Title: GameStop and H.R. 4618 - Short Sale Transparency and Market Fairness Act: Part 2
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## TLDR

It's been 21 days since Bloomberg published [*SEC Chief to Wall Street: The Everything Crackdown Is Coming*](https://news.bloomberglaw.com/financial-accounting/sec-chief-to-wall-street-the-everything-crackdown-is-coming) which mentioned the SEC having indicated a Short Sale Disclosure rule that, with encouragement from Congress, could be proposed by November 2021. I pointed this out two weeks ago in my post [*GameStop and H.R. 4618 - Short Sale Transparency and Market Fairness Act: Part 1*](https://www.reddit.com/r/Superstonk/comments/q6zgrn/gamestop_and_hr_4618_short_sale_transparency_and/) that discussed:

1. Securities Lending implications of Dodd-Frank's Section 929X
2. A possible timeline for the passage of H.R. 4618 and
3. How the SEC studying the use of confidential filings could tie Hedge Funds like Melvin Capital back to even bigger fish like Citadel, The Intercontinental Exchange, Credit Suisse, Greensill and Archegos

So after a brief Squid Game break I'm back to make good on the conclusion from my previous post that suggested I'd be following up with more to say on the topic of H.R. 4618. This post will be picking up on previously discussed topics but this time, thanks to newish data from the SEC's report on market volatility, with greater emphasis on how securities lending and confidential disclosures tie into some other trading strategies that cast further doubt on the narrative Retail Investors perpetrated some kind of market event or are in any way responsible for market volatility as portrayed by everyday news.

## Chapter 1: Securities Lending and Short Selling

My last post described how the lending of fully paid securities might've provided a financial incentive for brokerages to have turned off the buy button back in January. In this chapter I will be talking about Securities Lending in conjunction with Short Selling specifically, given how the two practices seem mutually dependent:

> "Securities lending is important to short selling, in which an investor borrows securities to immediately sell them. The borrower hopes to profit by selling the security and buying it back later at a lower price." - [Investopedia - February 24, 2021](https://www.investopedia.com/terms/s/securitieslending.asp)

So, which equity generated the most securities lending revenue in January 2021 you might ask?

Well that, of course, would be GameStop at $41.3mil in revenue during that month based on data from IHS Markit [here](https://ihsmarkit.com/research-analysis/securities-finance-january-2021.html). This is the highest share lending revenue for any single name in 2021 by $7.5mil out of all equities visible through IHS blog posts (they're missing posts for the months of June, August and September 2021). Makes you wonder, why would people short GameStop in January right after news outlets began picking up on the story and it going viral? There's no arguing against Ryan Cohen's leadership capabilities. Are there any other reasons why people might short or naked short sell a stock? Well…

> "Apart from speculation, short selling has another useful purpose—hedging…
The primary objective of hedging is protection, as opposed to the pure profit motivation of speculation. Hedging is undertaken to protect gains or mitigate losses in a portfolio, but since it comes at a significant cost, the vast majority of retail investors do not consider it during normal times." - [Investopedia - September 23, 2021](https://www.investopedia.com/terms/s/shortselling.asp)

Interesting, so institutional investors will sometimes hedge positions in their portfolio through the short sale of a stock and it doesn’t sound like Investopedia thinks Retail Investors are very interested in this strategy. But didn’t the GameStop report conclude that short selling substantially increased at the end of January 2021?

> “**The unusually high amount of short selling raised the question of whether some of the short sales were “naked”—namely, made without arranging to borrow the underlying security.** - [SEC - October 14th, 2021](https://www.sec.gov/files/staff-report-equity-options-market-struction-conditions-early-2021.pdf)

So not only talk of short selling but naked short selling. Makes you wonder, how exactly were those opening these short positions doing so?

> “Consistent with the trading activity in GME stock, trading in GME options increased significantly in January 2021…On January 27, 2021… **over 2 million contracts traded, worth over $8 billion.** Based on dollar volumes, the increased trading **concentrated heavily in call options, a large percentage of which were short-dated.**” - [SEC - October 14th, 2021](https://www.sec.gov/files/staff-report-equity-options-market-struction-conditions-early-2021.pdf)

Short-dated call options. It’s almost as if someone was *knew* the price would go down in the near future.

> “Further, data show that market-makers were buying, rather than writing, call options.” - [SEC - October 14th, 2021](https://www.sec.gov/files/staff-report-equity-options-market-struction-conditions-early-2021.pdf)

Wow so really it was market-makers who were the ones primarily purchasing call options… I wonder if these were the call options that were short-dated?

> “In mid-January, individual customer accounts reached a peak of 91% of the non-market maker volume in options… By late January, individual customer accounts were associated with only 56% of non-market-maker volume. **Between January 22 and January 27, GME traders began to suddenly close their call option positions.**” - [SEC - October 14th, 2021](https://www.sec.gov/files/staff-report-equity-options-market-struction-conditions-early-2021.pdf)

Almost as if the buy button being turned off was the plan all along. I wonder if some brokerages were more involved in this plan than others?

> “Individual customer accounts made up a high percentage of options trading in GME during this time… with three brokers (Robinhood, TD Ameritrade, and E*Trade Securities) representing over 66% of individual customer accounts trading GME options… with Robinhood and TD Ameritrade alone accounting for over half of this volume.**” - [SEC - October 14th, 2021](https://www.sec.gov/files/staff-report-equity-options-market-struction-conditions-early-2021.pdf)

So Robinhood, TD Ameritrade, and E*Trade were involved. Interesting considering how long it’s taking TD Ameritrade to transfer accounts to ComputerShare for DRS.

But wait a second… don’t you need a margin account in order to short sell a stock?

> “Short selling… is an advanced strategy that should only be undertaken by experienced traders and investors… To open a short position, a trader must have a margin account and will usually have to pay interest on the value of the borrowed shares while the position is open.” - [Investopedia - September 23, 2021](https://www.investopedia.com/terms/s/shortselling.asp)

So let me get this straight… In late January 2021 a bunch of Reddit users “banded together,” opened margin accounts and short sold a stock to hedge their portfolios? Yeah… so Robinhood must have a ton of margin accounts… right?

> “Overall, as of the end of 2020, 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.**” - [Vlad Tenev - February 18th, 2021](https://docs.house.gov/meetings/BA/BA00/20210218/111207/HHRG-117-BA00-Wstate-TenevV-20210218.pdf)

If Robinhood has [13mil](https://www.statista.com/statistics/1258468/online-stock-brokers-clients-usa/) brokerage accounts it means that they could have roughly 1.69mil margin accounts that trade basic options and 260,000 accounts trading "[multi-leg](https://www.investopedia.com/terms/m/multilegorder.asp)" options.

If we were to:
1. Divide the $8bil worth of options contracts in half to account for market maker activity and everyone else
2. Then take 66% of that to account for known volume across Robinhood, TD Ameritrade and E*Trade and
3. Divide that amount by 3 to account for Robinhood, TD Ameritrade and E*Trade then we'd get roughly $1.33bil worth of options contracts traded per broker on January 27th alone
4. Which would suggest that each of the 1.69mil "basic options" margin accounts would have been trading options contracts worth roughly ~$787 each in GameStop on January 27th alone.

This $787 napkin math average worth of contracts traded per margin account on January 27th, 2021 is also at odds with another piece of data disclosed by the SEC:

> "Robinhood reported that its average customer is 31 years old and has a median account balance of $240.30" - [SEC - October 14th, 2021](https://www.sec.gov/files/staff-report-equity-options-market-struction-conditions-early-2021.pdf)

Not only is $240.30 is substantially less than the rough $787 average I calculated above while working backwards from the $8bil worth of contracts traded on January 27th, 2021 but the types of contracts traded make the Retail Investor narrative sound like even more of a conspiracy theory:

> "While staff did find GME options trading volume from individual customers increased substantially, from only $58.5 million on January 21 to $563.4 million on January 22 until peaking at $2.4 billion on January 27, this increase in options trading volume was mostly driven by an increase in the buying of put, rather than call, options." - [SEC - October 14th, 2021](https://www.sec.gov/files/staff-report-equity-options-market-struction-conditions-early-2021.pdf)

Huh… put contracts constituted a large percentage of the increased trading volume? Again, like the increased short-dated call contracts, it seems like this put option activity actually sounds more like institutions hedging long exposure than frenzied Retail Investors:

> "Put options can be used either for speculation or for hedging long exposure. Puts can directly hedge risk. As an example, say you were concerned about a possible decline in the technology sector, you could buy puts on the technology stocks held in your portfolio… Buying put options also have risks, but not as potentially harmful as shorts. With a put, the most that you can lose is the premium that you have paid for buying the option, while the potential profit is high." - [Investopedia - March 12th, 2021](https://www.investopedia.com/articles/trading/092613/difference-between-short-selling-and-put-options.asp)

Long puts essentially allow investors to cap losses while leaving the opportunity available for potential profit if the share price falls below the contract's strike price at some point in the future. This practice reminds me of a well-established investment strategy meant for minimizing market exposure called [Long-short Equity](https://www.investopedia.com/terms/l/long-shortequity.asp):

> "Long-short equity is an investing strategy that takes long positions in stocks that are expected to appreciate and short positions in stocks that are expected to decline. A long-short equity strategy seeks to minimize market exposure while profiting from stock gains in the long positions… The long-short equity strategy is popular with hedge funds." - [Investopedia - December 28, 2020](https://www.investopedia.com/terms/l/long-shortequity.asp)

Alright so what was going on with GameStop behind the scenes that resulted in this flurry of hedging-related activity that was subsequently blamed on Retail Investors?

## Chapter 2: Kenneth Cordele Griffin and Convertible Debt Arbitrage

On October 4th, 2021 Kenneth Cordele Griffin sat down for an interview with Bloomberg's most high profile reporter and espoused, with a straight face, a few divisive topics like:

> "Chicago is like Afghanistan on a good day. And that's a problem." - [Kenneth Cordele Griffin- October 4th, 2021](https://www.chicagotribune.com/business/ct-biz-ken-griffin-hedge-fund-billionaire-chicago-economic-club-20211004-itadbjs3ebhojiog4pcxuhfyia-story.html)

Say what? He realizes that Afghanistan is a country (and not a city) that had over [5.8mil people](https://www.cfr.org/in-brief/where-will-afghan-refugees-go) displaced in 2020 alone… right? Seems like a factually inaccurate conspiracy theory to me and really makes you wonder why a wealthy institutional investor would go on stage, foment fear and provide others with yet another opportunity to further question their credibility? My read of the situation was and has been Griffin attempting to divert attention away from a much broader racket involving an investment strategy he seems to be a fan of based on his Wikipedia page - Convertible Debt Arbitrage.

> "A convertible bond arbitrage strategy is one that benefits from the difference in pricing between a convertible bond and the underlying stock price." - [Investopedia - July 30th, 2021](https://www.investopedia.com/terms/c/convertible-bond-arbitrage.asp)

Ok, seems simple enough, people are placing bets on their ability to convert bonds into shares at some point in the future and placing bets based on the assumption they'll be able to do so. It also sounds like the strategy was popular during 2020 like it was in 2008 according to the Financial Times [here](https://on.ft.com/35Ijse5).

So how exactly do investors "[hedge](https://www.investopedia.com/terms/h/hedge.asp)" these investments?

> "A convertible hedge is a trading strategy that consists of taking a long position in a company's convertible bond (or debenture), and a simultaneous short position in the amount of the conversion ratio in the underlying common shares." - https://www.investopedia.com/terms/c/convertible-hedge.asp

Which explains why the positions of Investors employing convertible bond arbitrage:

> "Must be adjusted continuously as the delta changes following changes in the price of the underlying shares." - [Investopedia - July 30th, 2021](https://www.investopedia.com/terms/c/convertible-bond-arbitrage.asp)

A piece of information that is interesting while re-evaluating another IHS Markit blog post from January 2021:

> "The process of hedging a long position in a convertible bond, when the common share price is increasing, involves shorting an increasing number of shares as the delta of the embedded call option approaches one. In practice, that will look like short sellers 'fighting the tape' by shorting more shares as the price increases; taking full account of the trade, the price of the convertible bond may be increasing by more than the delta-adjusted hedge, delivering a profit to the arbitrageur." - [IHS Markit - January 29th, 2021](https://ihsmarkit.com/research-analysis/biggest-short-squeeze-ever.html)

Sound familiar? It should:

> "Melvin Ramped Up New Bets Against Stocks Before 55% January Rout" - [Bloomberg - August 20th, 2021](https://www.bloomberg.com/news/articles/2021-08-20/melvin-ramped-up-new-bets-against-stocks-before-55-january-rout)

Wow. Fascinating behavior that actually lends credence to the notion Citadel and Point72's $2.75bil "[investment](https://www.reuters.com/article/us-melvin-capital-investment-idUSKBN29U2LU)" in Melvin was actually just collateral for securities lending.

But there is still one important open question - how were the long investments being made and in what ways did those investments necessitate naked short selling by market participants while hedging the underlying long's exposure? While I've only found one other post on r/Superstonk about convertible bond arbitrage authored 203 days ago by u/JustBeingPunny [here](https://www.reddit.com/r/Superstonk/comments/mnizvo/paging_uatobitt_you_needed_some_help_with/), it's aged like fine wine and I would highly recommend giving it a read. In the post the author mentions:

> "…what's referred to as a Chinese Hedge whereby… short the convertible bonds and long the underlying stock" - [u/JustBeingPunny - April 10th, 2021](https://www.reddit.com/r/Superstonk/comments/mnizvo/paging_uatobitt_you_needed_some_help_with/)

Which is a unique form of convertible bond arbitrage, also referred to as a reverse hedge, that will help us more easily understand the naked short setup for GameStop.

## Chapter 3: Loan-only Credit Default Swaps and Chinese Hedging

Between the 11th and 13th of January 2021 there was a failed credit default swap auction for Europcar Mobility Group. I have written about this extensively and still believe it to be a highly significant and under appreciated event that helps explain events leading up to GameStop volatility in January 2021.

By virtue of the failed auction being held by CreditEx (owned by The Intercontinental Exchange) we know two things for certain:

1. The loan was a Loan-only Credit Default Swap (LCDS) and
2. 3rd parties can invest in LCDS tranches

Which is helpful to know given the auction "failed" because a Credit Suisse [Term Loan Facility Agreement](https://www.cdsdeterminationscommittees.org/documents/2021/01/europcar-credit-suisse-facility-agreement.pdf/) was purchased, restructured and as a result not converted back into the shares those investing in the loan's tranches were expecting it to during the bankruptcy auction. This means those investors were effectively naked short Europcar Mobility Group and lost big money.

But what's particularly interesting about the Credit Suisse unsecured term loan facility is that it is by definition a [Convertible Debenture](https://www.investopedia.com/terms/c/convertibledebenture.asp) - **yes, the same exact type of debenture that can be used as part of a convertible hedge** - and provides further proof of a convertible bond arbitrage racket falling apart in January 2021.

What's amazing is that a few enlightened individuals appear to have seen this coming and were able to strategically position themselves to benefit from the bankruptcy auction scheme falling apart - notably the investment bank Jefferies.

By December 10th, 2020 the Europcar Credit Event was confirmed by the DTCC [here](https://www.dtcc.com/-/media/Files/pdf/2020/12/10/TIW730.pdf) and then right around the same time the CDS Determinations Committee announced the Europcar auction date, some interesting things began to happen.

On December 15th, 2021 longtime Jefferies client Aphria announced it would be merging with another company called Tilray. Ryan Cohen began increasing his [position](https://www.sec.gov/Archives/edgar/data/1326380/000119380520001571/e620151_sc13da-gamestop.htm) in GameStop on that same exact day.

Then came January 11th:

> "Media attention on GME increased with the **January 11** announcement that Mr. Cohen, of Chewy, would join the GameStop board of directors. That day, GME reached an intra-day high of $20.65, approximately 17% above its prior day closing price. GME's price and volume began to increase noticeably on January 13, when the closing price rose to $31.40 from $19.95 the prior day, and the share volume rose to approximately 144 million shares, compared with approximately 7 million shares the day before." - [SEC - October 14th, 2021](https://www.sec.gov/files/staff-report-equity-options-market-struction-conditions-early-2021.pdf)

That's right - Cohen announced he'd be joining GameStop's board on the same day it became clear the the Europcar Mobility Group auction would fail.

While those on the short selling side of GameStop would have had you believe the January rise in share price was solely related to Cohen's announcement, it seems, to me, even more likely that they were simply re-hedging an Archegos naked short Chinese Hedge preying on what very well could have been a **Bank of America** [Term Loan](https://news.gamestop.com/node/11546/html) that GameStop took on during what seems to have been a leveraged buyout of Micromania during 2008. Good thing RC decided to pay off that long term debt when he did.

Let's cap this chapter off by comparing a few bank stocks YTD to see how Jefferies' foresight has panned out thus far:

**JEF = +73.33%** (Give [Rich Handler](https://twitter.com/handlerrich?s=21) some love)
GS = +56.54%
SCHW = +55.88%
MS = +50.01%
JPM = +35.35%
C = +17.86%
**CS = -19.24%**

Really amazing, great work.

## Chapter 4: Short Sale Transparency & H.R. 4618

Remember how I mentioned the SEC was planning on studying the use of confidential disclosures? Let's dive into that now.

> "Plotkin obtained permission from the U.S. Securities and Exchange Commission to delay required disclosures starting in February, after Reddit traders used the fund's earlier filings to target stocks he had likely sold short." - [Bloomberg - August 21st, 2021](https://www.bloomberg.com/news/articles/2021-08-20/melvin-ramped-up-new-bets-against-stocks-before-55-january-rout)

Hmm Reddit traders "targeting" stocks… ■

> "Melvin's combined SEC filings for the fourth quarter listed put options on stocks that it hadn't previously disclosed betting against, including Beyond Meat, Helen of Troy Ltd., First Majestic Silver Corp. and CryoPort Inc. Yet the shares all started surging around late January, during the height of the retail-trader mania, even without any direct link to Plotkin's hedge fund. The moves confounded Wall Street and even the companies themselves" - [Bloomberg - August 21st, 2021](https://www.bloomberg.com/news/articles/2021-08-20/melvin-ramped-up-new-bets-against-stocks-before-55-january-rout)

Hmm all began surging at the same time… ■

> "Melvin released its first confidential amendment to its fourth-quarter report on April 28 and the second one this week. In addition to the first-time positions, they show a jump in the number of put options that Melvin held on earlier targets, including six-fold increases in its bets against ViacomCBS Inc. and Tanger Factory Outlet Centers Inc. By late January, rising stock prices had pushed the face value of Melvin's year-end put positions to $4.4 billion." - [Bloomberg - August 21st, 2021](https://www.bloomberg.com/news/articles/2021-08-20/melvin-ramped-up-new-bets-against-stocks-before-55-january-rout)

Hmm with puts, unbelievably, on companies Archegos was super leveraged and long on like ViacomCBS… ■

What was going on here? It's like Melvin knew Archegos was bound to collapse.

Well, if there was more transparency when it came to short sales made available through the investment of

Loan-only Credit Default Swaps tracked via an IHS Markit index called LCDX this would all make a lot more sense. But to view constituents you must be affiliated with an organization and able to pay a minimum of $5,000 to access the information. This is the index that seems most likely to have been tracking *all* “meme” stocks… and, if I had to guess, probably what Keith Gill had access to at work which is why MassMutual was probably fined earlier in the year.

It seems as if this information likely enabled Keith, like RC, to pick up on some themes involving Credit Suisse / Greensill creating loans tracked via LCDX whereby Archegos and others could invest in them in anticipation of a “supra competitive” payout through The Intercontinental Exchange’s auction service CreditEx. Makes me really curious to find out what’s in the recently delayed [Greensill Report](https://www.bloomberg.com/news/articles/2021-10-11/credit-suisse-to-delay-publishing-findings-from-greensill-report) … considering what was included in the Archegos report from July that was not delayed.

While the 13(f) disclosure amendments outlined in H.R. 4618 [here](https://www.congress.gov/bill/117th-congress/house-bill/4618/text#H03A47A16497344138D07305B0DC4266B) should hopefully provide more visibility into when investors are employing highly speculative derivatives, I fear problems related to transparency will persist as long as pay-for information like what is provided through IHS will continue to cultivate instability.

## Conclusion

As teased by my Conclusion in *Part 1* I’ll be wrapping this post up with an attempt at contextualizing one of Michael Burry’s recent tweets [here](https://mobile.twitter.com/burryarchive/status/1447590645502201861?s=10).

My best guess here is that these puts, like the 12mil that expire on January 21st, 2022 referenced by u/nayboyer2 [here](https://www.reddit.com/r/Superstonk/comments/q0vggs/the_more_you_learn_about_january_27th_the_more/) are a byproduct of investors hedging the positions related to the “Chinese Hedges” of firms like Archegos - priced like they were going to zero because that’s what those investors were expecting.

The expiration of these options interesting could be interesting given Archegos’ preference for 24mo tenor “bullet” swaps and the fact that for convertible hedges:

> “The strategy is typically closed when the bond is converted. The converted bond provides the same amount of shares that were previously shortly, and the entire position is closed and finished”- [Investopedia - September 1st, 2021](https://www.investopedia.com/terms/c/convertible-hedge.asp)

Which could mean that if Credit Suisse and Nomura haven’t yet closed their lingering 3% of exposure to Archegos and will need to do so around January 21st, 2022… could get bumpy for some folks.

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Just a Retail Investor, not a financial advisor