



SEC releases Meme Stock report at long last

Last week, the SEC released its much-anticipated report on “Equity and Options Market Structure Conditions of Early 2021”.¹ While the report stops short of making any specific policy recommendations, it reveals SEC staff’s official thinking on the events. Here are Deloitte’s five takeaways from the report:



1. Changes to equity market structure could be significant:

Although the report is not a policy paper, it points to multiple policy outcomes that are still under consideration by the Commission—so much so, in fact, that it prompted two Commissioners to speak against it.² In the conclusion, SEC staff identify the following as “additional areas for potential study and further consideration”: (1) forces that can cause brokerages to restrict trading; (2) digital engagement practices and payment for order flow; (3) trading in dark pools; and (4) short selling.³

2. Regulators didn’t wait for the report’s publication to begin acting on its findings:

The SEC released, in September 2021, a Request for Information on firms’ digital engagement practices, including applications of game-like features and artificial intelligence.⁴ Also in September, FINRA—the broker-dealer self-regulator—initiated a sweep exam focused on digital engagement.⁵

3. Short selling and wholesalers still under the microscope:

It’s well-established that the SEC agenda under Chairman Gensler is ambitious and expanding⁶, but this report points to a few under-the-radar areas where the SEC may ramp up activity, including short sales and margin calls:

1. *Short sales*—the report stops “short” of identifying naked shorting as a root cause. It goes as far as to suggest that social media furor over naked shorting in January 2021 is misplaced. Nevertheless, it identifies short selling as an area for further study and even suggests that regulatory reporting of short positions could prove useful.
2. *Payment for order flow*—among the most controversial potential policy outcomes from the meme stock saga would be a full stop ban on payment for order flow. Chairman Gensler has already alluded in several speeches that such a ban may be appropriate.⁷

4. Report finds evidence to support reducing the settlement cycle:

The report acknowledges that margin calls contributed to broker-dealers restricting trading, a spillover effect not previously contemplated by regulators. It emphasizes the importance of central clearing and openly admits that “one method” to reduce systemic counterparty risk is shortening the settlement cycle.

The report details the market mechanics that led to national headlines. SEC staff clearly see certain components (e.g., order routing) as within the SEC’s purview and others (e.g., the preferences of retail investors) as firmly beyond its scope. Nevertheless, more Commission activity can be expected on the heels of this report.

5. No major surprises:

The SEC report does not include the kind of bombshell disclosure for which some appear to have hoped.⁸ However, it offers a thorough and digestible analysis of the complex dynamics driving part of the market in late January.



Endnotes

- 1 <https://www.sec.gov/files/staff-report-equity-options-market-structure-conditions-early-2021.pdf>
- 2 <https://www.sec.gov/news/public-statement/peirce-roisman-staff-report-2021-10-18>
- 3 <https://www.sec.gov/files/staff-report-equity-options-market-structure-conditions-early-2021.pdf>
- 4 <https://www.sec.gov/rules/other/2021/34-92766.pdf>
- 5 <https://www.finra.org/rules-guidance/guidance/targeted-examination-letters/social-media-influencers-customer-acquisition-related-information-protection>
- 6 <https://www.sec.gov/news/testimony/gensler-2021-09-14>
- 7 <https://www.sec.gov/news/speech/gensler-sec-speaks-2021-10-12>
- 8 <https://www.bloomberg.com/opinion/articles/2021-10-19/matt-levine-s-money-stuff-gamestop-baffles-the-sec-too>



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