



May 6, 2021

The Honorable Maxine Waters
Chairwoman
Committee on Financial Services
U.S. House of Representatives
Washington, DC 20515

The Honorable Patrick McHenry
Ranking Member
Committee on Financial Services
U.S. House of Representatives
Washington, DC 20515

Re: May 6th Full Committee Hearing

Dear Chairwoman Waters and Ranking Member McHenry:

The American Securities Association (ASA)¹ provides these comments for the May 6th hearing of the Financial Services Committee entitled “Game Stopped? Who Wins and Who Loses When Short Sellers, Social Media, and Retail Investors Collide, Part III.” The ASA appreciates the Committee’s ongoing attention to fundamental issues of equity market structure and investor protection.

The ASA previously provided testimony to the Committee regarding the questions raised by the trading frenzy in GameStop (GME) and other stocks earlier this year.² In that testimony, we expressed our concerns over the increasing “gamification” of stock trading for retail investors, the lack of transparency surrounding stock lending, short selling practices, and whether trades executed on certain trading platforms should be considered “solicited” under Securities and Exchange Commission (SEC) and Financial Industry Regulatory Authority (FINRA) regulations.

The ASA is pleased that the Committee will be considering several bills that address many of these concerns and would boost protections for retail investors while maintaining their access to the equity markets. Our views on some of these bills are described below.

H.R. _____, to amend the Securities Exchange Act of 1934 to modernize reporting requirements under section 13(f) of such Act.

The ASA strongly supports the required disclosure of short positions by institutional investors because it will increase transparency of Wall Street hedge funds and other large institutions that often target America’s small public companies. This should go a long way to ending the “short

¹ The ASA is a trade association that represents the retail and institutional capital markets interests of regional financial services firms who provide Main Street businesses with access to capital and advise hardworking Americans how to create and preserve wealth. The ASA’s mission is to promote trust and confidence among investors, facilitate capital formation, and support efficient and competitively balanced capital markets. This mission advances financial independence, stimulates job creation, and increases prosperity. The ASA has a geographically diverse membership of almost one hundred members that spans the Heartland, Southwest, Southeast, Atlantic, and Pacific Northwest regions of the United States.

² <https://www.americansecurities.org/post/asa-raises-questions-on-gamestop-market-frenzy>





and distort” schemes that prey on these companies. While we support the draft legislation, we believe transparency can be improved by requiring SROs to publicly report aggregate short positions in individual securities on a daily basis (as opposed to monthly).

H.R. , to require the Securities and Exchange Commission to carry out a study on the impact of the gamification of online trading platforms.

The ASA strongly supports this bill, in particular the provisions which direct the SEC to study whether gamification features “may constitute investment advice or recommendations under Federal securities laws and regulations, including Regulation Best Interest.”

When a registered broker-dealer employs a business model that uses an interactive algorithm designed to encourage the execution of customer orders so it can sell those orders to a third-party for profit, then policymakers should acknowledge that the customer *is* the product.

The apps used in this model raise the question of whether the accounts users are trading from are truly self-directed, and whether trades should be classified as solicited for purposes of SEC and FINRA regulations. As a result, the study should also attempt to ascertain whether customers believe they are being “sold” certain stocks every time they open the app or once they begin trading.

We also believe the bill can be enhanced by including a study of stock lending practices. We would begin by asking whether there is any social good in allowing the short interest of a company’s stock to exceed 100% of its shares outstanding, and if the answer is no, then we recommend that Congressional study examine the details of the Reg SHO delivery rules³ and the mechanics and pricing of stock lending arrangements.

A thorough examination should (1) determine whether “naked” short selling is still occurring in the market, (2) review the delivery exemption for market makers, which effectively allows them to remain short a stock indefinitely, (3) examine whether Reg SHO contributed to and exacerbated market volatility, and (4) explore whether the re-hypothecation of shares through stock lending arrangements (hard-to-locate or not) and the costs associated with such arrangements should be transparently disclosed to all market participants.

A study of this detail will enhance Congress’ understanding of this opaque, but particularly important part of the plumbing of today’s equity market structure.

³ <https://www.sec.gov/investor/pubs/regsho.htm>





H.R. , to amend the Securities Act of 1934 to establish certain requirements with respect to retail investor options trading.

As described above, a significant amount of risk is posed to investors by gamified trading apps and this is amplified when those investors trade options. While options are an important tool for investors to hedge their risk exposure, they can sometimes lead to 100% or unlimited losses for investors who have been incentivized to trade them and do not understand how they work.

ASA supports provisions of this draft bill that would prohibit brokers from providing incentives to investors for trading options. However, we caution that the aggregation and disclosure aspects of the bill – which include a requirement that brokers calculate the aggregate options trading losses of *all* their customers – may prove costly, unworkable, and ultimately unnecessary if an incentive prohibition were in place.

Those requirements would also impose significant costs on broker-dealers that are not involved in the gamification business and do not have a track record of allowing their customers to trade options irresponsibly. We recommend that this bill be targeted toward those broker-dealers who created this problem and not unfairly impose costs on the rest of the industry that did not. That said, the ASA looks forward to working with the Committee on this legislation as it moves forward.

Legislation to address equity market structure issues.

We are pleased the Committee is focusing on the issue of “payment for order flow” by putting forward a discussion bill that would prohibit the practice. We believe that in light of the GME episode, the utility of the payment for order flow practice – and the misaligned incentives it creates – deserves heightened scrutiny. Importantly, the Committee should examine whether clients receive different prices on their purchases/sales depending on the level of payment for order flow.

Laws and regulations addressing equity market structure must support small business capital formation and market stability. For far too long, they have not. The big picture discussion in this area must recognize that different tiers of market structure exist; that the current one-size-fits-all regime has contributed to a decrease in IPOs; that the reliance on “time-price” priority exacerbates price moves in all securities; and that current law grants monopoly pricing power to for-profit entities whose interests are not aligned with those of mom-and-pop investors.

Market structure is a function of regulation, technology, and competition. Government sets the rules in a zero-sum game and market participants compete to obtain the best technology, so they can extract whatever profits they can before everyone else catches up. Today, we have a hyper-competitive market because everyone whose business model depends on it, has access to similar





technology and the rules haven't changed. As a result, both costs and margins have come down significantly and the market has reached a point of maximum efficiency. Except that certain players continue to *unfairly* extract government approved monopoly rents.

Today, market participants are left with two options: (1) petition policymakers to change the rules in a way that will increase their profits at the expense of others or (2) ask for a total reset of how the game is played. We support the later.

The Committee can end today's one-size-fits-all market structure by changing the law to recognize that: (1) different tiers of market structure exist within the current ecosystem; (2) the order handling, time-price priority, and best execution obligations must make sense for each tier or they should be eliminated; (3) government-licensed monopoly control over pricing must end; and (4) the profit motive of Wall Street's high frequency traders must take a back seat to Main Street's desire for market stability.

Wholesale changes to the core of the national market system are the only way to help more small businesses IPO and protect investors. We look forward to working with all members of the Committee on the draft legislation specifically and hitting the reset button on our equity market structure more broadly.

The ASA thanks the Committee for holding this important hearing and we remain committed to working with all members of Congress and the SEC to maintain the integrity and competitiveness of our nation's equity markets.

Sincerely,

Christopher A. Iacovella

Christopher A. Iacovella
Chief Executive Officer
American Securities Association

