

The GameStop case and investor protection. Towards a new regime for the provision of executive investment services

*La tutela dell'investitore alla luce
del caso GameStop.*

*Verso un nuovo regime per la prestazione
dei servizi di investimento esecutivi*

Matteo Arrigoni*

ABSTRACT:

Since the case of GameStop, in the first half of 2021 many listed companies registered anomalous trends of their shares. In these events, online trading platforms and internet communities have played a central role. Both facilitate access to financial markets and enable investors to reduce transaction and coordination costs. At the same time, these technological innovations favour investor overconfidence and herd effect. Therefore, it is reasonable to rethink the discipline of EU executive investment service, typically provided by the online trading platforms. From the perspective of increasing investors protection and the efficient functioning of the markets, after having presented and discussed the solutions proposed by ESMA, this paper proposes two further solutions: a cooling-off period in the execution only and appropriateness regime and an increase in the product governance discipline.

Keywords: investor protection; investment services; product regulation; MiFID II

Nella prima metà del 2021, le azioni di numerose società quotate hanno registrato un andamento anomalo comparabile con l'oscillazione dei titoli che ha caratterizzato il caso GameStop. In queste fattispecie, un ruolo centrale è stato svolto dalle piattaforme di trading online e dalle community su internet, che: (1) facilitano l'accesso ai mercati finanziari, comportando per gli investitori una significativa riduzione nei costi di transazione e di

*Post-doc researcher in Corporate Law at Università Cattolica del Sacro Cuore, Milan; e-mail address: matteo.arrigoni@unicatt.it. A previous version of this paper has been published by European Banking Institute Working Paper Series 2021 – no. 98.

coordinamento, ma, nel contempo, (2) sono foriere di nuovi rischi, favorendo eccessi di confidenza e comportamenti gregari. In tale contesto, è, pertanto, ragionevole ripensare la disciplina dei servizi di investimento esecutivi, tipicamente prestati dalle piattaforme di trading online. Nella prospettiva della tutela dell'investitore e dell'efficiente funzionamento dei mercati, dopo aver presentato e discusso le indicazioni dell'ESMA, il presente lavoro propone due soluzioni ulteriori: una modifica del regime di mera esecuzione e appropriatezza, mediante l'introduzione di un periodo di "riflessione", e un rafforzamento della disciplina di product governance.

Parole chiave: tutela dell'investitore; servizi di investimento; product regulation; MiFID II

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1. Introduction.

In the first half of 2021 numerous listed companies registered an anomalous trend in their shares. The first company to be affected has notoriously been GameStop Corporation (hereinafter "GameStop"), which was followed by, among others, Nokia, BlackBerry, AMC Entertainment, Express and Bed Bath & Beyond. These cases are characterized by a significant accumulation of short positions due to bearish forecasts on the stock, and, at the same time, by the concerted action of some investors – often retail clients – based on information shared on social media, to provoke the so-called short squeeze, thus making a profit at the expense of short-sellers.

The intervention of the supervisory authorities was timely and ESMA's statement¹ was followed by that of the national competent authorities². In-

¹ ESMA, *Episodes of very high volatility in trading of certain stocks*, Statement, 17 February 2021, ESMA70-155-11809, 1 (hereinafter "ESMA Statement").

² Cf., e.g., CONSOB, *Dichiarazione sui casi di anomala volatilità nella negoziazione di azioni e nell'utilizzo di social forum e piattaforme di trading online*, 13 aprile 2021 (hereinafter "Consob Statement"); AMF, *GameStop Mania: a look back over a market phenomenon*, 18 February 2021; FCA, *Statement on recent share trading issues*, 29 January 2021; BAFIN, *BaFin warnt Privatanleger vor Aufrufen zu Aktienkäufen in Sozialen Medien*, 18 Februar 2021.

deed, the events mentioned at the beginning pose multiple problems: was there a market manipulation? Is it legal for some trading platforms – RobinHood Markets Inc., for example – to prevent the purchase of additional shares or call options on the stock³?

Here we will consider the impact of these recent technological innovations on investment activity in the financial markets, and we will tackle the problem from the perspective of investor protection and the efficient functioning of the market, which can be compromised by them.

Online trading platforms and internet communities facilitate access to financial markets and let investors reduce transaction and coordination costs. In this way: (1) they permit many people to be directed towards a single goal, but, at the same time, (2) they allow operations aimed at influencing the prices of financial instruments that were previously not granted to those who did not have high resources (= in the case under consideration: “inflate” the prices of GameStop shares) and expose the participants to significant risks (= in the case under analysis: being the “useful idiots” that allow the first investors to earn money at the expense of those who arrive later).

These innovations raise numerous problems, including: the correctness of the payment system for order flows on securities; the correct execution of orders; compliance with the capital requirements for brokers; the speed of clearing; whether to limit the freedom of expression of those who, in communities or having considerable visibility on social media, can influence the formation of investors’ will⁴.

As has been correctly pointed out, «our central question is this: when new technologies come along and change the face of finance, how do we continue to achieve our core public policy goals and ensure that markets work for everyday investors?»⁵. Within a more general framework that aims to fully ad-

³ On this point, at the outset, see FINANCIAL TIMES, *GameStop mania: why Reddit traders are unlikely to face prosecution*, in *Financial Times*, January 31, 2021; and FORTE, *What Really Happened with GameStop*, in *Medium*, February 9, 2021, available at <https://medium.com/community-economics-by-forte/what-really-happened-with-gamestop-d0bed8f8abe0>.

⁴ Affirming that «the Gamestop situation touches on several relevant regulatory and supervisory issues, across the areas of investor protection, trading, market abuse and post-trading processes», S. MAIJOOR, *ECON Exchange of views in relation to GameStop share trading and related phenomena*, Introductory statement, Chair European Securities and Markets Authority (ESMA), 23 February 2021, ESMA22-105-1307, 1.

⁵ G. GENSLER, *Testimony*, Chair, Securities and Exchange Commission, Before the House Committee on Financial Services, May 6, 2021, spec. 1, available at: <https://www.congress.gov/117/meeting/house/112590/witnesses/HHRG-117-BA00-Wstate-GenslerG-20210506.pdf>.

dress the new problems⁶, therefore, it seems appropriate to focus on the discipline of EU executive investment services, typically provided by the online trading platforms.

The article is structured as follows. After a brief description of the GameStop saga in Section 2, Section 3 highlights the effects of recent technological innovations and how these pose new risks for investors, which therefore increase the need for real protection for the latter. Section 4 shows the implications of the changed technological context in the basic setting of the discipline on the provision of investment services, while Section 5 describes the possible reactions of the European system. After having presented and discussed the solutions proposed by ESMA in Section 6, Section 7 proposes, from a policy perspective, a possible alternative solution. Section 8 concludes.

2. *The GameStop Case.*

GameStop is specialized in the sale of video games. Due to the business model that could be overtaken by online video game sales and the effects of repeated lockdowns to deal with the Covid-19 pandemic that hinders retail sales, the prospects of GameStop – a company listed on the New York Stock Exchange (NYSE) – did not look good. Hence, the strong bearish position adopted by some investment funds with the choice to short sell the shares of GameStop.

At the same time, often fuelled by indications found on internet communities (in particular, the r/WallStreetBets forum on Reddit), many investors

⁶For example, with reference to the discipline of online platforms, not limited to those that allow trading activities, see: EUROPEAN COMMISSION, *Proposal for a Regulation on contestable and fair markets in the digital sector*, Brussels, 15.12.2020 COM(2020) 842 final 2020/0374 (COD) (so-called Digital Markets Act); and EUROPEAN COMMISSION, *Proposal for a Regulation on a Single Market For Digital Services and amending Directive 2000/31/EC*, Brussels, 15.12.2020 COM(2020) 825 final 2020/0361 (COD) (so-called Digital Services Act). From another point of view, regarding the clearing houses' role, it has been said that in volatile periods, the clearing house may demand more margin, or insurance, to cover any deal failures, thus putting a strain on brokers at a time when they are already under pressure. Therefore, the most logical way to reduce the risks is to shorten the settlement cycle: see DTCC, *Advancing Together: Leading the Industry to Accelerated Settlement*, White Paper, February 2021, that highlights the benefits of moving to a T+1 settlement cycle, including cost savings, reduced market risk, and lower margin requirements. Again, concerning the business models of platforms that have sprung up to offer commission-free trading, one of the key questions is about payment for order flow, where market makers pay brokers to route trades to them: this model could create conflicts of interest and could result in less transparency for retail clients, thus it «deserves scrutiny», S. MAIJOOR, (fn. 4), 3.

adopted a bullish position⁷ with a dual strategy. First, these investors directly increased the price of GameStop's shares by purchasing large quantities of them, causing the so-called short squeeze. This mechanism consists in the choice of the short-seller to dissolve short positions when the price of the financial instrument, when sold short, exceeds a certain threshold. This sale realizes losses but, at the same time, avoids the risk of suffering greater ones. Second, these investors indirectly increased the price of GameStop shares by purchasing call options, causing the so-called gamma squeeze. This mechanism consists in the choice of market makers to buy GameStop shares to hedge the risk assumed by selling call options to investors, causing a further rise in price, useful in the first perspective to cause the short squeeze⁸.

As the graphs relating to the price of the financial instruments involved show, these dynamics caused a bubble: in fact, the share price had reached a completely different level from the real value of the issuer. The bubble then burst, with evident initial positive impacts for the first long investors and subsequent losses for investors who had last adopted bullish positions on the stock.

3. *The increased need for investor protection.*

This story shows how more and more people – often retail clients⁹ – access the capital market favoured by new technologies¹⁰. One contributing factor is

⁷ For an analytical description of the story, FORTE, (fn. 3); T. DI MUZIO, *GameStop Capitalism. Wall Street vs. The Reddit Rally (Part I)*, in *The Bichler and Nitzan Archives* (2021), 1-13; and U.W. CHOCHAN, *Counter-Hegemonic Finance: The Gamestop Short Squeeze*, 2021, available at SSRN: <https://ssrn.com/abstract=3775127>.

⁸ As it was correctly summarized «large purchases of shares and of call options, combined with very high short positions created the conditions for unprecedented price increases»: see S. MAIJOOR, (fn. 4), 1.

⁹ Cf., among others, K. MARTIN, R. WIGGLESWORTH, *Rise of the retail army: the amateur traders transforming markets*, in *Financial Times*, March 9, 2021.

¹⁰ In the US, retail investors now routinely account for roughly 20% of stock market activity: M. FITZGERALD, *Robinhood Traders Cash in on the Market Comeback that Billionaire Investors Missed*, in *cnn.com*, 2020, available at <https://www.cnn.com/2020/06/09/robinhood-traders-cash-in-on-the-market-comeback-that-billionaire-investors-missed.html> and B. WINCK, *Retail Traders Make up Nearly 25% of the Stock Market Following COVID Driven Volatility, Citadel Securities Says*, in *markets.businessinsider.com*, 2020, available at: <https://markets.businessinsider.com/news/stocks/retail-investors-quarter-of-stock-market-coronavirus-volatility-trading-citadel-2020-7-1029382035#>. See also S. MAIJOOR, (fn. 4), 2. A significant example is

the spread of online trading platforms, which reduces transaction costs – it is possible to operate on the markets directly from your smartphone, at costs that are often much lower than traditional channels¹¹; even better: sometimes some brokers do not apply trading commissions to the end customer, due to the incentives received from directing the flow of orders collected from other broker intermediaries (so-called “payment for order flow”), and allow investors to invest even with minimal input amounts (sometimes even with the possibility of leveraged investments). Even more importantly, the birth of communities on the internet in which investment opinions are exchanged¹² makes it possible to overcome the problem of information asymmetries: trusting the “rating” read on the blog, an investor decides to allocate her/his savings to the listed company that borrows the reputation of the community. A similar dynamic occurs with certain statements of “financial gurus” expressed through social networks, like Twitter. Hence, the rise of the so-called “meme-stocks”.

At the same time, the urgency of effective investor protection has increased. In fact, due to reading the ratings or tweets, overconfident investors do not consider it justified to seek the assistance of a financial advisor who is more expensive but also more protective. In this way, they expose themselves to new risks, risks recognized by the European legislators¹³. In the same

the choice of Goldman Sachs Group Inc. to launch an investing app for customers that want to put at least \$1,000 to work, even if – at least so far – investors using the service can put money only into automated portfolios rather than individual stocks and bonds: see S. BASAK, *Goldman Sachs Open Investing App to Anyone With as Little as \$1,000*, in *Bloomberg.com*, February 16, 2021. See e.g., eToro, Bux, Trading 212 or Trade Republic, which offer clients an affordable way to invest in the financial markets.

¹¹ See also B.M. BARBER, X. HUANG, T. ODEAN, C. SCHWARZ, *Attention Induced Trading and Returns: Evidence from Robinhood Users*, 2 February 2021, available at SSRN: <https://ssrn.com/abstract=3715077>, 1. The “segmentation” of the market is also favoured by the new discipline of inducements that could make it inefficient to be assisted by a non-independent consultant – a typical model of continental Europe – for investments of small amounts: on this point, E.R. RESTELLI, *Shaped by the Rules. How Inducement Regulation Will Change the Investment Service Industry*, in *ECFR*, in course of publication.

¹² Robinhood reported 3 million new accounts in the first quarter of 2020 alone, as the pandemic shutdown put many other activities on hold: see G. W. EATON, T. C. GREEN, B. ROSEMAN, Y. WU, *Zero-Commission Individual Investors, High Frequency Traders, and Stock Market Quality* (2021), available at SSRN: <https://ssrn.com/abstract=3776874>.

¹³ «Information society services and especially intermediary services have become an important part of the Union’s economy and daily life of Union citizens ... new and innovative business models and services, such as online social networks and marketplaces, have allowed business users and consumers to impart and access information and engage in transactions in novel ways. A majority of Union citizens now uses those services on a daily basis. However, the digital

sense, ESMA has, in fact, recalled that «an increased participation of retail investors in stock markets is welcome for the development of the Capital Markets Union. Nonetheless, ESMA urges retail investors to be careful when taking investment decisions based exclusively on information from social media and other unregulated online platforms, if they cannot verify the reliability and quality of that information»¹⁴. Furthermore, by helping overcome collective action problems, communities generate the illusion of being able to “join forces” to move and beat the market. Thus, they favour the emergence of the herd effect¹⁵ and facilitate the creation of bubbles, which are profitable for leaders and harmful for followers¹⁶. From a purely economic point of view, this dynamic is particularly effective in the case of financial instruments relating to low capitalized listed companies (e.g., penny stocks) with high short interest (*i.e.*, the percentage of securities sold short out of total outstanding securities). In this case, it may be financially reasonable to sustain a position contrary to short-sellers – not so much because the price of the shares is considered lower than their real value, but because a collective action aimed at supporting the stock could cause short squeeze and gamma squeeze to bring gains for the first investors who “bet” on this result (and losses for subsequent investors)¹⁷.

The real analysis of the events mentioned at the beginning could, on the other hand, raise two objections. First, the investors involved do not need more protection, because they are not ignorant: most of the time they are sophisticated, with knowledge of financial mathematics and statistics¹⁸. Second, statistically, the investment that considered the “platform advise” was success-

transformation and increased use of those services has also resulted in new risks and challenges, both for individual users and for society as a whole»: Recital no 1 Digital Services Act.

¹⁴ ESMA Statement, 1.

¹⁵ Among many, see G. LIACE, *Sulle emozioni e le reazioni dell'investitore irrazionale*, in 1 *Giur. comm.* (2020), 140, 145; for an empirical analysis of the Robinhood users' behaviour, cf. B.M. BARBER, X. HUANG, T. ODEAN, C. SCHWARZ, (fn. 11), 2, 5, 7.

¹⁶ We do not argue here that trading platforms and communities are negative in any case. Indeed, recent studies show that they can bring benefits [see e.g., D. BRADLEY, J. HANOUSEK, R. JAME, Z. XIAO, *Place Your Bets? The Market Consequences of Investment Advice on Reddit's Wallstreetbets*, 15 March 2021, available at SSRN: <https://ssrn.com/abstract=3806065> but see also the literature cited at p. 3]. Regardless of the concrete advantages or disadvantages, however, it seems undeniable that these new modalities raise specific risks that must be taken into consideration.

¹⁷ See also D. VALIANTE, *GameStop: A Tragedy Waiting to Happen*, in *Oxford Bus. L. Blog*, 23 Feb 2021.

¹⁸ D. BRADLEY, J. HANOUSEK, R. JAME, Z. XIAO, (fn. 16), spec. 4 and the literature cited there.

ful¹⁹. However, these observations do not seem exhaustive. In fact, first, they do not consider the fact that, while sophisticated, most of the investors involved are inexperienced²⁰. And experience, together with knowledge, is one of the two relevant characteristics for the evaluation of the investment by the financial intermediary. Secondly, the statistics do not consider the distributive effects of investments: alongside investors who have received large gains (typically the first to have invested), some investors have suffered heavy losses (typically the last to have invested).

4. The implications of the changed technological context in the basic setting of the discipline on the provision of investment services.

The online trading platforms offer mostly low value-added investment services (typically, the service of execution of orders on behalf of clients)²¹. The distance relationship – without human interaction – and the ease of operating make it reasonable to offer less complicated services than investment advice²² and portfolio management²³. At the same time, the business model focused more on the number of transactions than on their amount favours the promotion of large-scale services²⁴, according to a pattern typical of executive services. The client will therefore execute the transaction under the appropriate-

¹⁹ D. BRADLEY, J. HANOUSEK, R. JAME, Z. XIAO, (fn. 16) but see also the literature cited at p. 3.

²⁰ In fact, «half of Robinhood users are first-time investors»: B.M. BARBER, X. HUANG, T. ODEAN, C. SCHWARZ, (fn. 11), 1; see also Consob Statement, 1 and G.W. EATON, T.C. GREEN, B. ROSEMAN, Y. WU, (fn. 12).

²¹ «Execution of orders on behalf of clients' means acting to conclude agreements to buy or sell one or more financial instruments on behalf of clients and includes the conclusion of agreements to sell financial instruments issued by an investment firm or a credit institution at the moment of their issuance» [art. 4(1)(5) Directive 2014/65/EU, MiFID II].

²² «Investment advice means the provision of personal recommendations to a client, either upon the client's request or at the initiative of the investment firm, in respect of one or more transactions relating to financial instruments» [art. 4(1)(4) MiFID II].

²³ «Portfolio management means managing portfolios in accordance with mandates given by clients on a discretionary client-by-client basis where such portfolios include one or more financial instruments» [art. 4(1)(8) MiFID II].

²⁴ In the same sense, regarding the Italian financial system, see M.A. SCOPELLITI, *Elementi informativi in merito alla vicenda Gamestop e all'impatto del trading on-line*, Audizione alla Commissione Parlamentare di inchiesta sul sistema bancario e finanziario, spec. 7. The possible adoption of the payment for order flow model also encourages attention to the quantity of transactions, rather than their quality.

ness test (if the product is complex) or at his own risk in execution-only (if the product is not complex and the transaction is regarded as being at the client's initiative) [respectively, art. 25(3) and art. 25(4) MiFID II].

In this way, online trading platforms avoid the risk of “blocking” the order in the event of a negative judgment of suitability [art. 25(2) MiFID II and art. 55 Commission Delegated Regulation (EU) 2017/565, “MiFID II Delegated Regulation”²⁵]. Instead, they take advantage of the absence of constraints, in the case of execution only, or of the possibility of proceeding with the release from liability, in the event of a negative judgment of appropriateness or lack of information from the client²⁶. Since this is only a reinforced information obligation, this latter constraint is easily respected without relevant costs, neither for the intermediary (who must only adapt its IT systems)²⁷ nor for the customer (who, often without reading the warning, must only click one more box than the order to buy or sell a specific financial instrument).

Due to these technological innovations, the choice of applying the suitability regime as a *default* rule becomes less effective. That choice was a solution adopted by the supervisory authorities during the Directive 2004/39/EC (MiFID I) regime and confirmed in the MiFID II regime. Indeed, EU supervisors decided to interpret the definition of investment advice [art. 4(1)(4) MiFID I and art. 52 Directive 73/2006/EC] in a broader way, «considering “investment advice” also ‘spot’ recommendations on a particular financial instrument provided by the intermediary during the performance of any other investment service». Hence, any single transaction was virtually subjected to the investment advice regime and, hence, «the rule of suitability applie[d], and intermediaries [were] prohibited from recommending investments which do not fit

²⁵ See also ESMA, *On MiFID II and MiFIR investor protection and intermediaries topics*, Questions and Answers, 21 December 2020, ESMA35-43-349, 2 Suitability and appropriateness, Q&A no. 6, 39 f.

²⁶ In fact, «where the investment firm considers ... that the product or service is not appropriate to the client or potential client, the investment firm shall warn the client or potential client» and «where clients or potential clients do not provide the information ... or where they provide insufficient information regarding their knowledge and experience, the investment firm shall warn them that the investment firm is not in a position to determine whether the service or product envisaged is appropriate for them» [art. 25(3) MiFID II; see also art. 56 MiFID II Delegated Regulation].

²⁷ Moreover, the compliance cost is increasingly reduced by the use of RegTech: amongst many, see V.A. COLAERT, *RegTech as a Response to Regulatory Expansion in the Financial Sector*, June 2018, available at SSRN: <https://ssrn.com/abstract=2677116> and A. PERRONE, F. PANISI, *Systems So Perfect That No One Will Need to Be Good?* *RegTech and the “Human Factor”*, in *Rivista ODC* (2018), 1-11.

with the investors»²⁸. This, however, is no longer true in all cases. Since the ‘spot’ advice does not occur in the service of execution of orders only on behalf of customers without any human interaction and/or without the use of robo-advisors, it is not possible to apply the suitability regime. Therefore, there is an expanding market segment that most needs protection (because it typically consists of investors with little money and financial knowledge) although it nevertheless receives less protection. For those clients, investor protection is referred above all to the rules based on the principle of “disclosure”, rather than the one – more protective and encouraged by MiFID I and II²⁹ – of “confidence”³⁰.

²⁸ A. PERRONE, *A Brave New World? Investment Services and Investor Protection*, in S. LANINI, *Harmonization of European and Latin-American Consumer Law*, Convegno Conclusivo Progetto Jean Monnet Module HELACOL, vol. 5, Naples, ESI (2018), 175 ff.; see CESR, *Cesr’s Technical Advice on Possible Implementing Measure of the Directive 2004/39/EC on Markets in Financial Instruments*, 05-290b, 2005, 7, according to observations reiterated in CESR, *Understanding the definition of advice under MiFID*, Consultation Paper 09-665, 2009, para. 32.

²⁹ Indeed, «the importance of the suitability assessment for the protection of investors was already clear under MiFID I and has been confirmed in MiFID II. While the objectives of the suitability assessment, as well as the key principles underpinning the regulatory requirements, have remained unchanged, the obligations have been further strengthened and detailed by including the following main requirements: reference to the fact that the use of electronic systems in making personal recommendations or decisions to trade shall not reduce the responsibility of firms; the requirement for firms to provide clients with a statement on suitability (the so called ‘suitability report’) prior to the conclusion of the recommended transaction; further details on conduct rules for firms providing a periodic assessment of the suitability; the requirement for firms performing a suitability assessment to assess, taking into account the costs and complexity, whether equivalent products can meet the client’s profile; the requirement for firms to analyse the costs and benefits of switching from an investment to another; the strengthened requirement for firms to consider the clients’ risk tolerance and ability to bear losses; the extension of suitability requirements to structured deposits»: see ESMA, *Guidelines on certain aspects of the MiFID II suitability requirements*, Final Report, 28 May 2018, ES-MA35-43-869, Overview, 4.

³⁰ Among others, see V.A. COLAERT, *Building Blocks of Investor Protection: All-Embracing Regulation Tightens Its Grip*, 1 March 2017, available at SSRN: <https://ssrn.com/abstract=2943985>; D. BUSCH, *MiFID II: Stricter conduct of business rules for investment firms*, in 12.3 *Capital Markets L. J.* (2017), 340 ff.; F. ANNUNZIATA, *Investment services and investment funds*, in M. VENTORUZZO, F. FABBRINI (Eds.), *Research Handbook on EU Economic Law*, Edward Elgar Publishing, 2019.

5. The possible solutions of the European legal system.

In the perspective that interests us here, investor protection and the orderly and efficient performance of the financial markets are pursued through a plurality of safeguards: some of a general nature (Section 5.1.); others specifically aimed at regulating the activity of the investment services provisions (Section 5.2.).

5.1. General tools for investor protection and the efficient functioning of the market.

The legal system combines a variety of tools for investor protection and the efficient functioning of the market³¹.

First, ESMA and National Competent Authorities (NCAs) have the power to temporarily restrict or prohibit the marketing, distribution, or sale of financial products when the issue raises either: a significant investor protection concern; a threat to the orderly functioning and integrity of financial markets or commodity markets; or a threat to the stability of the whole or part of the financial system [so-called “product intervention”: art. 40 and art. 42 MiFIR; see also art. 69(2)(m-n) MiFID II]. However, the supervisory authorities can intervene in advance only in strictly limited cases: in fact, the freedom to conduct a business (see art. 16 Charter of Fundamental Rights of the European Union) of investors in the financial market can be limited only if it is «justified by the overall objectives pursued by the Community, on condition that the substance of these rights is left untouched»³². From this point of view, the possibility for the supervisory authorities to suspend trading on a specific financial product could be justified in the presence of those conditions that exist in cases like GameStop: when financial instruments relating to listed companies with low capitalization are involved and there is high short interest (see above, par. 3). The precise identification of these criteria (how low should the capitalization be? What should be the short interest threshold?) could also grant greater legal certainty, which could be beneficial both for the supervisory authorities and for the market players.

³¹ The specific rules relating to the assumption of financial leverage and the monitoring of financial instruments that create volatility are not addressed here: on this point, cf. Regulation (EU) No 648/2012 (EMIR) and Regulation (EU) 2015/2365 (SFTR).

³² Quote from ECJ, 14 May 1974, *J. Nold, Kohlen- und Baustoffgroßhandlung v Commission of the European Communities*, C-4/73, ECLI:EU:C:1974:51.

Likewise, market management companies can reject unusual and irregular orders and/or temporarily halt or constrain trading if there is a significant price movement in a financial instrument³³. However, both solutions do not seem completely decisive for the case in question. The first, preventive, does not consider the fact that in the case under analysis there is no “irregular” order, but the operation consists of a multitude of orders which, when considered individually, do not appear anomalous. The second, on the other hand, can be applied but is an *ex-post* tool which, by definition, does not prevent the occurrence of damage (and is also the object of strong criticism by those who do not want obstacles in the dynamics of the market).

Third, there is the prohibition of market manipulation, which sanctions conduct aimed at giving false or misleading signals as to the supply of, demand for, or price of, a financial instrument and/or securing the price of one or several financial instruments at an abnormal or artificial level [cf. art. 12(a)(i-ii) Regulation (EU) No 596/2014 (MAR) and art. 5 Directive 2014/57/EU (MAD II)]³⁴. In this perspective, in general, ESMA recalls that «discussing the opportunity to buy or sell the shares of an issuer does not constitute market abuse. However, organising or executing coordinated strategies to trade or place orders at certain conditions and times to move a share’s price could constitute market manipulation» and that «similarly, special care should be taken when posting information on social media about an issuer or a financial instrument, as disseminating false or misleading information may also be market manipulation. Additionally, care should be taken when disseminating invest-

³³ More in detail, «Member States shall require a regulated market to have in place effective systems, procedures and arrangements to reject orders that exceed pre-determined volume and price thresholds or are clearly erroneous» [art. 48(4) MiFID II] and «shall require a regulated market to be able to temporarily halt or constrain trading if there is a significant price movement in a financial instrument on that market or a related market during a short period and, in exceptional cases, to be able to cancel, vary or correct any transaction» based on parameters «appropriately calibrated in a way which takes into account the liquidity of different asset classes and sub-classes, the nature of the market model and types of users and is sufficient to avoid significant disruptions to the orderliness of trading» [art. 48(5) MiFID II]. See also ESMA, *Guidelines Calibration of circuit breakers and publication of trading halts under MiFID II*, 6 April 2017, ESMA70-872942901-63, 1, 6 ff. Another hypothesis is governed by art. 32(1-2) and art. 52(1-2) MiFID II, and art. 80 MiFID II Delegated Regulation.

³⁴ Overcoming the collective action problem typically present among retail investors allows, in fact, those who use the platforms to coordinate the behaviour of a large group of investors and, theoretically, adopt a behaviour of operational manipulation of the market, traditionally held only by those – such as institutional investors – had the economic power to “move” the market.

ment recommendations through any media, including social media and online platforms, as they are subject to a number of regulatory requirements»³⁵. The indicators of manipulation that can typically exist in such cases [for example (1) abusive squeeze, (2) pump and dump, and (3) cornering the market] are not, however, easily detectable and, in any case, they require an *ex-post* solution that does not prevent the occurrence of damage to investors, nor does it appear to have an effective deterrent function, especially in a context such as that of the Internet where it is difficult to identify the author to determine statements written in the communities (or something equivalent: for example, messaging groups, live trading sessions streamed on platforms like Twitch, or finally “rooms” on the newer Clubhouse audio social networking)³⁶. Concerning market manipulation operations, the supervisory authority can both suspend trading of the financial instrument concerned and require the temporary cessation of any practice that the competent authority considers contrary to the market abuse regulation [art. 23(2)(j-k) MAR]. Even this solution, however, is not a sufficient safeguard to stop the overall design, not only for the necessary *ex-post* intervention, but also for the peculiar nature of the operation. Traditionally, the manipulative operation consists of single trading activity and the supervisory authority can thus effectively prevent the manipulation. In the case in question, however, the manipulation would take place through multiple operations that can be performed by many intermediaries. When considering each operation individually, the supervisory authority will have difficulty justifying its intervention.

³⁵ ESMA Statement, 1. For the requirements for it to be considered “Investment advice”, see art. 9 MiFID II Delegated Regulation; with reference, instead, to the requirements and regulations relating to “Investment research and marketing communications”, see art. 36 MiFID II Delegated Regulation; having regard, moreover, to “Investment recommendations and statistics”, see art. 20 MAR; finally, as regards “Disclosure or dissemination of information in the media”, see art. 21 MAR. In the same sense, «coordinated strategies to buy and sell at certain conditions and at a certain point in time with the objective to inflate the share’s price could constitute market manipulation. Moreover, posting false or misleading information about an issuer or a financial instrument on social media may also represent market manipulation»: S. MAIJOOR, (fn. 4), 3.

³⁶ See also M.A. SCOPELLITI, (fn. 24), 14, stating that even if the MAR was also considered adequate to deal with cases of coordinated manipulation, however, there could be problems of the effectiveness of the investigations and questions of privacy or legitimacy in the acquisition of the data traffic. Among other things, it would not be easy to demonstrate the existence of an agreement between hundreds or thousands of investors in disseminating directional information signals to take advantage of the increase in the price of stocks.

5.2. Specific tools for investor protection in the investment services provision.

Regarding the investment services provisions, the investor receives a first form of protection from the limitation of the scope of the execution only regime. Indeed, «when providing investment services that only consist of execution or reception and transmission of client orders», investment firms can «provide those investment services to their clients without the need to obtain the information or make the [assessment of appropriateness]» where «the services relate to» a non-complex «financial instruments» [art. 25(4)(a) MiFID II]. From this point of view, options are not considered non-complex financial instruments and therefore could not be bought in the execution only regime [apart from if they meet the conditions set out in art. 57 MiFID II Delegated Regulation]. Moreover, the possibility to provide investment services that consist only of execution and/or of the reception and transmission of client orders is excluded if it is «in conjunction with the ancillary service consisting of granting credits or loans to investors to allow them to carry out a transaction in which the investment firm is involved» and «the criteria for the selection of the financial instruments to which those services should relate» should «exclude certain financial instruments, including those which embed a derivative or incorporate a structure which makes it difficult for the client to understand the risk involved» (Recital no. 80 MiFID II)³⁷. While excluding options and transactions made with financial leverage, however, this solution clearly cannot prevent the shares from being subject to the execution only regime.

Secondly, in the event of a negative judgment of appropriateness or lack of information communicated by the client, the latter receives a form of protection from the obligation of “enhanced information” that is imposed on the intermediary and requires them to warn the client. Such a solution seems, not very effective, however, because it does not consider the typical behaviour of the client who does not read the warning, to save time, or does not understand the meaning of it, due to cognitive bias³⁸.

Third, there is the distributor’s product governance obligation [art. 9(3), art. 16(3), art. 24(1-2), MiFID II] to which the online trading platforms are also subjected when they offer or recommend financial instruments manufac-

³⁷ Previously, see also CESR, *Q&A MiFID complex and non-complex financial instruments for the purposes of the Directive’s appropriateness requirements*, 3 November 2009, Ref.: CESR/09-559.

³⁸ For an analysis of the disclosure paradigm and its drawbacks, see V.A. COLAERT, (fn. 30), 1, 4 ff. and A. PERRONE, (fn. 28), 177 f.

tured by entities that are not subject to MiFID II [art. 10 Commission Delegated Directive (EU) 2017/593 (MiFID II Delegated Directive)]³⁹. In this regard, «distributors should ... decide which products will be made available to (existing or prospective) clients at their own initiative through execution services without active marketing, considering that in such situations the level of client information available may be very limited»⁴⁰. Moreover, «the target market assessment influences the decision on the type of services that are going to be provided in relation to the nature of the product and the circumstances and needs of the identified target clients, considering that the level of investor protection varies for different investment services» and, «in particular, investment advice and portfolio management services allow for a higher degree of investor protection, compared to other services provided under the appropriateness regime or under execution-only»⁴¹. In the absence of information received from the client, however, the distributor cannot assess whether the client is within the target market. In this case, the distributor is required to fulfil the additional obligations of communicating to the client the impossibility of assessing the target market and organizing the distribution of the products considering their risk⁴². They too seem insufficient: the first appears to be an obligation of reinforced information, as ineffective as the indemnity mentioned before; the second does not seem to be a defence for cases like the GameStop

³⁹ See also ESMA, *Guidelines on MiFID II product governance requirements*, 05 February 2018, ESMA35-43-620, no. 60 ff., V.3. Guidelines for distributors, 15 ff. (hereinafter “ESMA GL PG”).

⁴⁰ ESMA GL PG, no. 31, V.3. Guidelines for distributors, 9 f.

⁴¹ ESMA GL PG, no. 44, V.3. Guidelines for distributors, 12.

⁴² More in detail, «where distributors only carry out execution services with the assessment of appropriateness (for example through a brokerage platform), they should consider that they will usually be able to conduct an assessment of the actual target market which is limited to the sole categories of clients’ knowledge and experience ...; where they only conduct execution services under the execution-only regime, not even the assessment of clients’ knowledge and experience will usually be possible. In this respect, firms should pay particular attention to the distribution strategy suggested by the manufacturer»: ESMA GL PG, no. 45, V.3. Guidelines for distributors, 12 f.; moreover, «for products characterised by complexity/risk features ... it is most important that distributors take into due consideration all relevant information provided by the product manufacturer, both in terms of potential target market and distribution strategy» and «distributors may also decide to let clients operate on a non-advised basis after having warned them that the firm is not in the position to assess their full compatibility with such products»: ESMA GL PG, no. 46-47, V.3. Guidelines for distributors, 13. See also ESMA, *Guidelines on MiFID II product governance requirements*, no. 34, Final Report, 2 June 2017, ESMA35-43-620, 22, no. 40, par. 3.4.3 Guidelines for distributors, 39, and no. 72, par. 3.4.4 Guidelines on issues applicable to both manufacturers and distributors, 46.

affair because the shares of a listed company are currently never considered risky for retail investors.

Finally, the “payment for order flow” model must comply with the best execution and inducements rules: in particular, intermediaries using this business model must demonstrate to the national competent authorities whether this method (*i.e.*, the PFOF) can improve the quality of the service provided to customers⁴³. And, in fact, the correct interpretation of these rules «would probably make it impossible or illegal, and therefore they are forbidden, at least in some EU countries»⁴⁴.

6. Some solutions proposed by ESMA.

To increase investor protection in the case of “non-advised services” (*i.e.*, investment services with a low-added value that require appropriateness or mere execution), ESMA has published a consultation paper⁴⁵.

In the perspective under analysis, ESMA’s approach consists of favouring the flow of information between client and intermediary and in improving the obligation of reinforced information. In this way, it is assumed, the investor should make more well-founded decisions.

More specifically, ESMA intervenes in the phase preceding the provision of executive investment services, first asking intermediaries to fulfil a disclosure obligation: «firms should, in good time before the provision of non-advised services, inform their clients clearly and simply about the appropriateness assessment and its purpose which is to enable the firm to act in the client’s best interest» (Guideline 1 ESMA CP)⁴⁶. In the case of intermediaries providing «online services», ESMA also believes that for transparency to be effective, these companies must «emphasi[ze] the relevant information (e.g. through the use of design features such as pop-up boxes)» and «considering whether some information should be accompanied by interactive text (e.g. through the use of design features such as tooltips) or other means to provide additional details to clients who are seeking further information (e.g. through a

⁴³ Consob Statement, 2; S. MAIJOOR, (fn. 4), 3.

⁴⁴ U. BASSI, *GameStop and similar recent market events: Exchange of views with representatives of the European Commission and the European Securities and Markets Authority*, European Commission’s Director for Financial Markets, ECON Committee, 23 February 2021.

⁴⁵ ESMA, *Guidelines on certain aspects of the MiFID II appropriateness and execution-only requirements*, Consultation Paper, 29 January 2021, ESMA35-36-2159 (hereinafter “ESMA CP”).

⁴⁶ ESMA CP, no. 13, Annex III – Guidelines, 25.

F.A.Q. section)»⁴⁷. Second, ESMA intends to facilitate the flow of information from the client to the intermediary: «ESMA emphasises that firms [...] do not discourage clients in any way from providing this information. A warning that the firm is not in a position to determine the appropriateness of the investment service or product should thus only be given after all questions have been asked to the client and it turns out that the firm does not have the necessary information. Moreover, firms should encourage a client that has not provided the necessary information for the appropriateness assessment to provide this information anyway, for example by reminding the client of providing this information before each transaction»⁴⁸.

In the event of a negative judgment of appropriateness or impossibility of judgment due to lack of information, ESMA instead requires that the warning to the client be effective. «To ensure its effectiveness, the warning issued by firms in case no information is provided by the client on his knowledge and experience or this is insufficient, or in case the assessment of such information shows that the investment service or product offered or demanded is not appropriate for the client, must be clear and not misleading» (Guideline 9 ESMA CP)⁴⁹: «this could be done for example by using a different colour for the warning message from the rest of the information provided or, if the order is placed over the telephone, by asking clients whether they understand the content of the warning and the impact of such a warning (i.e. the fact that the client will benefit from less or no protection)»⁵⁰.

A better perception of the importance of discipline can certainly incentivize more adequate behaviour by the investor. Despite making simplified disclosure more “evident” and more “user-friendly”, such a strategy nevertheless neglects the importance not only of the perception, but also of the cognitive bias and rational limits of investors, especially the less sophisticated ones: due to time and/or for cost savings, such warnings often do not have the desired effect and do not lead to better reflection by the investor. It thus turns out to be an inexpensive approach for the system (for the legislator and for intermediaries), but one that does not effectively achieve the objective of investor protection⁵¹.

⁴⁷ ESMA CP, no. 18, 9 and no. 17, Annex III – Guidelines, 26.

⁴⁸ ESMA CP, no. 20, 9.

⁴⁹ ESMA CP, no. 44, 15 and no. 64, Annex III – Guidelines, 37.

⁵⁰ ESMA CP, no. 65, Annex III – Guidelines, 37.

⁵¹ That this is the goal is remembered by ESMA itself at the outset: «ESMA believes that the implementation of these guidelines should strengthen investor protection – a key objective for ESMA», ESMA CP, Executive Summary, 5.

Even though the objective of investor education is promoted⁵², it seems more useful in a long-term perspective as it necessarily requires time to transmit certain knowledge and best practices.

7. Ideas for better investor protection.

The problem of market malfunction could be solved by affecting the dynamics of short selling. However, banning short selling altogether seems extreme, since it would eliminate some benefits: a more correct price formation (short-sellers signal to the market the possible overvaluation of security), if not a faster discovery of fraud (e.g., the Wirecard scandal)⁵³, and an increase in market liquidity⁵⁴. On the other hand, it could be more appropriate to intervene to avoid situations that favour short squeeze⁵⁵, which is less frequent in the European Union because, unlike in the United States, short selling is not allowed without the availability of the underlying security [art. 12 Regulation (EU) No. 236/2012, SSR]⁵⁶.

More generally, there may be sources of damage other than those relating

⁵² S. MAIJOOR, (fn. 4), 3; Consob Statement, 2.

⁵³ P. OUDIN, J.P. VALBUENA, *Is Reddit the New Bloomberg Chat? GameStop, Short Sellers and Social Media*, in *Oxford Bus. L. Blog*, February 3, 2021, available at: <https://www.law.ox.ac.uk/business-law-blog/blog/2021/02/reddit-new-bloomberg-chat-gamestop-short-sellers-and-social-media>.

⁵⁴ On this point, B.M. BLAU, R.J. WHITBY, *How Does Short Selling Affect Liquidity in Financial Markets?*, in *25 Finance Research Letters* (2018), 244-250.

⁵⁵ Indeed, «shall the system be allowed to produce a squeeze of these dimensions even in normal market conditions? Hence, are such levels of (naked) short positions sustainable and should they be allowed even temporarily?», D. VALIANTE, (fn. 17). It is, however, important to remember that there are studies that show how the probability (cost) of a short squeeze is higher (lower) for stocks with greater liquidity. Short squeezes thus serve as an “invisible” cost of short sales, limiting the scope of arbitrage: see W. XU, Y. ZHENG, *The Short Squeeze: The ‘Invisible’ Cost of Short Sales*, 24 May 2016, available at SSRN: <https://ssrn.com/abstract=2783374>.

⁵⁶ «The likelihood of similar events happening in the European Union (EU) appears limited. While some EU shares were mentioned in the press as potential targets after the GameStop related events, European short positions levels are lower than in the US, with only 20 issuers with net short positions above 10% (at a maximum of 16%). This limits the risk of a GameStop style “short squeeze”. Moreover, short positions – especially large positions leading to public disclosures – have reduced markedly since the end of January. No increase in overall short-selling activity in the EU was observed in January 2021»: see S. MAIJOOR, (fn. 4), 2; in the same sense, D. VALIANTE, (fn. 17).

to securities with high short interest and in the perspective promoted by the supervisory authorities of «analyzing market events and consider adopting further initiatives aimed at preserving investor protection and market integrity as appropriate»⁵⁷. The protection of the investor could pass from a strengthening of the discipline in the case of investment services with low-added value. In addition to the ESMA approach, there may be solutions that, based on behavioural finance studies and nudging techniques, favour the adoption of more “reasoned” decisions⁵⁸.

In this perspective, first, instead of operating in any case, the indemnity could allow the execution of an inappropriate order only if one of the following conditions is met: (1) the order has a sufficiently high minimum denomination (e.g., € 10,000), so as to induce greater caution in the investor who may be the victim of overconfidence; (2) between the warning received and the possibility of proceeding with the order there is a period of time (e.g., 2 hours or 1 day) – the so-called cooling-off period⁵⁹ – that encourages the adoption of a less impulsive choice) which ESMA proposes regarding the different hypotheses of responding more than once to a questionnaire⁶⁰. Due to the size of the amount of the “forced” passage of time, in fact, the investor is encouraged to move from a spontaneous search of an intuitive solution that sometimes fails (fast thinking) to a more deliberate and effortful form of thinking (slow thinking), or – according to the well-known expressions of Daniel Kahneman – from “System 1” to “System 2”⁶¹. This also favours what ESMA suggests

⁵⁷ ESMA Statement, 2.

⁵⁸ As correctly pointed out, the issue is neither to limit the freedom of small savers to operate, making their autonomous (and hopefully well informed) choices and exposing themselves to risks, nor to criticize the possibility that technology reduces certain transaction costs or contributes to “disintermediate” certain activities, or to defend one type of operator over others. On the contrary, it is a question of assessing whether those who operated did so under equal conditions, if the information integrity of the market is protected, and to protect the less professional investors. There may be different opinions on the optimal level of protection, but few deny the opportunity for less sophisticated and wealthy investors to be protected by the law: see M. VENTORUZZO, *Investire non è un gioco per dilettanti allo sbaraglio*, in *Lavoce.info*, 8 February 2021.

⁵⁹ In general, stating that the cooling-off period could be a tool to reduce self-control problems, G. LIACE, (fn. 15), 145.

⁶⁰ ESMA CP, no. 22, 10 and no. 23, Annex III – Guidelines, 27 f. Moreover, «ESMA emphasises that firms should not downplay the importance of warnings and should not encourage the client to proceed with the transaction, to re-take the appropriateness assessment or to request an upgrade to professional client»: ESMA CP, no. 45, 15.

⁶¹ D. KAHNEMAN, *Thinking, Fast and Slow*, New York, Farrar, Straus and Giroux, 2011, 1-499.

and the fact that «a key step for any investor before making an investment decision is to gather investment information from reliable sources, while keeping in mind one's investment objectives, the benefits of diversification and the ability to bear losses»⁶². In this perspective, a short-term cooling-off period could, however, also extend to all operations in execution only (to avoid excessively “plastering” this channel, an obligation of a cooling-off period only for a part of retail investors with specific characteristics, e.g., with assets below a certain threshold).

Clearly, such a solution is not without costs: in particular, time is an important variable in finance and having to wait for the cooling-off period is certainly expensive, especially with volatile prices. Nonetheless, these costs should not be emphasized: in fact, the cooling-off period would only apply in the limited cases in which the order is inappropriate, and the amount does not exceed the high minimum denomination set above. In essence, it should apply almost exclusively to retail clients, when the financial instruments are particularly complex (so much so that they do not pass the appropriateness test) or when they do not provide the information based on which it is possible to proceed with the appropriateness assessment. In such cases, it seems reasonable to start from the fact that these investors need more protection, rather than the possibility of exploiting volatility to make money on the financial markets. Therefore, the benefit in terms of having more reasoned decisions seems to outweigh the costs. Moreover, a better position for the investor could pass – instead of reducing the time for placing the order – for the reduction of times of its execution⁶³.

To conclude, this solution could be judged under the “Coase Theorem” framework⁶⁴. As it is well known, the Coase Theorem offers a justification for the intervention of law to remedy market failures. In such cases, the intervention of the law is justified only in the presence of high transaction costs; indeed, in the case of low transaction costs, a party agreement will reach an efficient outcome. In this perspective, the obligation of the cooling-off period could lead to an efficient solution where there is a market failure (negative externalities, such as bubbles) and transaction costs are high (especially, investors' cognitive bias).

⁶² ESMA Statement, 1.

⁶³ On this point, cf. fn. 6; also, stating that technological developments could make it possible in the future to reduce the settlement times of transactions (today $T + 2$), M.A. SCOPELLITI, (fn. 24), 12.

⁶⁴ R.H. COASE, *The Problem of Social Cost*, in *Classic papers in natural resource economics*, London, Palgrave Macmillan, 1960, 87-137.

Another possible idea is related to the product governance regime. In particular, the distributor's product governance obligation should be interpreted as meaning that, in the absence of client information, the distribution strategy should exclude the execution of orders on financial instruments that have certain characteristics, for example: (1) shares with low capitalization and high short interest that typically lend themselves to the dynamics mentioned at the beginning; (2) options; (3) «day-trading strategies in which margin trading, i.e. trading with money borrowed from the firm, or derivatives are used. ESMA stresses that trading with leverage is complex and should be entered into with a full understanding of the risks»⁶⁵. Once again, there are the same reasons mentioned not so long ago that could justify this (more paternalistic) approach.

8. *Conclusions.*

The cases related to GameStop, Nokia, BlackBerry, AMC Entertainment, Express and Bed Bath & Beyond have made it clear how technological innovations can compromise investor protection and the efficient functioning of the markets. In fact, the online trading platforms and the internet communities let many people work towards a single goal, but, at the same time, they permit operations aimed at influencing the prices of financial instruments previously closed to those who did not have high resources and expose those participants to significant risks. Those who buy last bear the risk of having to face a large loss, indeed – the price of the financial instrument could drop drastically, once the speculative thrust is exhausted.

Even if the European legal system has tools aimed at preventing such problems, it is quite clear that without adequate rules, the financial markets favour anomalous behaviours – especially due to overconfidence and herd effect – that, in the end, cause a mere redistribution of wealth among investors and (possibly) systemic risks.

Within a more general framework that aims to fully address the new problems, the improvement of the discipline of executive services and of the product governance regime offered by this work aims to promote investors' protection and the correct transfer of resources from investors to companies, according to the real purpose of the financial markets. As we have tried to demonstrate, in fact, the benefits introduced by these policy suggestions would in

⁶⁵ ESMA Statement, 1.

fact exceed their costs. The European Commission is preparing a retail investment strategy for the first half of 2022⁶⁶. In this regard, the elements that emerged in the GameStop affair will be taken into consideration for the protection of retail investors. The present work intends to provide its contribution to the debate.

⁶⁶EUROPEAN COMMISSION, *EU strategy for retail investors*, available at: https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12755-Retail-Investment-Strategy/public-consultation_en.