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SEC REPORT SUMMARY

Hello Apes, SEC Report dropped. I recommend everyone read it (45 Pages). Source: https://www.sec.gov/files/staff-report-equity-options-market-struction-conditions-early-2021.pdf

If you want a summary of important information and some key takeaways here it is (13 Pages). Some of the report touches on concepts well-understood by Apes. I've included relevant market and GME information so new investors understand more clearly but try to keep it brief on what Apes likely already know. Hopefully, this will help Apes understand the report and dispel FUD because it will be seen that what the Apes already know remains true. Buy, Hold, Register, Buckle Up.

Anything in quotations is directly from the text as per the link. I've written this fairly quickly so if you see a random number, it is an intext source I missed removing. I offer a summary and personal interpretation/speculation of the released report. Not advice at all.

Summary:

So to start just remember the SEC says that none of this is enforceable lol.

"DISCLAIMER: This is a report of the Staff of the U.S. Securities and Exchange Commission. Staff reports, Investor Bulletins, and other staff documents (including those cited herein) represent the views of Commission staff and are not a rule, regulation, or statement of the Commission. The Commission has neither approved nor disapproved the content of these documents and, like all staff statements, they have no legal force or effect, do not alter or amend applicable law, and create no new or additional obligations for any person. The Commission has expressed no view regarding the analysis, findings, or conclusions contained herein."

The first part of the report goes over things like payment for order flow (PFOF), market structure, clearing agencies/procedures, and how rules are made and enforced. Apes know most of this but I'm including important tidbits.

"the Commission oversees self-regulatory organizations ("SROs")... all of whom act as regulators of their broker-dealer members. The SROs are subject to the Exchange Act. The Exchange Act includes various rules, requirements, and principles, such as those that prohibit exchanges from engaging in unfair discrimination and require them to promote the protection of investors and the public interest"

They identify how rules are mandated/enforced (SEC to SRO which is a conglomerate of broker-dealers) as well as their obligation to engage in fair practice. It's laughable that self-regulatory agencies govern the whole economy, but Apes know this. The report is the right step but I'll believe in change when I see it.

" Less than 60% of overall equities volume is typically executed on exchanges"

"Off-exchange market makers have more flexibility compared to on-exchange participants because they are not subject to the rules of the exchanges on which they quote. For example, exchanges are required under Rule 612 of Regulation NMS to price displayed orders for stocks in penny increments, whereas wholesalers can execute more freely in sub-pennies when transacting off-exchange. At the same time, off-exchange market makers use the public quotes submitted by on-exchange participants when setting the prices at which they execute individual investor orders off exchange."

Yep retail gets cukd n fukd

“clearing agency for the U.S. equities markets, NSCC, a subsidiary of the Depository Trust and Clearing Corporation (“DTCC”), maintains a “Clearing Fund” into which its member brokerdealers contribute margin to protect NSCC from potential losses arising from a defaulted member’s portfolio until it is able to close out that member’s positions. The Clearing Fund consists of required deposits posted by members in the form of cash and **eligible securities**.”

Depending on what qualifies as an eligible security, large swaths of the market are on the table (this Apes know).

“While margin requirements typically change in response to broad-based market movement, the NSCC’s margin framework also allows for both intraday mark-to-market calls and additional special charges from clearing members if NSCC observes unusual volatility in specific securities that it believes would present heightened risk to the clearing agency and its members.”

When GME rises above margin requirements the clearinghouse can act on the same day to protect themselves; as the stonk rises the dominos fall.

Onto Section 3: “Gamestop: What Happened”

“The underlying causes of the meme stock phenomenon that are unrelated to market structure are a subject of speculation that is beyond the scope of this report”

You can’t predict a black swan…

“GME experienced a confluence of all of these factors: (1) large price moves, (2) large volume changes, (3) large short interest, (4) frequent Reddit mentions, and (5) significant coverage in the mainstream media”

“From January 13-29, an average of approximately 100 million GME shares traded per day”

“On January 22, 2021, the day of GME’s highest share volume in the month, 197.2 million GME shares traded.”

All right jack your tits some Apes.

“by January 27, the number of unique accounts trading GME on a given day increased from less than 10,000 at the beginning of the month to nearly 900,000.”

My nips are sore… on a given day nearly a million unique accounts of potential Apes… I wonder where we are now ■■

“Some institutional accounts had significant short interest in GME prior to January 2021. GME short interest (as a percent of float) in January 2021 reached 122.97%”

“Yet while the swings in GME’s share price and volume attracted significant attention, they were not unusual for January 2021. For instance, single-day price changes on January 27 from the closing prices on January 26 for KOSS (480.0%), AMC (301.2%), NAKD (252.3%), and Express, Inc. (symbol: EXPR) (214.1%) were larger than any single-day GME price change. In fact, **since 2020** began, 134 common stocks had at least one one-day price increase greater than GME’s largest one-day price increase.”

Wait it’s all rigged? Always has been. ■■■■■■■

“In the past, GME had several periods of high short interest, but none as high as the levels achieved from 2019 to mid-January 2021. GME short interest hit 50% of shares outstanding first in 2012 and then again in 2015, 2016, and 2018, before rising even further in 2019.”

As always the attempted ‘bust out’ has been instigated over a period of years.

“broker-dealers typically require that the short-selling investor post collateral in a margin account of at least 50% of the shorted position in addition to the cash obtained from the short sale”

“From then until early 2021, GME short interest hovered around 100%, hitting its high of 109.26% on December 31, 2020.”

They just said 122.97%?? It’s high of 2020 maybe idk?

“When examining short interest as a percent of shares outstanding, GME is the only stock that staff observed as having short interest of more than shares outstanding in January 2021.”

“from January 22 to 27 the price of GME rose as the short interest decreased. Staff also observed discrete periods of sharp price increases during which accounts held by firms known to the staff to be covering short interest in GME were actively buying large volumes of GME shares, in some cases accounting for very significant portions of the net buying pressure during a period. Figure 6 shows that buy volume in GME, including buy volume from participants identified as having large short positions, increased significantly beginning around January 22 and remained high for several days, corresponding to the beginning of the most dramatic phase of the run-up in GME’s price”

So the January run-up was the result of covering… when buying halted shorts were likely on the precipice of a complete and likely very fast domino process of liquidation (recall the same day charges clearinghouses may institute).

“the run-up in GME stock price coincided with buying by those with short positions. However, it also shows that such buying was a small fraction of overall buy volume, and that GME share prices continued to be high after the direct effects of covering short positions would have waned. The underlying motivation of such buy volume cannot be determined; perhaps it was motivated by the desire to maintain a short squeeze. Whether driven by a desire to squeeze short sellers and thus to profit from the resultant rise in price, or by belief in the fundamentals of GameStop, it was the positive sentiment, not the buying-to-cover, that sustained the weeks-long price appreciation of GameStop stock.”

Retail has always had more power than was thought possible, now we know it’s possible. And I think it’s pretty clear Apes are here to support this fundamentally excellent company long-term.

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“As noted above, though, staff did not find evidence of a gamma squeeze in GME during January 2021.... the call options by purchasing the underlying stock, driving up the stock price in the process. 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. Further, data show that market-makers were buying, rather than writing, call options. These observations by themselves are not consistent with a gamma squeeze.”

“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. When a naked short sale occurs, the seller fails to deliver the securities to the buyer, and staff did observe spikes in fails to deliver in GME.”

As Dr. T says this can go on forever until the FTD loopholes are resolved… or we register the float.

“based on the staff’s review of the available data, GME did not experience persistent fails to deliver at the individual clearing member level. Specifically, staff observed that most clearing members were able to clear any fails relatively quickly, i.e., within a few days, and for the most part did not experience fails across multiple days”

oF tHe AVaiLbLE DaTa (data is provided by the NSCC, recall the NSCC is a subsidiary of the Depository Trust and Clearing Corporation (DTCC) and is a clearing agency for the U.S. equities markets.)

“Finally, as discussed above, the volatility in GME impacted some ETFs due to their holdings in GME, and potential short interest in the ETFs themselves. The most notable of these was XRT, an ETF of retail companies.”

“Shorting XRT could have served as an indirect, though imperfect, way of shorting GME. In fact, staff observed a large spike in net redemptions of nearly 6 million shares in XRT on January 27, which may be consistent with short selling activity. 83 This redemption activity was generated nearly entirely by ETF market making firms.”

“While a short squeeze did not appear to be the main driver of events, and a gamma squeeze less likely, the episode highlights the role and potential impact of short selling and short covering.”

Exactly Jan was a sneeze and they just barely managed to avoid shitting themselves when it happened but rest assured they ate a whole bad bet and then doubled down. It’s just like me after a night of drinking and Taco Bell... liquidation is imminent. (Provided we DRS the float ofc)

“Clearing agencies (i.e., NSCC and, to a lesser extent, OCC) played important roles during the January 2021 GME market events. The risk management mechanisms of these clearing agencies effectively led others in the transaction chain—such as retail broker-dealers—to pause and manage the risk exposure that arose as the rate of transactions accelerated. Both NSCC and OCC experienced record volumes cleared on January 27, 2021. After the market events of late January 2021, both NSCC’s and OCC’s margin requirements returned to prior and more historically consistent levels.”

So the clearinghouses issued their new intraday margin requirements to protect themselves and short parties narrowly avoided succumbing to the pressure when the buy button was turned off.

“On January 27, 2021, in response to market activity during the trading session, NSCC made intraday margin calls from 36 clearing members totaling $6.9 billion, bringing the total required margin across all members to $25.5 billion. Of the $6.9 billion, $2.1 billion were intraday mark-to-market calls, while the remaining $4.8 billion was a special ECP charge. Specifically, NSCC observed unusual volatility in certain securities, including GME, which presented heightened risk to the clearinghouse and its members.86 As a result, it calculated and assessed against certain affected members the remaining $4.8 billion as an additional special charge pursuant to its established rules. NSCC imposed this charge on 18 members, all of whom provided the additional margin. NSCC subjected one additional member to the special charge, but that member ultimately did not have to meet that charge after offsetting its exposure with a transfer from an affiliate.”

This is important for wrinkled brains I think? (ECP: excess capital premium)

“Because these members’ ratios of excess risk versus capital were not driven by individual clearing member actions, but by extreme volatility in individual cleared equities, NSCC exercised its rules-based discretion to waive the ECP charge for all members on January 28, 2021. Absent this waiver, one retail broker-dealer would have had an additional ECP charge of more than double its margin requirement of $1.4 billion on January 28, 2021.”

Free pass for the DTCC’s rich friends/overlords !!

“NSCC, like most similar central counterparties, does not instruct its member firms to stop trading or clearing individual symbols because its rules do not give it that ability. However, as discussed below, some broker-dealers restricted activities in a limited number of individual stocks in reaction to margin calls and capital charges imposed by NSCC. This would be a decision made by the broker-dealers and not directed by NSCC.”

So now the story has changed from ‘we were protecting retail investors’ to ‘we were protecting ourselves but don’t worry the people whose money is on the line and who run the DTCC would never enact something illegal and outside of their legal power.’

“Some broker-dealers temporarily restricted trading for stated reasons they did not explicitly or publicly attribute to NSCC margin. For example, on January 28, one such firm stated that it restricted purchases in GME and AMC for its customers and required customers to post additional margin for one day only”

“On January 28, 2021, a clearing broker-dealer that services other broker-dealers also instructed its customer broker-dealers (other broker-dealers that have customer accounts) to temporarily restrict new purchases in AMC, GME, and KOSS. This firm represented that it removed the trading restrictions on its customer broker-dealers later that day starting at 2:55 p.m”

Read that again. Yup…

“The imposition of additional margin by a broker-dealer to its customers is separate from NSCC margin or capital charges imposed on the NSCC member broker-dealer.”

They were about to be liquidated.

“GME trading in January 2021 shifted the prevailing distribution of GME equity executions across venues. Specifically, the proportion of off-exchange activity initially rose as individual investor activity increased, then fell as volatility increased. Approximately half of GME’s dollar and share volume reported to the consolidated tape in 2020 was executed on a national securities exchange. On January 21, 2021 (when GME opened at $39.23 and closed at $43.03), 62.60% of the day’s dollar volume was executed off exchange. But, beginning on January 22 (when GME opened at $42.59 and closed at $65.01), the percentage of dollar volume executed off exchange consistently dipped below 50%, reaching a low of 32.83% on January 28 (when GME opened at $265.00 and closed at $193.60).”

As they started covering, dark pool percentage decreases, price go up…

“An increasing percentage of volume executed on exchange when volatility spikes may indicate that market participants, including wholesalers, are seeking to avoid internalizing customer orders to reduce potential losses when hedging becomes more difficult.”

So due to a potential risk, they were unable to continue making a profit from their usual tactics.

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“TRF refers to the Trade Reporting Facility for the reporting of transactions effected otherwise than on an exchange.”

“The vast majority of GME stock trades executed off exchange in January 2021 were internalized (approximately 80%) as opposed to executed on ATSs. The market for internalization of GME was highly concentrated, with 88% of internalized dollar volume in January executed by just three wholesalers. Citadel Securities accounted for nearly 50% of internalizer dollar volume during the month, rising to as high as 55% of daily internalized dollar volume twice. Virtu Americas accounted for approximately 26% of the internalized volume during January. While the percentage of GME trading internalized declined during the last week in January, the absolute volumes executed by internalizing firms during the days of the most intense trading in this period were, in some cases, an order of magnitude larger than what had previously been typical for these firms. For example, Citadel internalized an average of just under $37 million of GME per day in December 2020. On January 27, Citadel internalized nearly $4.2 billion of GME. Similarly, Virtu internalized an average of $23.4 million of GME each day in December 2020 and $2.2 billion of GME on January 26. 105 On January 29, Citadel internalized approximately $2.2 billion of GME stock, while Virtu internalized approximately $1.4 billion.”

“Consistent with increased volatility in GME, various measures of liquidity declined substantially during January 2021.107 As shown in Figure 9 below, bid-ask spreads widened significantly for GME in January 2021. For example, on January 28, 2021, the daily average relative effective spread for GME stock was 0.54%, three times the average of 0.18% for 2020. Nominal quoted spreads for GME stock were nearly 50 times larger than the 2020 daily average.”

“Measured in dollar value, the notional value (i.e., share price times number of shares quoted) of GME’s inside depth at the best bid and ask prices did not fluctuate as dramatically during January 2021, signifying that liquidity providers continued to commit capital to quoting GME, albeit with fewer shares as the share price dramatically increased. Further, as the proportion of volume in GME shifted to exchanges at the end of the month, the dollar value of displayed inside liquidity increased.”

“As extreme intraday volatility in GME occurred, exchanges’ Limit-Up, Limit-Down (“LULD”) trading pauses were triggered on six trading days in late January. LULD is a trading mechanism that attempts to address extraordinary volatility in stocks. If either the National Best Bid equals the stock’s upper bound or the National Best Offer equals the stock’s lower bound for fifteen seconds, the stock’s trading will be paused for five minutes. Significant price movement in GME during January 2021 triggered 40 LULD pauses, compared with only one in all of 2020. On January 28 alone, 19 LULD pauses were triggered in GME”

“Trading in GME also triggered two short sale circuit breakers on January 15 and January 28. Id. A short sale circuit breaker is triggered when a stock has declined 10% or more relative to the previous day’s closing price. When triggered, this mechanism imposes restrictions that last for the remainder of the day and the following day, during which short sale orders generally may not be executed or displayed at a price that is less than or equal to the current National Best Bid.”

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“Based on dollar volumes, the increased trading concentrated heavily in call options, a large percentage of which were short-dated.

Except recall the report previously stated:

“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. Further, data show that market-makers were buying, rather than writing, call options.”

I’m fairly smooth so this confuses me, can anyone offer clarification?

“Theoretically, a large number of call options written could have contributed to further increases in the price of GME. If market makers purchased GME stock to hedge the risk associated with writing call options on GME, it would put further upward pressure on GME’s stock price. However, as discussed above, staff did not find evidence of a gamma squeeze for GME during January 2021 in the available data.”

“Individual customer accounts made up a high percentage of options trading in GME during this time. A small number of retail brokers facilitated this activity, with three brokers (Robinhood, TD Ameritrade, and E*Trade Securities) representing over 66% of individual customer accounts trading GME options.120 A small number of retail-focused online brokerages had the majority of volume from individual customer accounts, with Robinhood and TD Ameritrade alone accounting for over half of this volume.121 In mid-January, individual customer accounts reached a peak of 91% of the non-market maker volume in options.122 By late January, individual customer accounts were associated with only 56% of non-market-maker volume.123 Between January 22 and January 27, GME traders began to suddenly close their call option positions”

The conclusion of this report I will leave wholly intact so as to best let you decide how you will judge the SEC.

“The 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. At the same time, the trading in meme stocks during this time highlighted an important feature of United States securities markets in the 21st century: broad participation.

There are many different types of investors, and they buy and sell stocks for many different reasons. However, when share prices change rapidly and brokerage firms suddenly suspend trading, investors may lose money. Underneath the memes are actual companies, with employees, customers, and plans to invest in the future. Those who bought GameStop became co-owners of a company through a system of mutual trust and participation that sustains our economy. 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. These events present an opportunity to reflect on the market structure and regulatory framework and identify additional areas for potential study and further consideration in the interests of protecting investors, maintaining fair, orderly, and efficient markets, and facilitating capital formation.

These areas include:

1. Forces that may cause a brokerage to restrict trading. A number of clearing brokers experienced intraday margin calls from a clearinghouse. In reaction, some broker-dealers decided to restrict trading in a limited number of individual stocks in a way that some investors may not have anticipated. This episode highlights the integral role clearing plays in risk management for equity trading, but raises questions about the possible effects of acute margin calls on more thinly-capitalized broker-dealers and other means of reducing their risks. One method to mitigate the systemic risk posed by such entities to the clearinghouse and other participants is to shorten the settlement cycle.

2. Digital engagement practices and payment for order flow. Consideration should be given to whether game-like features and celebratory animations that are likely intended to create positive feedback from trading lead investors to trade more than they would otherwise. In addition, 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.

3. Trading in dark pools and through wholesalers. Much of the retail order flow in GME was purchased by wholesalers and executed off exchange. Such trading interest is less visible to the wider market—and payments to broker-dealers may raise questions about the execution quality investors receive. Further, though wholesalers increasingly handle individual investor order flow, they face fewer requirements concerning their operational transparency and resiliency as compared to exchanges or ATSs.

4. Shortselling and market dynamics. While short selling and calls on social media for short squeezes received a great deal of media attention, the interplay between shorting and price dynamics is more complex than these narratives would suggest. Improved reporting of short sales would allow regulators to better track these dynamics."

Hopefully, everyone takes a chance to read through the report. Maybe there is data that wrinkled brains can use, idk. Imo this report is nothing new and many of the details have been known to Apes for a while. If you feel this summary is incorrect or missing something crucial please let me know; I always appreciate kind and well-intentioned feedback.

Nothing has changed. Buy, Hold, Register, Buckle Up.