

MEMO# 35626

February 23, 2024

SEC Adopts Amendments to the Definitions of "Dealer" and "Government Securities Dealer"

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TO: ICI Members

Equity Markets Advisory Committee

Fixed-Income Advisory Committee

Investment Advisers Committee SUBJECTS: Fixed Income Securities

Investment Advisers

Trading and Markets RE: SEC Adopts Amendments to the Definitions of "Dealer" and "Government Securities Dealer"

On February 6, 2024, the Securities and Exchange Commission (SEC or "Commission"), on a 3-2 vote, adopted new rules ("Final Rules") that 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 Final Rules reflect significant modifications from the proposed rules ("Proposed Rules"),^[2] based on comments of ICI^[3] and others.

Background and Summary of Final Rules

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 statutory exclusions from the definition of "dealer" and "government securities dealer" have often been referred to as the "trader exception."^[4] The Commission in the Adopting Release asserts that "in recent years, market participants [relying on the trader exception] regularly engaging in significant liquidity provision have not registered, either as 'dealers' . . . or 'government securities dealers.'"^[5]

To capture market participants that the Commission believes should be registered as either dealers or government securities dealers, the Commission adopted new Rules 3a5-4 and 3a44-2 under the Exchange Act to further define what it means to be engaged in the business of buying and selling securities or government securities "as part of a regular business" for purposes of the trader exception. Under the Final Rules, a person is considered a dealer or government securities dealer if the person engages in a "regular pattern" of buying and selling securities or government securities that has the effect of providing liquidity to other market participants by:

- (1) Regularly expressing trading interest^[6] that is at or near the best available prices on both sides of the market for the same security and that is communicated and represented in a way that makes it accessible to other market participants^[7] ("Expressing Trading Interest Test"); or
- (2) 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 interest ("Primary Revenue Test").

Notably, even if a person does not satisfy either the Expressing Trading Interest Test or Primary Revenue Test, they may still be required to register as a dealer or government securities dealer, based on existing SEC positions, if such person engages in a regular business of buying and selling securities (or government securities) for its own account.^[8]

Finally, any person that controls assets of less than \$50 million, registered investment companies, central banks, sovereign entities and international financial institutions are expressly excluded from the Final Rules.

Key Modifications from Proposed Rules

In adopting the Final Rules, the Commission made certain modifications from the Proposed Rules to better tailor the scope of the rules and address various concerns raised by commenters, including ICI.

Qualitative Standard

The Commission modified the proposed qualitative factors to:

- (1) eliminate the proposed qualitative factor that would have captured persons engaging in liquidity provision by routinely making roughly comparable purchases and sales of the same or substantially similar securities in a day;
- (2) more closely track the statutory language of the Exchange Act by referring to "regular" rather than the proposed "routine" patterns of behavior that have the effect of providing liquidity to other market participants;^[9] and
- (3) add the phrase "for the same security" to the factor relating to the expression of trading interest^[10] to clarify that it will apply only when a person is on both sides of the market for the same security.

Notably, the modifications outlined in (1) and (3) above are consistent with the recommendations in ICI's Letter, which explained that trading in "substantially similar" securities could unintentionally capture persons engaging in ordinary investment and trading strategies, not de facto market making activity.

Quantitative Standard

As proposed, the Commission would have instituted a bright line test under which persons engaged in buying and selling more than \$25 billion of trading volume in government securities in each of four out of the last six months would be deemed to be engaged in buying and selling government securities for its own account "as part of a regular business," regardless of whether such person met any of the qualitative factors.[\[11\]](#) After consideration of comments provided by ICI and others, the Commission ultimately decided to eliminate the quantitative standard from the Final Rules.

As a result of these modifications, the Final Rules establish two non-exclusive ways in which a person will be determined to be engaged in a regular pattern of providing liquidity to other market participants "as part of a regular business," the Expressing Trading Interest Test and the Primary Revenue Test.

Exclusions

The Commission adopted exclusions for certain market participants as proposed (i.e., persons that have or control assets of less than \$50 million and registered investment companies), while also adding an exclusion for central banks, sovereign entities, and international financial institutions, as defined in the Final Rules.[\[12\]](#)

Definitions and Anti-Evasion

In addition to adopting definitions for "central bank," "international financial institution" and "sovereign entity" for purposes of the Final Rules, the Commission also substantially modified its proposed definition of "own account" to mean an account: (i) held in the name of that person; or (ii) held for the benefit of that person.[\[13\]](#) The Commission also removed definitions of "control" and "parallel account structure" as the corresponding language in the aggregation provisions of the proposed rules has been removed. As proposed, a person's "own account" would have been broadly defined to mean any account that is (i) held in the name of that person, (ii) held in the name of a person over whom that person exercises control or with whom that person is under common control, or (iii) held for the benefit of those persons, subject to certain exclusions, including for an account in the name of another person that is under common control with that person solely because both persons are clients of a registered investment adviser, unless those accounts constitute a "parallel account structure."[\[14\]](#)

As requested in ICI's Letter, the revised definition of "own account" removes the problematic aggregation provision and related "parallel account structure" provision for accounts managed by registered investment advisers, which would have inappropriately aggregated separately owned client accounts that follow substantially the same investment objectives and strategies and are managed by the same investment adviser in the ordinary course of business.

The Commission also followed ICI's recommendation to instead adopt a general anti-evasion provision that prohibits structuring activities or disaggregating accounts for the purpose of evading the dealer registration requirements.

Compliance Date

The compliance date is one year from the effective date of the Final Rules (i.e., 60 days after publication in the Federal Register) for all persons who engage in activities that meet

the dealer registration requirements under the Final Rules.

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Notes

[1] See Further Definition of "As a Part of a Regular Business" in the Definition of Dealer and Government Securities Dealer in Connection with Certain Liquidity Providers, Securities Exchange Act Release No. 34-99477 (Feb. 6, 2024), available at <https://www.sec.gov/files/rules/final/2024/34-99477.pdf> (the "Adopting Release"). Commissioners [Peirce](#) and [Uyeda](#) dissented. [Chair Gensler](#), [Commissioner Crenshaw](#), and [Commissioner Lizárraga](#) also issued statements.

[2] For a summary of the Proposed Rules, please see ICI Memorandum No. 34116 (Apr. 19, 2022), available at <https://www.ici.org/memo34116>.

[3] ICI submitted a comment letter on the Proposed Rules. See Letter to Ms. Vanessa A. Countryman, Secretary, SEC, from Sarah A. Bessin, Associate General Counsel, and Nhan Nguyen, Assistant General Counsel, ICI (May 27, 2022), available at <https://www.sec.gov/comments/s7-12-22/s71222-20129683-295958.pdf> ("ICI's Letter").

[4] Adopting Release at 7.

[5] Adopting Release at 9. The Commission further asserts that it was "particularly true in the U.S. Treasury market where certain market participants, particularly those commonly known as proprietary or principal trading firms ("PTFs"), account for about half of the daily volume in the interdealer market and yet are not registered dealers - despite performing critical market functions, in particular liquidity provision, that historically have been performed by dealers."

[6] The term "trading interest" means (i) an "order" as that term is defined under Rule 3b-16(c) of the Exchange Act (i.e., any firm indication of a willingness to buy or sell a security, as either principal or agent, including any bid or offer quotation, market order, limit order, or other priced order) or (ii) any non-firm indication of a willingness to buy or sell a security that identifies the security and at least one of the following: quantity, direction (buy or sell), or price. Adopting Release at 41.

[7] The Commission explains in the Adopting Release that the phrase "accessible to other market participants" means that a person expresses trading interest to more than one market participant and cites an example "where a person makes a trading interest available (such as streaming two-way indicative quotes) to more than one market participant, even if the person made that trading interest available through individual communications, that person would be expressing trading interest accessible to other market participants." Adopting Release at 49.

[8] Rules 3a5-4(d) and 3a44-2(d) both state that no presumption shall arise that a person is

not a dealer or government securities dealer, respectively, within the meaning of the Exchange Act solely because that person does not satisfy paragraph (a) of the rule.

[9] The SEC notes that the proposing release defined the term "routinely" to mean that a person "must express trading interests more frequently than occasionally, but not necessarily continuously, both intraday and across time." See Adopting Release at 33. However, the Commission determined to replace the term "routinely" with "regularly" after consideration of commenters' concerns that the meaning of the term "routinely" was unclear. Unfortunately, the meaning of the term "regularly" also is unclear, based on statements in the Adopting Release that "regularly" will apply "to a person's expression of trading interest both within a trading day and over time" and such person need not to be "continuously expressing trading interest to be engaging in a 'regular' business." The Commission further explains that whether a person's activity is "regular" "will depend on the liquidity and depth of the relevant market for the security." See Adopting Release at 35-36.

[10] The Commission explains in the proposing release that it chose the broader term "trading interest" (rather than "quotations") as it would reflect the prevalence of non-firm trading interest offered by marketplaces and account for the varied ways in which developing technologies permit market participants to effectively make markets. See Adopting Release at 38. The Adopting Release further explains that the use of streaming quotes, requests for quotes, or order books are some of the mechanisms by which market participants make markets but notes that expressing trading interest "depends less on the method used to communicate trading interest and more on whether the person is expressing trading interest on both sides of the market for the same security that has the effect of providing liquidity in the same security to other market participants." See Adopting Release at 41.

[11] The Adopting Release notes that the quantitative standard was intended as a backstop to the qualitative factors to capture the most significant Treasury market participants.

[12] The Adopting Release explains that the excluded market participants do not provide liquidity to the markets in a manner requiring dealer registration or are otherwise subject to a comparable regulatory structure.

[13] The Commission notes in the Adopting Release that the revised definition of "own account" is consistent with its historical "entity" approach to broker-dealer regulation.

[14] The term "parallel account structure" was defined under the Proposed Rules to mean 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.