Canadian perspectives on mass mobilization and the risks to investors and financial market stability

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Canadian equity market experts, ranging from market enablers to investor protectors, were recently gathered by the Global Risk Institute (GRI) to discuss the future implications of last month's events which captivated financial markets observers. Novice retail investors harnessed the power of social media to take on Wall Street professionals. The protagonists have done so by buying up shares in U.S. video games retailer GameStop (GME) as well as other short-sold targets like AMC and Blackberry. This "Meme stock mania" was a crowd-sourced attempt to beat billionaire hedge fund traders at their own game, while creating volatility and broader awareness of high street activities in the market.

Specific Canadian insights on last month's trading frenzy were seen in Wealthsimple trade data. Analysis of data from Canada's largest, no commission stock trading app showed many amateur Canadian investors with minimal investing experience were participating. The majority (67 per cent) lost money on GME stock. However, stereotypical Canadian risk-aversion meant only a small fraction of the platform's active user base traded in GME, and their exposures and losses tended to be small. Major banks were able to use the event to pressure-test their systems to the increased market activity.

It was noted that this increase in retail participation was already in full swing as a consequence of the pandemic. Apps such as Wealthsimple had provided an easy, stay-at-home channel for an equity trading trend that is expected to continue. The experts generally agreed on the broader benefits of retail democratization of the equity markets, however recognized risks are involved.

A NEW RISK OR AN OLD RISK IN NEW CLOTHES?

Although there have been prior examples, the key difference now is the emergence of utilizing social media for purposes of mass mobilization. Speed was acknowledged as the key differentiator. One example that demonstrates the speed of information flow (being misinterpreted) was a run on a European bank caused from Twitter-like messages about the regulator showing up to the doorstep. Information and misinformation are now being disseminated at unprecedented speeds. Questions of system financial stability comes into play with the volatility brought by such speed of information flow which gets actioned by the masses directly in the markets via their phones.

It was a common view from the experts that with people making decisions faster, it is imperative for us to put information into their hands faster. One market participant felt constrained by how much they could warn their customers as they had to abide by rules of not providing financial advice. Another view was that even if the education or information was readily available, would it be enough to rise above the mass of stimulus bombarding investors or to counter any purposeful misinformation?

Social media apps are structured to take advantage of the network effect. An unintended side effect is that it produces a mob mentality through the formation of echo chambers. The clear and present danger of such echo chambers was plainly evident in Washington D.C. earlier this year. Bad actors have worked out means and tools to harness social media for nefarious purposes. The current tools and policies used by regulators may be inadequate to monitor and track the broadcasting of this misinformation and the potential for market manipulation.

The business models being run by certain market players raised some concerns. The incentive model of one app was particularly questioned in relation to the order in which trades are fulfilled. The ethics of gamification of trading was also raised as a concern in our discussion. One market participant was adamant that simplification of access to market should never include the "dopamine hit" of gamification based on ethical grounds.

Finally, it was acknowledged that crypto-assets is the next domain likely to present widespread challenges. This is an unregulated space that warrants closer attention now and in the future.

POTENTIAL FOR REFORMS

The group addressed the following three focus areas for further examination:

1. **Ethical trade-offs and education:** There is a need to explicitly discuss and agree on the trade-off between individual rights versus the responsibility to the greater good. In the same manner of gaining consensus on other public safety matters (motorcycle helmets, age limits on alcohol, etc.), this will provide a systemic level-set in which market access providers are expected to inform investors of the risks. It is a recognition that the difference between a full-service and a no-frills order execution access provider are no longer separate when it comes to protecting individuals and the system. Judgment should include addressing standards on the use of behavioural science techniques in marketing in what may be perceived as encouraging one to engage in risky behavior (i.e., the gamification of trading).
2. **Improved analytical tools:** Detailed, traceable individual order tracking will provide the data to identify market distorting issues such as front-running within times of large market movements. These tools are only just coming online in North America and should become a powerful deterrent of bad/illegal market behavior.
3. **Innovative policy / regulation mindset:** It was recognized by all present that the time regulators take to enact policy has been slow. Given speed has been the main differentiator in the risk the industry faces today, it is imperative that "good" policy rather than "perfect" policy become the operating model norm. The speed to fight misinformation was felt missing in the regulator toolkit. The need exists for greater delegated authority for faster discretionary action.

Although democratization of the markets has been a positive market development, there are social media powered bad actors who can take advantage of the system. These actors can use this targeted, echo chamber, mass communication technology to gain tremendous leverage. No amount of education is going to save us from this purposeful misinformation which is why we, as an industry, will need to step up.