958) (“Just as the status of citizenship conferred upon all has achieved political democracy, so the individual and private ownership of capital by all households would achieve economic democracy.”). Kelso was not the only person to advocate this approach. See, e.g., JOSEPH R.

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.²²⁸

Kelso invented the Employee Stock Ownership Plan (or “ESOP”).²²⁹ 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 to own a meaningful share in the growth of the economy.²³⁰ The ESOP would increase the motivation of employees to make the company successful, because those efforts would redound to their benefit as stockholders.²³¹ Finally, employee stock ownership would unite the interests of management, employees, public stockholders and consumers.²³²

Kelso discussed General Motors as an example of how ESOPs could facilitate the connection between employees and the companies for which they work.²³³ He highlighted the potential for using an ESOP to fuel corporate growth, which could then be shared with the employees through employee-owned stock. As Kelso explained, 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 employer’s labor costs.”²³⁴ In addition to incentivizing

BLASI, RICHARD B. FREEMAN & DOUGLAS L. KRUSE, *THE CITIZEN’S SHARE: PUTTING OWNERSHIP BACK INTO DEMOCRACY* 10 (2013) (arguing that allowing workers to share ownership and profits is way to restore middle class).

²²⁸ See 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) (explaining Kelso’s idea to “facilitate the outright acquisition by capially disenfranchised wage-laborers and others of new generative sources of income”); see also Louis O. Kelso & Patricia Hetter Kelso, *Could an ESOP Save General Motors?*, KELSO INST. (Nov. 1981), <http://kelsoinstitute.org/louiskelso/literary-legacy/could-an-esop-save-general-motors/> [<https://perma.cc/D22L-T9MM>] (describing ESOP as “enormous step toward the unification of the interests of management (who would be participants in the Kelso ESOP), employees, public stockholders, and consumers”).

²²⁹ Burt A. Folkart, *Louis Kelso; Force Behind Employee Stock Ownership Plans*, L.A. TIMES, Feb. 21, 1991, at A24 (describing Kelso as “maverick investment banker and self-styled economist who conceived of today’s popular employee stock ownership plans”). 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*, in *SOCIAL POLICIES FOR AMERICA IN THE SEVENTIES: NINE DIVERGENT VIEWS* 147 (Robert Theobald ed., 1968) (“[M]eans 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.”).

²³⁰ See Kelso & Kelso, *supra* note 228.

²³¹ *Id.* (arguing ESOP would “powerfully motivate[]” employees “to make GM (‘their company’) succeed in international and domestic competition”).

²³² *Id.*

²³³ Kelso & Kelso, *supra* note 228.

²³⁴ *Id.*

worker productivity, the ESOP would increase employee voice through their participation as shareholders.²³⁵ Kelso's writings influenced Congress to include ESOPs in ERISA in 1974.²³⁶ Although ESOPs have been controversial, a variety of studies demonstrate correlations between ESOPs and corporate profitability.²³⁷

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."²³⁸

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.²³⁹ 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."²⁴⁰

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.²⁴¹ The same benefits

²³⁵ *Id.*

²³⁶ 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 Kelso's "efforts were largely responsible for getting ESOPs included into ERISA in 1974").

²³⁷ See, e.g., Jedidiah J. Kroncke, *ESOPs and the Limits of Fractionalized Ownership*, 2017 U. CHI. LEGAL F. 287, 300-01 (discussing literature on ESOP company profitability, including studies that show "two to three percent increases in ESOP profitability relative to their corporate cohort").

²³⁸ Brett McDonnell, *ESOPs' Failures: Fiduciary Duties when Managers of Employee-Owned Companies Vote to Entrench Themselves*, 2000 COLUM. BUS. L. REV. 199, 231.

²³⁹ See David Millon, *Enron and the Dark Side of Worker Ownership*, 1 SEATTLE J. SOC. JUST. 113, 118 (2002) ("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.").

²⁴⁰ *Summers v. State St. Bank & Tr. Co.*, 453 F.3d 404, 411 (7th Cir. 2006), *cert. denied*, 549 U.S. 1245, 1257 (2007).

²⁴¹ Lynn Stout, Sergio Alberto Gramitto Ricci, and Tamara Belinfanti offer a somewhat different view of citizen capitalism in their influential book. See LYNN STOUT, SERGIO GRAMITTO & TAMARA BELINFANTI, *CITIZEN CAPITALISM: HOW A UNIVERSAL FUND CAN PROVIDE INFLUENCE AND INCOME TO ALL 25* (2019). As with the ESOP, Stout, Gramitto Ricci,

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. The New York Stock Exchange and a number of brokerage firms recognized the potential value of this partnership in the mid 1900's and mounted a publicity campaign to encourage stock ownership by ordinary investors, terming it a "people's capitalism."²⁴²

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.²⁴³ Some have termed this approach "inclusive capitalism."²⁴⁴ 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. Inclusive capitalism can also increase societal stability by reducing wealth and income inequality.²⁴⁵

Citizen capitalism may also enhance the voice of ordinary citizens in corporate decisions. Corporate law vests the board of directors with the ultimate responsibility for determining the direction of a corporation.²⁴⁶ Shareholders play a role in corporate operations by electing that board.²⁴⁷ They play an

and Belinfanti posit an intermediated form of ownership. As this Article explains below, direct ownership adds engagement and accountability to the economic participation offered by Stout, Gramitto Ricci, and Belinfanti's proposed universal fund.

²⁴² The New York Stock Exchange campaign operated under the slogan, "Own Your Share." See Cable, *supra* note 101 (manuscript at 10-11) (describing campaign); Janice Traflet, *Spreading the Ideal of Mass Shareownership: Public Relations and the NYSE*, 22 *ESSAYS ECON. & BUS. HIST.* 257, 257, 266-67 (2004) (discussing efforts to promote retail investing).

²⁴³ See generally THOMAS PIKETTY, *CAPITAL IN THE TWENTY-FIRST CENTURY* (Arthur Goldhammer trans., Harvard Univ. Press 2014) (2013).

²⁴⁴ 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) ("[W]e must establish a more inclusive capitalism by democratizing 'capital acquisition with the earnings of capital' based on the principles of 'binary economics.'").

²⁴⁵ 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) ("[M]ost experts agree that inequality and poverty . . . pose a serious threat to the sustainability of democracy.").

²⁴⁶ See, e.g., *DEL. CODE ANN.* tit. 8, § 141(a) (West 2022) ("The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors.").

²⁴⁷ See, e.g., *id.* § 211(b).

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 highlight problematic corporate practices, including corporate governance, ESG issues, and operational decisions, through the shareholder proposal rule.²⁴⁸ The power of shareholder action continues to increase. For example, tiny hedge fund Engine No. 1 dramatically spotlighted Exxon’s refusal to address climate change through its successful 2021 proxy contest.²⁴⁹ Weeks later, Exxon announced its plan to achieve net zero greenhouse gas emission by 2050.²⁵⁰ A recent study reports that the first three years of the Big Three’s campaign to increase gender diversity on corporate boards led to a “76% increase in the net flow of new female board members and an 11% increase in the overall proportion of female directors.”²⁵¹

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. Due to the conservatism of institutional investors, retail investors generate the majority of shareholder proposals and are typically the source of most innovation in such proposals. For the proposals to impact corporate behavior, however, 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.²⁵²

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

²⁴⁸ 17 C.F.R. § 14a-8 (2021).

²⁴⁹ See Matt Phillips, *How a Tiny Green Fund Turned the Exxon Tanker*, N.Y. TIMES, June 11, 2021, at B3 (reporting Engine No. 1 “successfully waged a battle to install three directors on the board of Exxon with the goal of pushing the energy giant to reduce its carbon footprint”).

²⁵⁰ *ExxonMobil Announces Ambition for Net Zero Greenhouse Gas Emissions by 2050*, EXXONMOBIL: NEWSROOM (Jan. 18, 2022), https://corporate.exxonmobil.com/News/Newsroom/News-releases/2022/0118_ExxonMobil-announces-ambition-for-net-zero-greenhouse-gas-emissions-by-2050 [<https://perma.cc/4WQS-F7RP>].

²⁵¹ 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* 9 (Eur. Corp. Governance Inst., Fin. Working Paper No. 714/2020, 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3724653 [<https://perma.cc/W3SL-2KVJ>].

²⁵² Jeff Mordock, *Retail Shareholders Cited as Key to DuPont’s Victory*, DEL. ONLINE (May 13, 2015, 8:06 PM), <https://www.delawareonline.com/story/money/business/2015/05/13/trian-rebuffed-dupont-slate-wins-seats/27226613/> (“Peltz and DuPont CEO Ellen Kullman cited retail investors . . . for turning the election in favor of the company’s director slate.”).

resulting from the pandemic lockdown provide a more accessible forum in which shareholders can participate in a dialogue with issuer management. Some brokers such as Robinhood have developed mechanisms to facilitate the submission of retail shareholders' questions at such meetings.²⁵³ Sergio Ricci and Christina Sautter argue that the actions of retail investors at issuers like GameStop and AMC demonstrate retail investors' ability to use new technology such as social media to overcome traditional collective action problems.²⁵⁴ Ricci and Sautter predict that this will cause retail investors to engage not just with stock trading but with corporate governance.²⁵⁵

Significantly, retail participation in corporate governance offers a new tool for ordinary citizens to hold corporations accountable for their actions. As Joseph Blasi, Richard Freeman, and Douglas Kruse observed in 2013, "the public has grown increasingly critical of corporations and suspicious of the relationship between big government and the big corporate sector."²⁵⁶ In 2018, "[a] majority of Americans [viewed] large businesses as self-serving and self-dealing."²⁵⁷ Both Democrats and Republicans increasingly believe that corporations wield too much power.²⁵⁸ Data from interactive investors show that retail shareholders' efforts to use their voting power to increase corporate accountability have grown dramatically.²⁵⁹ 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.²⁶⁰

²⁵³ See, e.g., Lewis Braham, *Robinhood's New Proxy Platform Battles Investor Apathy*, BARRON'S, Oct. 25, 2021, at 27 (describing Robinhood's acquisition of Say Technology to create platform enabling individual shareholders to ask questions of corporate management).

²⁵⁴ Sergio Alberto Gramitto Ricci & Christina M. Sautter, *Corporate Governance Gaming: The Collective Power of Retail Investors*, 22 NEV. L.J. 51, 84-86 (2021).

²⁵⁵ 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 Alberto Gramitto Ricci & Christina M. 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/> [<https://perma.cc/N8DX-FBPF>].

²⁵⁶ Blasi, Freeman & Kruse, *supra* note 227, at 10.

²⁵⁷ Robert D. Atkinson & Michael Lind, *Is Big Business Really That Bad?*, ATLANTIC, Apr. 2018, at 22, 22.

²⁵⁸ Ben Casselman & Jim Tankersley, *Parties Agree: Big Business Wields Too Much Power*, N.Y. TIMES, May 17, 2021, at B1.

²⁵⁹ 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 many retail votes in 2021 as in 2020).

²⁶⁰ See, e.g., Gabe Rissman, *New Strategies Help Investors Hold Corporations Accountable on Human Rights*, OPEN GLOB. RTS. (May 16, 2019), <https://www.openglobalrights.org/new-strategies-help-investors-hold-corporations->

Greater disclosure subjects those practices to greater scrutiny, not just by shareholders but by regulators, other stakeholders, and society at large.²⁶¹ Ricci and Sautter argue that retail engagement has the potential to reduce corporate externalities and cause issuers to embrace a broader public interest,²⁶² an idea that will be explored in more detail below.²⁶³ At the same time, however, citizen capitalism can also reshape ordinary citizens' views of the corporate sector, altering their preferences on how corporations are regulated.²⁶⁴

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.²⁶⁵ AMC CEO Adam Aron began using Twitter and Reddit to communicate with the company's retail shareholders, engaging in 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.²⁶⁶ Aron also shifted the focus of the company's traditional quarter earnings calls to addressing the concerns of retail investors.²⁶⁷ Investor relations

accountable-on-human-rights/ [https://perma.cc/RK27-UZFT] (recounting how retail investor used shareholder proposal process to push for human rights improvements at ExxonMobil).

²⁶¹ See BRAM HENDRIKS, INT'L CORP. GOVERNANCE NETWORK, SHAREHOLDER PROPOSALS—AN ESSENTIAL INSTRUMENT FOR ENSURING CORPORATE ACCOUNTABILITY 16 (2021), <https://www.icgn.org/sites/default/files/2021-12/ICGN%20Shareholder%20Proposal%20Viewpoint%20review%20021221%20Final.pdf> [https://perma.cc/6UGW-5SQJ].

²⁶² Gramitto Ricci & Sautter, *supra* note 254, at 94 (describing how increased retail engagement leads to wider disbursement of shares and, ultimately, internalization of corporate externalities).

²⁶³ See *infra* Section IV.D.

²⁶⁴ For evidence that the transformation of workers into investors leads them to oppose more stringent regulatory policies, see Stefano Pagliari, Lauren M. Phillips & Kevin L. Young, *The Financialization of Policy Preferences: Financial Asset Ownership, Regulation and Crisis Management*, 18 SOCIO-ECON. REV. 655, 674 (2020) (“[O]wnership of financial assets is associated with lower levels of support for more stringent regulatory policies targeting the financial industry.”).

²⁶⁵ Michael Flaherty, *P&G, Peltz Vie for Small Investor Votes in Biggest-Ever Proxy Fight*, REUTERS (Sept. 25, 2017, 7:13 AM), <https://www.reuters.com/article/us-procter-gamble-trian-investors/pg-peltz-vie-for-small-investor-votes-in-biggest-ever-proxy-fight-idUSKCN1C01CW>.

²⁶⁶ 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, 3:41 PM), <https://www.businessinsider.com/amc-adam-aron-twitter-reddit-investors-meme-stock-2021-12> [https://perma.cc/U4MN-JRZT].

²⁶⁷ *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.”).

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.²⁶⁸ And corporate executives are using new tools to connect with retail investors and respond to their concerns.²⁶⁹

Direct investment is necessary, however, for retail shareholders to play an effective role in influencing corporate behavior.²⁷⁰ 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.²⁷¹ They do not even have the right to vote the shares reflecting their proportionate ownership interest in the portfolio companies held by the fund.²⁷² In addition to depriving investors of say in their portfolio companies, intermediation deprives investors 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 retail investors' interests.

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

²⁶⁸ See 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> [<https://perma.cc/V6EC-5KK2>] (advising issuers to publish accessible information on company's website and engage with retail investors on nontraditional platforms).

²⁶⁹ See, e.g., Nina Trentmann, *Firms Try Relating to Small Investors*, WALL ST. J., Feb. 8, 2022, at B1 ("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.").

²⁷⁰ This is where direct ownership provides a form of citizen capitalism that extends beyond Stout, Gramitto, and Belinfanti's universal fund proposal. See STOUT, GRAMITTO RICCI & BELINFANTI, *supra* note 241, at 49-50 (proposing citizen capitalism through universal fund through which all citizens can share in economic proceeds from capitalism).

²⁷¹ Ari I. Weinberg, *What to Know About . . . Proxy Voting*, WALL ST. J., Jan. 10, 2022, at R7.

²⁷² *Id.*

hands of a dozen or fewer people.”²⁷³ 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.²⁷⁴

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 the possible anticompetitive effects when large institutions own substantial stakes in competing firms, and offers empirical evidence in support of such effects.²⁷⁵ The empirical findings have led regulators to initiate inquiries into these concerns.²⁷⁶ In response, some commentators have sought to limit the size or holdings of large mutual funds.²⁷⁷

One man in particular, BlackRock’s Larry Fink, was described in 2010 “as possibly the most important man in finance today.”²⁷⁸ 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.²⁷⁹ That responsiveness likely results from the fact that Fink’s instructions are backed 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.²⁸⁰

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 control but instead exercise that power on

²⁷³ Coates, *supra* note 12, at 2.

²⁷⁴ *Id.* at 3.

²⁷⁵ See, e.g., José Azar, Martin C. Schmalz & Isabel Tecu, *Anticompetitive Effects of Common Ownership*, 73 J. FIN. 1513, 1517 (2018); Martin C. Schmalz, *Common-Ownership Concentration and Corporate Conduct*, 10 ANN. REV. FIN. ECON. 413, 428-33 (2018).

²⁷⁶ See, e.g., Hemphill & Kahan, *supra* note 15, at 1395-96 (describing inquiries by U.S. Department of Justice, Federal Trade Commission, and European Commission).

²⁷⁷ See, e.g., Eric A. Posner, Fiona M. Scott Morton & E. Glen Weyl, *A Proposal to Limit the Anticompetitive Power of Institutional Investors*, 81 ANTITRUST L.J. 669, 670 (2017) (proposing that institutional investors be limited “to a stake of no more than 1 percent in more than a single firm in oligopolies”).

²⁷⁸ Suzanna Andrews, *Larry Fink’s \$12 Trillion Shadow*, VANITY FAIR, Apr. 2010, at 140, 142.

²⁷⁹ Andrea Pawliczek, A. Nicole Skinner & Laura A. Wellman, *A New Take on Voice: The Influence of BlackRock’s “Dear CEO” Letters*, 26 REV. ACCT. STUDS. 1088, 1121 (2021) (finding evidence that firms respond to BlackRock’s “Dear CEO” letters).

²⁸⁰ 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. 17, 2022), <https://www.nytimes.com/2022/01/17/business/dealbook/larry-fink-blackrock-letter.html> (explaining BlackRock’s \$10 trillion in assets under management “gives Mr. Fink a huge amount of influence”).

behalf of dispersed individual fund shareholders.²⁸¹ 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.²⁸²

A growing number of commentators have expressed concern over empty voting and the agency problems it creates.²⁸³ 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.”²⁸⁴ The commentary identifies a variety of reasons why the interests of institutional intermediaries may differ from those of retail investors.²⁸⁵ These reasons include the business interests of the institutions such as enabling them to secure revenues from the administration of or inclusion in 401(k) plans,²⁸⁶ the personal views²⁸⁷ or political aspirations of fund managers,²⁸⁸ and a fear of regulation or public retribution in response to the

²⁸¹ Coates, *supra* note 12, at 5 (finding public individuals remained dominant source of capital “even if their investments were increasingly held by institutional investors”).

²⁸² See Fisch, *The Empty Voting Problem*, *supra* note 1.

²⁸³ See, e.g., Jeff Schwartz, “Public” Mutual Funds, in CAMBRIDGE HANDBOOK ON INVESTOR PROTECTION (forthcoming 2022) (manuscript at 1), <https://ssrn.com/abstract=3821388> [<https://perma.cc/EWL8-Y7MY>]; Bernard S. Sharfman, *Opportunism in the Shareholder Voting of the “Big Three” Investment Advisers to Index Funds*, 48 J. CORP. L. (forthcoming 2022) (manuscript at 6-7), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3995714 [<https://perma.cc/Q84P-PCMS>] (arguing Big Three investment advisors should be treated as investors’ agents in funds they manage as solution to “their opportunistic behavior”); Paul G. Mahoney & Julia D. Mahoney, *The New Separation of Ownership and Control: Institutional Investors and ESG*, 2021 COLUM. BUS. L. REV. 840, 858, 860, 865; Sean J. Griffith & Dorothy S. Lund, *Conflicted Mutual Fund Voting in Corporate Law*, 99 B.U. L. REV. 1151, 1155 (2019) (describing adverse consequences of “empty voting” in relation to mutual funds and hedge funds).

²⁸⁴ Allison Herren Lee, Acting Chair, U.S. Sec. & Exch. Comm’n, *Every Vote Counts: The Importance of Fund Voting and Disclosure* (Mar. 17, 2021), <https://www.sec.gov/news/speech/lee-every-vote-counts> [<https://perma.cc/D76A-UXGC>].

²⁸⁵ 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. PERSPS. 161, 164 (2004) (describing conflicts resulting from funds’ compensation structures).

²⁸⁶ See Griffith & Lund, *supra* note 283, at 1176 (terming these “corporate client” conflicts).

²⁸⁷ Mahoney & Mahoney, *supra* note 283, at 866 (stating that fund managers’ personal views might explain predictable voting of money managers on shareholder proposals for social and environmental issues).

²⁸⁸ Robin Wigglesworth, *The Ten Trillion Dollar Man: How Larry Fink Became King of Wall St*, FT MAG. (Oct. 7, 2021), <https://www.ft.com/content/7dfd1e3d-e256-4656-a96d-1204538d75cd> [<https://perma.cc/3GQF-L95S>] (“A host of former government officials work at BlackRock, and others have departed for plum jobs in the Biden administration.”).

asset managers' size and power.²⁸⁹ Although empirical evidence on retail voting is limited, it supports these concerns—retail investors vote differently from institutional intermediaries.²⁹⁰

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.²⁹¹ 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.²⁹² 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.²⁹³

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

²⁸⁹ Schwartz, *supra* note 283, at 1.

²⁹⁰ Alon Brav, Matthew Cain & Jonathon Zytznick, *Retail Shareholder Participation in the Proxy Process: Monitoring, Engagement, and Voting*, 144 J. FIN. ECON. 492, 493 (2021) (documenting “substantial differences” between retail shareholders and institutional investors on various categories of shareholder proposals).

²⁹¹ See, e.g., Jill Fisch, *The Uncertain Stewardship Potential of Index Funds*, in GLOBAL SHAREHOLDER STEWARDSHIP: COMPLEXITIES, CHALLENGES AND POSSIBILITIES 470 (Dionysia Katelouzou & Dan W. Puchniak eds., Cambridge Univ. Press 2022) (“[A] number of commentators have demanded that [index funds] do more to influence the decisions made at their portfolio companies.”); see also Sharfman, *supra* note 283, at 28-29 (summarizing several feasible mechanisms by which retail investors could convey their voting preferences to fund managers); Caleb N. Griffin, *We Three Kings: Disintermediating Voting at the Index Fund Giants*, 79 MD. L. REV. 954, 983 (2020) (advocating pass-through voting).

²⁹² See, e.g., Alicia Adamecyk, *Your 401(k) Might Be Invested in Private Prison Companies. Here's How to Find Out*, CNBC: MAKE IT (Aug. 12, 2020, 3:29 PM), <https://www.cnbc.com/2020/08/12/new-tool-tells-you-if-your-401k-is-invested-in-private-prisons.html> [<https://perma.cc/DAL8-DSAZ>] (quoting Andrew Behar, CEO of As You Sow, as saying that many people are unaware that they are invested through their 401(k) plan “in companies that don't align with their values”).

²⁹³ 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> [<https://perma.cc/CR2M-LX8C>] (reporting data from Fidelity that 92% of 401(k) plans use target date funds as default option, and that among Millennials, 69% are “invested exclusively in 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. BLANCHETT & BRUNS, *supra* note 216, at 1.

they invest.²⁹⁴ Early evidence since the GameStop frenzy suggests that this engagement is extending to participation in corporate governance as well.²⁹⁵ Reducing the extent to which retail investment is intermediated by increasing direct capital 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.²⁹⁶ At its core, stakeholder governance is about using corporate governance to achieve societal objectives that cannot be addressed adequately through regulation.²⁹⁷

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 whether corporate managers can pursue stakeholder value without violating their fiduciary duties to shareholders. From a practical perspective, stakeholder governance requires corporate decisionmakers to decide which stakeholders' interests should be considered and how competing 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,²⁹⁸ or

²⁹⁴ See *supra* notes 265-69 and accompanying text (discussing companies' information campaigns and outreach to retail investors).

²⁹⁵ See, e.g., *supra* note 252 and accompanying text (describing retail investors' role in defeating hedge fund Trian in DuPont proxy contest).

²⁹⁶ See, e.g., Lucian A. Bebchuk & Roberto Tallarita, *The Illusory Promise of Stakeholder Governance*, 106 CORNELL L. REV. 91, 94 (2020) (describing stakeholderism).

²⁹⁷ See, e.g., Edward B. Rock, *For Whom Is the Corporation Managed in 2020? The Debate over Corporate Purpose*, 76 BUS. LAW. 363, 367 (2021) (explaining renewed debate over stakeholderism and corporate purpose as response to "the political polarization of our electoral politics [that] has resulted in legislative deadlock").

²⁹⁸ 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-serves-all-americans> [https://perma.cc/U7A3-EX37]. 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

should that decision require shareholder input or even formal structural change?²⁹⁹ 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.³⁰⁰

Because retail shareholders are themselves stakeholders, retail investing offers an end-run around these complex issues. Retail shareholders do not simply represent, but 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 investors, acting in their interests as shareholders, engage in what might be termed "automatic stakeholder governance."³⁰¹

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.³⁰² But heterogeneity does not prevent these stakeholder views from being raised and considered in a corporation's operating decisions. In addition, a variety of

boards of those companies did not appear to play a role in the CEOs' decisions to sign it. Bebhuk & Tallarita, *supra* note 296, at 130-31 (finding that out of forty-eight companies contacted, forty-seven responded that decision to endorse Business Roundtable statement was approved by only the CEO and not the board).

²⁹⁹ See generally Jill E. Fisch, *Purpose Proposals*, 1 U. CHI. BUS. L. REV. (forthcoming 2022) (describing shareholder efforts to cause corporations to adopt stakeholder governance by converting to public benefit corporations).

³⁰⁰ See Mahoney & Mahoney, *supra* note 283, at 843 (arguing that institutions cannot sacrifice shareholder value for stakeholder values consistent with their fiduciary duties).

³⁰¹ 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 Value*, 2 J.L. FIN. & ACCT. 247, 263 (2017). Hart and Zingales do not, however, consider the agency problem discussed above resulting from the intermediation of most shares. See *id.* Ironically, at least one study has found that public pension funds, which might be viewed as natural advocates of employee interests, do not appear to function as "effective instruments of worker power in the aggregate" through their ownership of publicly traded companies. Larry Liu & Adam Goldstein, *Labor's Capital and Worker Well-Being: Do US Pension Funds Benefit Labor Interests?*, 100 SOC. FORCES 1080, 1083 (2022) (concluding pension funds do not encourage "labor-friendly behaviors" and that this trend has not shifted since the early 2000s).

³⁰² See, e.g., Robert H. Mundheim, *What Is the Significance of the Business Roundtable Statement on the Purpose of a Corporation?*, SALZBERG GLOB. SEMINAR NEWSL. (Oct. 22, 2019), <https://www.salzburgglobal.org/news/publications/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).

market mechanisms allow shareholders with different preferences to influence corporations. Shareholders can choose which companies to invest in. 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.³⁰³ 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-8,³⁰⁴ enables shareholders with relatively small stakes to introduce shareholder proposals, thereby putting issues of concern on the corporate agenda.³⁰⁵ Social media tools such as Reddit reduce the costs of publicizing a proposal and mobilizing support.³⁰⁶

Historically, a substantial proportion of shareholder proposals have addressed social policy issues and reflected stakeholder concerns.³⁰⁷ Toward this end, they have been remarkably effective.³⁰⁸ 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.³⁰⁹ Moreover, because many proposals seek to have corporations provide greater disclosure of the negative externalities they impose on stakeholders, they can have broader effects—increasing the transparency of

³⁰³ See *supra* note 170 and accompanying text.

³⁰⁴ 17 C.F.R. § 14a-8 (2021).

³⁰⁵ 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*, 2021 COLUM. BUS. L. REV. 1147, 1197 (describing shareholder proposal rule as “corporate town square”).

³⁰⁶ See Gramitto Ricci & Sautter, *supra* note 254.

³⁰⁷ 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.”).

³⁰⁸ 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) (“[S]hareholder proposals have been an extremely effective tool for activists and interested shareholders to effect employment protections for LGBT employees.”).

³⁰⁹ See generally Fisch, *supra* note 299 (describing these purpose proposals).

corporate behavior and energizing stakeholders, regulators, or the public at large to take action.³¹⁰

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.³¹¹ In 2022, Amazon employee Daniel Olayiwola purchased stock in Amazon and, at the 2022 shareholder meeting, introduced a shareholder proposal seeking better treatment for Amazon workers.³¹² These efforts have been facilitated by the SEC staff, which in 2021 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.³¹³

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."³¹⁴ For millennials and Gen-Zers, social justice issues—including climate change, racial justice, and inequality—are increasingly important.³¹⁵ Millennial 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

³¹⁰ 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, 21-26 (2020).

³¹¹ See generally Harwell Wells, *Shareholder Meetings and Freedom Rides: The Story of Peck v Greyhound* (Temple Univ. Legal Stud. Research Paper No. 2021-29, 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3873430 [<https://perma.cc/V8MK-R8JR>].

³¹² Lauren Rosenblatt, *Stock-Owning Amazon Employee*, SEATTLE TIMES, May 6, 2022, at A11.

³¹³ SEC Staff Legal Bulletin No. 14L (CF) (Nov. 3, 2021).

³¹⁴ 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, 3:16 PM), <https://www.cnbc.com/2021/08/02/not-all-investors-who-say-they-support-impact-investing-are-doing-it.html> [<https://perma.cc/XN7Y-MB46>].

³¹⁵ Deloitte, *For Millennials And Gen Zs, Social Issues Are Top of Mind—Here's How Organizations Can Drive Meaningful Change*, FORBES (July 22, 2021, 11:38 AM), <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/> ("Many millennials and Gen Zs make decisions about their careers and about where they shop based on their values.").

strategies.”³¹⁶ As Barzuza, Curtis, and 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.³¹⁷ Although the extent to which citizens will pursue stakeholder or societal goals in their role as investors remains unclear, as Ricci and Sautter explain, “[c]itizens 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.”³¹⁸

V. 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 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 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, vote their shares, or 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.³¹⁹

³¹⁶ 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).

³¹⁷ *Id.* at 1285.

³¹⁸ Gramitto Ricci & Sautter, *supra* note 254.

³¹⁹ See, e.g., Yesha Yadav, *How Algorithmic Trading Undermines Efficiency in Capital Markets*, 68 VAND. L. REV. 1607, 1607 (2015) (arguing that algorithmic trading undermines capital market efficiency).

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.³²⁰ Retail investors rely, however, on nontraditional sources of information. In particular, retail investors appear to be heavily influenced by postings on social media sites.³²¹ One study reported that a third of young investors rely on social media for investment advice.³²² 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.”³²³

To be sure, social media presents an ever-growing danger of misinformation and disinformation that can manipulate the behavior of users—a danger that extends well beyond the capital markets.³²⁴ A collaborative study explored the role of social media in spreading both misinformation and mistrust in connection with the COVID-19 pandemic.³²⁵ Commentators have highlighted the role that social media platforms played in the January 6, 2021, Capitol insurrection,³²⁶ and debated Facebook’s use of algorithms to promote posts that are likely to

³²⁰ See *supra* notes 265–69 and accompanying text; *infra* notes 334–36 and accompanying text.

³²¹ See, e.g., SEC STAFF REPORT, *supra* note 89, 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 135 (showing empirically that “an increase in Reddit posts on GameStop is followed by an increase in the ratio of retail trading proportion of GameStop”).

³²² 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*, INSIDER: MKTS. INSIDER (Aug. 23, 2021, 10:30 AM), <https://markets.businessinsider.com/news/stocks/retail-investing-trends-robinhood-gamification-survey-social-media-trading-2021-8> [<https://perma.cc/K6R3-QF3V>].

³²³ EUROPEAN SEC. & MKTS. AUTH., EPISODES OF VERY HIGH VOLATILITY IN TRADING OF CERTAIN STOCKS 1 (2021), https://www.esma.europa.eu/sites/default/files/library/esma70-155-11809_episodes_of_very_high_volatility_in_trading_of_certain_stocks_0.pdf [<https://perma.cc/WJB6-926R>].

³²⁴ Thomas Lewton & Alice McCool, *Greenwashing on Facebook: How the World’s Biggest Polluters Use Social Media to Obfuscate on Climate Change*, *TIME* (Nov. 3, 2021, 10:23 AM), <https://time.com/6113396/greenwashing-on-facebook> (reporting data compiled by Eco-Bot.Net revealing broad-based Facebook disinformation campaign by “the world’s most polluting companies”).

³²⁵ INGRID VOLKMER, UNIV. OF MELBOURNE, SOCIAL MEDIA AND COVID-19: A GLOBAL STUDY OF DIGITAL CRISIS INTERACTION AMONG GEN Z AND MILLENNIALS (2021), https://arts.unimelb.edu.au/_data/assets/pdf_file/0007/3958684/Volkmer-Social-Media-and-COVID.pdf [<https://perma.cc/23V2-7JGW>].

³²⁶ 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> [<https://perma.cc/G9JE-VFML>] (“Technology platforms make sensational, attention-grabbing content more visible through what’s called maximizing user engagement.”).

generate outrage or other strong reactions.³²⁷ Social media provides users with the potential to reach a greater audience than other communication mediums, and to do so with limited accountability.³²⁸ The ability to post anonymously has been cited as creating the potential for lack of civility and other undesirable behaviors.³²⁹ With respect to investing information, anonymous posting heightens the risk of fraud.³³⁰

On the other hand, efforts to manipulate the market through online communications are not new,³³¹ traditional sources of investment information have proven similarly unreliable,³³² and even professional investors are subject to manipulation and cognitive biases.³³³ 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 posts have limited price effects.³³⁴ Another study suggests that social media users respond most to posts by people who

³²⁷ Jon Evans, *Facebook Isn't Free Speech, It's Algorithmic Amplification Optimized for Outrage*, TECHCRUNCH (Oct. 20, 2019, 9:00 AM), <https://techcrunch.com/2019/10/20/facebook-isnt-free-speech-its-algorithmic-amplification-optimized-for-outrage/> [<https://perma.cc/8HQB-CDZX>].

³²⁸ Cf. Elsa Massoc & Maximilian Lubda, *Social Media, Polarization and Democracy: A Multi-Methods Analysis of Polarized Users' Interactions on Reddit's r/WallStreetBets* (Sustainable Architecture for Fin. in Eur., Working Paper No. 337, 2022), <https://ssrn.com/abstract=4006283> [<https://perma.cc/YVF3-MQEJ>] (offering evidence that social media platforms “can provide a deliberative space where citizens with different views accept to debate and engage with each other—in a disagreeing yet non-violent way”).

³²⁹ Biju Dominic, *Anonymity on Social Media and Its Ugly Consequences*, MINT (Feb. 10, 2021, 10:57 PM), <https://www.livemint.com/opinion/columns/anonymity-on-social-media-and-its-ugly-consequences-11612977615856.html> [<https://perma.cc/SG56-AV7E>].

³³⁰ See, e.g., *Investor Alert: Beware of Stock Recommendations on Investment Research Websites*, U.S. SEC. & EXCH. COMM'N (Apr. 10, 2017), <https://www.investor.gov/additional-resources/news-alerts/alerts-bulletins/investor-alert-beware-stock-recommendations> [<https://perma.cc/D5AM-F23D>] (warning of potential for fraud based on postings by authors using pseudonyms or false credentials).

³³¹ For example, a student comment details the widespread use of the internet in the 1990s, including on-line chat rooms and discussion forums, to perpetrate securities fraud and manipulation. Nancy Toross, Comment, *Double-Click on This: Keeping Pace with On-line Market Manipulation*, 32 LOY. L.A. L. REV. 1399, 1417-29 (1999).

³³² 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 research analyst scandal and its impact on information quality of analyst recommendations).

³³³ See Prentice, *supra* note 167, at 1415-16 (observing that “[f]inancial fraud and ‘earnings management’ . . . tend to fool even professional investors”); Donald C. Langevoort, *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).

³³⁴ Travis Dyer & Eunjee Kim, *Anonymous Equity Research*, 59 J. ACCT. RSCH. 575, 578 (2021).

develop a reputation for credibility.³³⁵ Research also suggests that the analyst postings on social media are informative and that investors can trade profitably on those beliefs.³³⁶ Although there is substantial heterogeneity in the quality of postings, investors have some ability to identify the high quality sources of information.³³⁷ 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.”³³⁸

Although empirical studies of the GameStop frenzy are ongoing, early results do not indicate social media is distinctively problematic as an information source; rather, investor use of these 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, like other regulators, must pay continued attention to the use of social media platforms. Social media use by securities professionals, corporate officials, and people who are trading the securities about which they post warrants particular oversight. Notably, issuers are increasingly using social media to communicate with their investors and to combat misinformation.³³⁹ The SEC might follow their lead and consider engaging directly with social media to monitor ongoing developments, play a role in educating investors about how to determine the reliability of posts, and even 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.³⁴⁰

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

³³⁵ Michael Farrell, T. Clifton Green, Russell Jame & Stanimir Markov, *The Democratization of Investment Research and the Informativeness of Retail Investor Trading*, 145 J. FIN. ECON. 616, 616-18 (2022).

³³⁶ Chukwuma Dim, *Should Retail Investors Listen to Social Media Analysts? Evidence from Text-Implied Beliefs* 28 (May 2022), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3813252 [<https://perma.cc/8KJM-6VSN>].

³³⁷ *Id.*

³³⁸ Chiu & Yahya, *supra* note 195, at 86.

³³⁹ *See, e.g.*, Trentmann, *supra* note 269 (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”).

³⁴⁰ *See, e.g.*, Devin Coldewey, *Who Regulates Social Media?*, TECHCRUNCH (Oct. 19, 2020, 4:33 PM), <https://techcrunch.com/2020/10/19/who-regulates-social-media/> [<https://perma.cc/4XRN-J9G4>] (describing FCC and FTC’s roles in social media regulation).

attractive.³⁴¹ The Massachusetts enforcement action against Robinhood is premised, in large part, on the allegedly manipulative aspects of its trading platform.³⁴² The SEC's request for public input on DEP solicited 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.³⁴³

While concerns over the ability of app-based platforms to influence investing behavior are undoubtedly valid, 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' Donuts' free coffee.³⁴⁴ A paternalistic approach that regulates or limits business activity because of its capacity to influence behavior sweeps far more broadly than fintech. Moreover, that the platform provider has a financial motive in encouraging the targeted behavior 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 on that debt.³⁴⁵ Pharmaceutical companies hope that people will demand costly prescription drugs from their doctors based on what they see on television.³⁴⁶

The power of platforms to gather customer-specific information and then to use that information to exploit vulnerabilities presents a distinct concern. A brokerage app can collect information on a customer's trading patterns, predict which types of securities the customer is most likely to buy, and target that customer with recommendations for more of those types of securities.³⁴⁷

³⁴¹ See Darbyshire, *supra* note 120; see also *Game Stopped? Part II*, *supra* note 8, at 9 (written testimony of Alexis Goldstein, Senior Policy Analyst, Americans for Financial Reform) (describing Robinhood as "using targeted advertising on social media").

³⁴² See *supra* notes 91-92 and accompanying text.

³⁴³ Request for Comment on Digital Engagement Practices, *supra* note 7, at 49069.

³⁴⁴ See *DD Perks*, DUNKIN, <https://www.dunkindonuts.com/en/dd-perks> [<https://perma.cc/2KT8-VX4Y>] (last visited Oct. 25, 2022) (offering free coffee to customers who join DD Perks and accumulate 200 points, where customers earn five points for every dollar spent).

³⁴⁵ 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).

³⁴⁶ 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, 350-54 (2009).

³⁴⁷ See, e.g., *Generation Z Are More Conservative Investors than You May Think—Data from Financial Platforms Moomoo and Futubull Shows*, YAHOO! FIN. (July 25, 2022),

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 are 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 responses to nudges and cues. The platform can then use artificial intelligence to respond to that information. In particular, while an app can use the information to encourage behavior that is in the customer's best interests, it can also encourage behavior that is inconsistent 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 those data to generate "predictive suggestions for products and services that each user might be inclined to purchase."³⁴⁸ Cambridge Analytica obtained user data from Facebook that it then used to create targeted messages to voters in the 2016 presidential election.³⁴⁹ Target received negative publicity for collecting information that it used to predict when its customers were pregnant to send them maternity advertisements.³⁵⁰ The technology used in these examples is powerful, and it may be a matter of algorithmic programming that is not visible in the same way as overt verbal or written actions.³⁵¹ As with other artificial intelligence-type tools, platform regulation should ensure 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 their potential influence on customer behavior. Brokers have an obligation to know their customers and to determine that their recommendations are suitable for the

<https://finance.yahoo.com/news/generation-z-more-conservative-investors-140800882.html> [<https://perma.cc/8YYT-YHCN>] (reporting investment patterns based on data digital trading platform Moomoo collected from users).

³⁴⁸ 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).

³⁴⁹ Ido Kilovaty, *Legally Cognizable Manipulation*, 34 *BERKELEY TECH. L.J.* 449, 466-67 (2019).

³⁵⁰ Dacia Green, *Big Brother Is Listening to You: Digital Eavesdropping in the Advertising Industry*, 16 *DUKE L. & TECH. REV.* 352, 368 (2018).

³⁵¹ 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.³⁵² The SEC adopted Regulation Best Interest (“Reg BI”) in 2019 requiring brokers to comply with a “best interest” standard.³⁵³ Reg BI also limits how brokers can be compensated for their recommendations.³⁵⁴

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.³⁵⁵ A recommendation need not be explicit; if a digital design or function suggests an investment or strategy, that design may constitute a recommendation.³⁵⁶ A key issue in the determination of whether Reg BI applies is the degree to which a communication is individually tailored. 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.’”³⁵⁷ 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.³⁵⁸

Brokers have greater obligations with respect to margin loans and options trading. FINRA rules require brokers affirmatively to approve customer accounts for options trading and, in doing so, to exercise due diligence in

³⁵² 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 suitability requirement); Robert H. Mundheim, *Professional Responsibilities of Broker-Dealers: The Suitability Doctrine*, 1965 DUKE L.J. 445, 449 (providing history of suitability requirement).

³⁵³ Regulation Best Interest: The Broker-Dealer Standard of Conduct, Exchange Act Release No. 86,031, 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 J. CORP. L. 263, 272 (2020) (explaining Reg BI as imposing “heightened standard of care for broker-dealers, raising broker’s obligation from ‘suitability’ standard to ‘best interest’ standard”).

³⁵⁴ Schadle, *supra* note 353.

³⁵⁵ Regulation Best Interest, *supra* note 353, at 33334.

³⁵⁶ See Darbyshire, *supra* note 120 (explaining that “the SEC is looking at how digital design itself could be construed as giving investment advice”).

³⁵⁷ Regulation Best Interest, *supra* note 353, at 33335.

³⁵⁸ See Letter from David Dusseault, President, Robinhood Fin., LLC, to Vanessa Countryman, Sec’y, Sec. & Exch. Comm’n (Oct. 1, 2021), <https://www.sec.gov/comments/s7-10-21/s71021-9316498-260092.pdf> [<https://perma.cc/YJ7P-EVSR>], 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.”).

determining whether options trading is appropriate for that account.³⁵⁹ 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.³⁶⁰ Brokers are also required to review the need to impose higher margin requirements, if necessary, for individual accounts or securities.³⁶¹ 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.

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.³⁶² Retail investors lack the basic skills necessary to manage their money, use credit cards, and 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.³⁶³

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

³⁵⁹ FINRA Rule 2360(b)(16). Options, FIN. INDUS. REGUL. AUTH., <https://www.finra.org/rules-guidance/rulebooks/finra-rules/2360> (last visited Oct. 25, 2022) [<https://perma.cc/XB97-B3LJ>].

³⁶⁰ FINRA Rule 4210, *supra* note 209.

³⁶¹ FINRA Rule 4210(d), *supra* note 209; *see also* *Regulatory Notice 21-15: FINRA Reminds Members About Options Account Approval, Supervision and Margin Requirements*, FIN. INDUS. REGUL. AUTH., <https://www.finra.org/rules-guidance/notices/21-15> [<https://perma.cc/YK5H-9N3W>] (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").

³⁶² *See, e.g.*, JILL E. FISCH, ANDREA HASLER, ANNAMARIA LUSARDI & GARY MOTTOLA, FINRA INVES. EDUC. FOUND., *NEW EVIDENCE ON THE FINANCIAL KNOWLEDGE AND CHARACTERISTICS OF INVESTORS 2* (2019), https://gflec.org/wp-content/uploads/2019/10/FINRA_GFLEC_Investor_FinancialIlliteracy_Report_FINAL.pdf [<https://perma.cc/8NR9-G2SD>] ("Data from the 2018 National Financial Capability Study . . . 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 . . .").

³⁶³ *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 importance of financial education and recounting studies showing mixed success of education efforts).

ever purchased fractional shares, or whether their account allowed them to purchase securities on margin.³⁶⁴

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.³⁶⁵ Webull describes its in-app community platforms as enabling its customers to learn from each other.³⁶⁶ As one commentator explains, these platforms that are designed for self-directed investors are increasingly offering “embedded education” tools that provide such investors with direction, research, and analysis to assist the decision-making process.³⁶⁷ 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 considers funding a trade through margin lending. Just-in-time information has been shown to improve the effectiveness of financial education because investors have access to the educational material when it is decision-relevant.³⁶⁸ 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, and 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. 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

³⁶⁴ LUSH, FONTES, ZHU, VALDES & MOTTOLA, *supra* note 223, at 12-13.

³⁶⁵ Dusseault, *supra* note 358, at 9-10.

³⁶⁶ Benzina, *Webull's CEO on Empowering Traders Through Education and Community*, WEBULL FIN. LLC (Sept. 26, 2019, 1:32 PM), <https://www.webull.com/news/21495543> [<https://perma.cc/733S-RW4Z>]. A commentator, however, describes Webull as having a “relative dearth of educational materials.” Emily Guy Birken & Benjamin Curry, *Webull Review 2022*, FORBES ADVISOR (Jan. 13, 2022, 2:05 PM), <https://www.forbes.com/advisor/investing/webull-review/> [<https://perma.cc/S4H9-GA4F>].

³⁶⁷ Rebecca Fu, *How Embedded Education Is Disrupting Fintech*, UX COLLECTIVE (Jan. 5, 2022), <https://uxdesign.cc/how-embedded-education-is-disrupting-fintech-275cc6f85507> [<https://perma.cc/7QWZ-33NJ>].

³⁶⁸ See, e.g., Michael Kitces, *Financial Literacy Effectiveness & Providing Just-In-Time Training by Financial Advisors*, KITCES.COM (Sept. 21, 2016, 7:01 AM), <https://www.kitces.com/blog/financial-literacy-program-effectiveness-just-in-time-training-by-financial-advisors/> [<https://perma.cc/BP27-PP2J>] (describing importance of providing financial education on “just-in-time” basis).

with the disclosures before being approved for trading certain types of instruments or increasing their level of risk exposure.³⁶⁹

Regulators could also “nudge” fintech in this direction. Rather than constraining 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 effectively to improve 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 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 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, this 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.

³⁶⁹ Stephen Choi suggested 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 CALIF. L. REV. 279, 310-313 (2000).