

Title: GameStop's Adventures in Wonderland Pt. 1: H.R. 4618 Short Sale Transparency and Market Fairness Act

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TLDR

Two weeks ago my interest in a piece of legislation brought forth by Rep. Maxine Waters on July 22nd, 2021 called *H.R. 4618 Short Sale Transparency and Market Fairness Act* was renewed during the U.S. House of Representatives Committee on Financial Services hearing on September 29th, 2021 and down the rabbit hole I went.

This post will explore two topics discussed during the hearing:

1. Why the SEC needs to complete rulemaking pursuant to Section 929X of the Dodd-Frank Act and
2. How the SEC plans to study and report the use of confidential filing requests

And why I believe the seemingly imminent proposal and subsequent adoption of Section 929X rules provide an indication of the financial incentives that have existed for Brokerages to actually halt the purchasing of GameStop and other securities like they did in January / February 2021.

Seems as if the implications might be broader and more sprawling than many realize.

Background

H.R. 4618 is a previously r/Superstonk-analyzed topic by u/bluemasonjar in a great post [here](https://www.reddit.com/r/Superstonk/comments/owls12/congressional_affairs_ape_with_some_dd_for_you_on) that describes four reasons why the proposed legislation makes the author feel "Bullish AF" about it's potential passage. One of those four reasons involves the timeline H.R. 4618 lays out for the adoption of rules outlined in Section 929X:

> "Section 3 of the law states that after 180 days of the enactment of the Act, the SEC has to implement rules made by Section 929X of title IX of the Dodd-Frank Act... This puts a statutory requirement for the SEC to promulgate rules to actually enforce this part of the law." - [Congressional Affairs Ape - August 3rd, 2021](https://www.reddit.com/r/Superstonk/comments/owls12/congressional_affairs_ape_with_some_dd_for_you_on)

Ok! So these rules *must* be adopted by the SEC within 180 days of the bill passing Congress. With that timeframe in mind, here is what was said during the committee hearing that piqued my interest:

> "***Transparency in short-selling***. Volatility surrounding the trading of GameStop and other meme stocks, the resulting "short squeeze" in January 2021, and the collapse of the "family office" Archegos, elicited industry and investor advocate support for increased market transparency, including heightened 13F reporting requirements and short sale reporting... These reports, however, do not contain information on short or derivatives positions. **The collapse of the Archegos fund occurred when it appeared that some market participants were engaged in sophisticated forms of short-selling.** Archegos also used highly leveraged derivatives products. **In July 2021, as a response to meme stocks volatility and the Archegos collapse, the Committee passed H.R. 4618, the "Short Sale Transparency and Market Fairness Act," led by Chairwoman Maxine Waters, which** authorizes the SEC to revise the reporting period for 13F disclosures from quarterly to monthly; shortens the time period to submit such reports; expands the list of items to be disclosed to include certain derivatives; **directs the SEC to complete rulemaking pursuant to Section 929X of the Dodd-Frank Act**, which requires aggregate short positions to be disclosed on Form 13F; **and directs the SEC to study and report the use of confidential filing requests***" - [United States House of Representatives, Committee on Financial Services - September 29th,

2021](<https://financialservices.house.gov/uploadedfiles/hhrg-117-ba00-20211005-sd002.pdf>)

So this very clearly states the impetuses for the introduction of H.R. 4618 being "Meme Stock" volatility and the collapse of Archegos Capital - crazy, right?

This makes me wonder two things:

1. Are there any interesting rules in Section 929X that would need to be completed by the SEC within 180 days of the passage of H.R. 4618?
2. Who has been requesting confidential filings and why?

Let's dig into these questions.

Are there any interesting rules in Section 929X that would need to be completed by the SEC within 180 days of the passage of H.R. 4618?

While you can find the full text for Section 929X on page 496 [here](<https://www.govinfo.gov/content/pkg/PLAW-111publ203/pdf/PLAW-111publ203.pdf>), one rule that stood out to me as particularly interesting was:

> "(e) NOTICES TO CUSTOMERS REGARDING SECURITIES LENDING.— **Every registered broker or dealer shall provide notice to its customers that they may elect not to allow their *fully paid securities* to be used in connection with short sales. If a broker or dealer uses a customer's securities in connection with short sales, the broker or dealer shall provide notice to its customer that the broker or dealer may receive compensation in connection with lending the customer's securities.** The Commission, by rule, as it deems necessary or appropriate in the public interest and for the protection" - [Dodd-Frank Wall Street Reform and Consumer Protection Act - July 21, 2010](<https://www.govinfo.gov/content/pkg/PLAW-111publ203/pdf/PLAW-111publ203.pdf>)

Wait, is this telling us that when Retail Investors purchase [street name securities](<https://www.investopedia.com/ask/answers/185.asp>) some Brokerages have been turning around and using this capital for short selling without the acknowledgement or consent of Retail Investors instead of simply purchasing securities on their behalf? ■

What are "fully paid securities" anyways?

> "The term 'fully paid securities' refers to securities held in a customer's margin or cash account that have been completely paid for and are not being pledged as collateral to support the purchase of other securities on margin. The term is relevant from a regulatory perspective as the SEC requires that U.S. broker dealers segregate and maintain in a good control location (e.g., DTC or bank) all customer securities which are fully paid." - [Interactive Brokers](<https://ibkr.info/node/1966>)

While my brokerage has previously mentioned not using securities from cash accounts for lending... would they even have a legal obligation to tell me? Or ask for my permission to do so? Seeing as how these rules were never adopted by the SEC, despite their inclusion in legislation passed by Congress 10 years ago, I'm not sure. Also, why weren't these rules ever adopted by the SEC in the first place? Here is the best explanation I've been able to find:

> "The environment that existed, brought on by Dodd-Frank, no longer exists," said Amy Lynch, founder and president of FrontLine Compliance and a former SEC regulator with the Office of Compliance Inspections and Examinations. "What was implemented seemed like it was good enough for a long time." - [Compliance Week - June 10th, 2021](<https://www.complianceweek.com/regulatory-policy/a-decade-later-dodd-frank-remains-unfinished-will-gary-genslers-sec-close-it-out/30467.article>)

Wild. Sounds like an assumption was made that people lost interest and the rules were no longer needed. So what's happening nowadays? Does any concern remain that Brokerages are lending out fully paid shares in connection with short selling?

> "**Re: Broker-Dealers Borrowing Fully Paid and Excess Margin Securities from Customers:**" **Your staff

has brought to our attention that a number of broker-dealers are operating programs in which they borrow fully paid and excess margin securities from their customers ("FPL Programs").** As discussed below, the staff of the Division of Trading and Markets ("Division staff") believes that some of these programs do not comply with the requirements of the broker-dealer customer protection rule ("Rule 15c3-3").¹ The staff also believes it would be appropriate to provide a limited amount of time for broker-dealers to come into compliance with Rule 15c3-3..." - [SEC - October 22nd, 2020](<https://www.sec.gov/divisions/marketreg/mr-noaction/2020/finra-fpl-20201022-15c3-3.pdf>)

Incredible. Seems like the concern has persisted. The "no action" letter from October 2020 makes me think broker-dealers have in fact continued to use fully paid securities in connection with short selling. This warning by the SEC was then followed up by a subsequent staff statement on April 16th, 2021 [here](<https://www.sec.gov/news/public-statement/staff-fully-paid-lending>), a narrative that u/onecreamyboy was admirably following closely at the time [here](https://www.reddit.com/r/Superstonk/comments/msdokd/fully_paid_lending_fpl_program_where_brokers_go).

All-in-all, seems like the SEC has been telling us there's a chance some undisclosed short selling by Brokerages has been taking place since 2010 (and earlier) based on the fact there was some legislation that was passed, never put into effect, and since revisited within the context of "Meme Stock" volatility and the collapse of Archegos Capital.

Who has been requesting confidential filings and why?

Do you remember a hedge fund by the name of Melvin Capital? This sounds like a trick out of their playbook:

> "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. Yet by then, the damage was already done: The group banded together in January to trade in the opposite direction, an unprecedented move by retail investors that saddled one of Wall Street's most successful traders with a stunning monthly loss of 55%... **Melvin released its first confidential amendment to its fourth-quarter report on April 28 and the second one this week**." [Bloomberg - August 20th, 2021](<https://www.bloomberg.com/news/articles/2021-08-20/melvin-ramped-up-new-bets-against-stocks-before-55-january-rout>)

Sounds to me like the SEC might also be studying Melvin's behavior as a result of H.R. 4618 passing Congress. Nice! Yet another topic that has been analyzed on r/Superstonk over the past few months in posts [here](https://www.reddit.com/r/Superstonk/comments/pam30m/the_melvin_capital_misdirection) and [here](https://www.reddit.com/r/Superstonk/comments/pcb39f/gabe_is_this_legal).

Hypothesis

By now you might be thinking, "Talk is cheap, where's my whiskey?" I hear you, let's tie this all together and get back to the reasons why I believe the seemingly imminent proposal and subsequent adoption of Section 929X rules might be a much bigger deal than many realize.

Surely many of you are familiar with the 50+ class actions lawsuits that have coalesced into a single [case]([https://f.hubspotusercontent30.net/hubfs/6398037/0416%20-%202021-09-22%20Corrected%20Antitrust%20Cmplt%20\(Partially%20Unredacted%20Version\).pdf](https://f.hubspotusercontent30.net/hubfs/6398037/0416%20-%202021-09-22%20Corrected%20Antitrust%20Cmplt%20(Partially%20Unredacted%20Version).pdf)) being litigated in the Southern District of Florida. Of the case's 14 defendants there are 10 Brokerages like the ones said by the SEC to have been lending out fully paid securities in connection with short selling. **Could this have been the financial incentive that resulted in the decision of these Brokerages to disable the buy button in January? Undisclosed short positions using fully paid securities of Retail Investors?**

If Brokerages stood to lose a lot of money on undisclosed positions you could see why they might be compelled to participate in the manipulation of certain stocks. Reminds me of an excerpt from a popular post I was reading yesterday:

> "They take your money and use it to generate more money for themselves and hope to make profit on your shares in the meantime and then help to manipulate the price down so you eventually sell them at a

lower price. As well as receiving PFOF from their overlords like Shitadel who front run and again manipulate the price down desperately." - [u/franklamp8 - October 11th, 2021](https://www.reddit.com/r/Superstonk/comments/q5t3c9/important_drs_info_if_you_use_a_pfof_broker)

Anyways, based on a recent Bloomberg article titled "SEC Chief to Wall Street: The Everything Crackdown Is Coming" I believe we now have a possible date range for the passage of H.R. 4618 by virtue of having been firmly provided with some indication of when the rules outlined in Section 929X of Dodd-Frank could be proposed for comment by the SEC. Check out this excerpt from an infographic in the article titled "Gensler's Terrible 10: SEC Rules That Make Wall Street Tremble:"

> "Because of Capitol Hill pressure, it seems inevitable that the SEC will force money managers to make periodic disclosures... The SEC has indicated a rule could be proposed by next month" - [Bloomberg - October 8th, 2021](<https://news.bloomberglaw.com/financial-accounting/sec-chief-to-wall-street-the-everything-crackdown-is-coming>)

Sounds to me like the rules could be proposed in the next 30 days, after which they would be statutorily adopted within 180 days... seems imminent to me... and like this could be a big deal for Brokerages if their undisclosed short sales were cash cows that the SEC is now shutting that practice down through the adoption of Section 929X... which are insane changes to think about considering the changes were brought about, per Congress, in direct response to "Meme Stock" volatility and the collapse of Archegos Capital.

So, perhaps what this amounts to is yet another regulation that has the potential to cripple Brokerages not acting in the best interest of their clientele in a way that has not been discussed ad nauseam to date.

Keen readers might still be wondering.... Ok so what does the SEC studying the use of confidential filings tell us? I believe the TLDR answer to this question is that the study of confidential disclosures is telling of a much bigger picture, as alluded to in the background section, that ties hedge funds like Melvin Capital to even bigger fish like Citadel, The Intercontinental Exchange, Credit Suisse, Greensill and Archegos.

Conclusion

More to come on the bigger picture with bigger fish and [my take](https://www.reddit.com/r/Superstonk/comments/q5ye9m/cassandra_and_the_put_in_gme/hga29ly) on the January 27-29th, 2022 PUTs referenced by Burry yesterday. Stay tuned.

Just a Retail Investor, not a financial advisor.