

**MEMO# 34116**

April 19, 2022

# SEC Proposes Changes to the Definitions of "Dealer" and "Government Securities Dealer"

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TO: Equity Markets Advisory Committee

Fixed-Income Advisory Committee RE: SEC Proposes Changes to the Definitions of "Dealer" and "Government Securities Dealer"

On March 28, the Securities and Exchange Commission (SEC or "Commission") proposed new rules ("Proposal") that would further define the phrase "as part of a regular business," as used in the definitions of "dealer" and "government securities dealer" under Sections 3(a)(5) and 3(a)(44), respectively, of the Securities Exchange Act of 1934 ("Exchange Act").[\[1\]](#) The Proposal is summarized below.

Comments on the Proposal are due May 27, 2022. On **Wednesday, April 27, from 2-3 pm ET**, ICI will hold a members-only call to discuss the Proposal and potential comments. We will send you an Outlook calendar invitation with Zoom login information to participate in the call.

## Background

The Proposal is intended to address concerns raised by the increasingly prominent role of firms, such as principal trading firms (PTFs), that provide liquidity and engage in other activities traditionally performed by "dealers" or "government securities dealers" as defined in the Exchange Act, but are not regulated as dealers.[\[2\]](#) The Commission explains that a significant rise in electronic trading in US securities markets has enabled PTFs and other firms that are not regulated as dealers to perform critical market functions, including serving as major liquidity providers across a range of asset classes, including US Treasury securities. The Commission believes the activities of these entities have resulted in an uneven playing field that makes it difficult for regulators and others to detect, investigate, understand, or address key market events, such as the October 2014 "flash rally" in the Treasury market.[\[3\]](#) The Commission concedes that the proposed rules may not necessarily prevent future market disruptions but believes the rules will "support transparency; market integrity and resiliency; and investor protection; across the U.S. Treasury and other securities markets by closing the regulatory gap that currently exists and ensuring

consistent regulatory oversight of persons engaging in the type of activities described in [the rules]."[\[4\]](#)

Both the Commission and the Department of Treasury previously have raised the issue of whether PTFs should be subject to broker-dealer regulation.[\[5\]](#) The Proposal follows the Commission's re-proposal earlier this year of its 2020 amendments to Regulation ATS and its proposed amendments to the definition of "exchange."[\[6\]](#)

### **Existing Definitions of "Dealer" and "Government Securities Dealer"**

Section 3(a)(5) of the Exchange Act defines the term "dealer" to mean "any person engaged in the business of buying and selling securities . . . for such person's own account through a broker or otherwise," but excludes "a person that buys or sells securities . . . for such person's own account, either individually or in a fiduciary capacity, but not as a part of a regular business." Similarly, Section 3(a)(44) of the Exchange Act defines the term "government securities dealer" as "any person engaged in the business of buying and selling government securities for his own account, through a broker or otherwise, but does not include," among others, "any person insofar as he buys or sells such securities for his own account, either individually or in some fiduciary capacity, but not as part of a regular business."

The Proposing Release discusses factors the courts and Commission historically have considered in determining whether someone is a "dealer" within the meaning of the Exchange Act. Among others, these factors include consideration of the frequency with which a person buys and sells securities for its own account, as well as the nature of the trading activity. The Commission explains that the "trader exclusion" from the definition of "dealer," for a "person that buys or sells securities . . . for such person's own account, either individually or in a fiduciary capacity, but not as a part of a regular business," is intended to exclude from the definition of "dealer" persons "who buy and sell securities for their own account as ordinary traders."[\[7\]](#)

### **Proposal**

The Commission proposes two new rules under the Exchange Act, Rule 3a5-4 and Rule 3a44-2, that would further define the phrase "as part of a regular business" for purposes of determining whether a person meets the definition, respectively, of a "dealer" in Section 3(a)(5) or a "government securities dealer" in Section 3(a)(44) of the Exchange Act. If the Commission adopts the proposed rules, and a person is deemed to meet the definition of a "dealer" or "government securities dealer" as a result, that person would be required to: (i) register with the Commission under Section 15(a) as a dealer or under Section 15C as a government securities dealer; (ii) become a member of a self-regulatory organization (i.e., FINRA); and (iii) comply with applicable federal securities laws and regulatory obligations including, as applicable, SEC, SRO, and Treasury rules and requirements. The Commission proposes a one-year compliance period from the effective date of any final rules.

First, both proposed Rules 3a5-4 and 3a44-2 include identical qualitative standards that provide that a person would be deemed to be engaged in buying and selling securities for its "own account" "as part of a regular business" if the person engages in a routine pattern of buying and selling securities that has the effect of providing liquidity to other market participants by: (i) routinely making roughly comparable purchases and sales of the same or substantially similar securities in a day; (ii) routinely expressing trading interests[\[8\]](#) that are at or near the best available prices on both sides of the market and that are communicated and represented in a way that makes them accessible to other market

participants; or (iii) earning revenue primarily from capturing bid-ask spreads, by buying at the bid and selling at the offer, or from capturing any incentives offered by trading venues to liquidity-supplying trading interests.<sup>[9]</sup> The proposed rules exclude (i) a person that has or controls total assets of less than \$50 million; or (ii) an investment company registered under the Investment Company Act of 1940 ("Investment Company Act").

Second, proposed Rule 3a44-2 also includes a quantitative test, which is an alternative to the qualitative test. If either test is met, the person would be deemed to be acting as a government securities dealer within the meaning of Section 3(a)(44) of the Exchange Act. The quantitative test provides that a person would be deemed to be engaged in buying and selling government securities for its "own account" "as a part of a regular business" if, in each of four out of the last six calendar months, the person engaged in buying and selling more than \$25 billion of trading volume in government securities.<sup>[10]</sup>

For purposes of the proposed rules, a person's "own account" means any account: (i) held in the name of that person; or (ii) held in the name of a person over whom that person exercises control<sup>[11]</sup> or with whom that person is under common control, but does not include: (A) an account in the name of a registered broker, dealer, or government securities dealer, or an investment company registered under the Investment Company Act; or (B) with respect to an investment adviser registered under the Investment Advisers Act of 1940 ("Advisers Act"), an account held in the name of a client of the adviser unless the adviser controls the client as a result of the adviser's right to vote or direct the vote of voting securities of the client, the adviser's right to sell or direct the sale of voting securities of the client, or the adviser's capital contributions to or rights to amounts upon dissolution of the client; or (C) with respect to any person, an account in the name of another person that is under common control with that person solely because both persons are clients of an investment adviser registered under the Advisers Act unless those accounts constitute a parallel account structure;<sup>[12]</sup> or (iii) held for the benefit of a person that has or controls assets of less than \$50 million or for the benefit of a registered investment company.

The Commission explains that the exclusion for registered investment advisers would "exclude registered investment advisers from aggregating their trading activities with those of their clients when the adviser and client only have a discretionary investment management relationship (i.e., where the registered investment adviser does not control the client as a result of the adviser's right to vote or direct the vote of voting securities of the client, the adviser's right to sell or direct the sale of voting securities of the client, or the adviser's capital contributions to or rights to amounts upon dissolution of the client)."<sup>[13]</sup> The Commission, in an example, appears to clarify that by "voting securities of the client," it means "the voting securities issued by [the client] . . . ,"<sup>[14]</sup> consistent with the definition of control in Rule 13h-1(a)(3).<sup>[15]</sup>

As noted above, under the proposed rules, a person's "own account" would not include an account in the name of another person that is under common control with that person solely because both persons are clients of an investment adviser registered under the Advisers Act unless those accounts constitute a "parallel account structure."<sup>[16]</sup> This provision is intended to prevent a registered investment adviser from avoiding application of the proposed rules by dividing trading activities among multiple clients pursuing substantially the same investment objective and strategy.<sup>[17]</sup>

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#### endnotes

[1] Further Definition of "As a Part of a Regular Business" in the Definition of Dealer and Government Securities Dealer, Securities Exchange Act Rel. No. 34-94524 (Mar. 28, 2022), 87 Fed. Reg. 23054 (Apr. 18, 2022), available at <https://www.govinfo.gov/content/pkg/FR-2022-04-18/pdf/2022-06960.pdf> ("Proposing Release"). The SEC's Fact Sheet for the Proposal is available at <https://www.sec.gov/files/34-94524-fact-sheet.pdf>. Chair Gensler's statement on the Proposal is available at <https://www.sec.gov/news/statement/gensler-statement-further-definition-dealer-trader-032822>, and Commissioner Peirce's statement, which includes additional questions on which she requests public comment, is available at <https://www.sec.gov/news/statement/peirce-statement-proposal-further-define-dealer-032822>.

[2] The Commission intends for the Proposal to also apply to certain hedge funds, advisers, and other firms engaging in these activities.

[3] Proposing Release at 23056.

[4] Proposing Release at 23060.

[5] See Concept Release Concerning Equity Market Structure, Securities Exchange Act Release No. 61358 (Jan. 14, 2010), 75 Fed. Reg. 3594 (Jan. 21, 2010); Department of the Treasury, Notice Seeking Comment on the Evolution of the U.S. Treasury Market Structure, 81 Fed. Reg. 3928 (Jan. 22, 2016).

[6] Amendments to Exchange Act Rule 3b-16 Regarding the Definition of "Exchange" and Alternative Trading Systems (ATSs) That Trade U.S. Treasury and Agency Securities, National Market System ("NMS") Stocks, and Other Securities, Exchange Act Release No. 94062 (Jan. 26, 2022), 87 Fed. Reg. 15496 (Mar. 18, 2022), available at <https://www.govinfo.gov/content/pkg/FR-2022-03-18/pdf/2022-01975.pdf> ("Reg ATS Proposal"). ICI's comment letter on the Reg ATS Proposal is available at <https://www.sec.gov/comments/s7-02-22/s70222.htm>.

[7] Proposing Release at 23059 (internal quotations and citations omitted).

[8] The Commission notes that the use of the broader term "trading interest" is intended to "reflect the prevalence of non-firm trading interest offered by market places today, and account for the varied ways in which developing technologies permit market participants to effectively make markets." Proposing Release at text accompanying n.153. The Commission references its discussion of communication protocol systems, or CPSs, in the Reg ATS Proposal, and later states that the proposed rules are intended to capture dealer activity wherever it occurs, "whether on a national securities exchange, an ATS, a

Communication Protocol System, or another form of trading venue." Id. at 23070.

[9] The proposed rules state that no presumption shall arise that a person is not a dealer solely because the person does not meet these criteria.

[10] "Government securities" is defined by reference to Section 3(a)(42)(A) of the Exchange Act.

[11] The proposed rules provide that "control" has the same meaning as in Rule 13h-1 under the Exchange Act.

[12] The proposed rules provide that "parallel account structure" means a structure in which one or more private funds (each a "parallel fund"), accounts, or other pools of assets (each a "parallel managed account") managed by the same investment adviser pursue substantially the same investment objective and strategy and invest side by side in substantially the same positions as another parallel fund or parallel managed account.

[13] Proposing Release at 23075.

[14] The example provides, in full, that "A would not need to aggregate its trading activities with the trading activities of B, C, F or G unless A controls B, C, F or G as a result of the right to vote or direct the vote of the voting securities issued by these clients, the right to sell or direct the sale of the voting securities issued by these clients, or the amount of capital contributions to or rights to amounts upon these clients' dissolution." Proposing Release at 23076 (emphasis added).

[15] Proposing Release at n.181.

[16] See supra note 12.

[17] See Proposing Release at 23075. As described above, however, under paragraph (b)(2)(ii)(A) of the proposed rules, "where an account is held in the name of a person who is a registered broker, dealer, government securities dealer, or registered investment company, the Commission believes that it would be inappropriate to attribute the registered person's accounts to controlling persons or persons under common control, because the registered person is already subject to the broker-dealer regulatory regime or the investment company regulatory regime. Thus, the definition of "own account" would not include those types of accounts." Id. at 23074 (emphasis added).