Securities Regulation Daily Wrap Up, EXCHANGES AND MARKET REGULATION—SEC proposes to regulate significant market participants as 'dealers', (Mar. 28, 2022)

Securities Regulation Daily Wrap Up

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The proposed rules would regulate liquidity providers with the aim of increasing transparency, market integrity, and resiliency in the U.S. Treasury market and other securities markets.

Driven partly by concern about events in the U.S. Treasury market, the SEC unanimously proposed new rules to require certain market participants to register with the SEC, become members of a self-regulatory organization (SRO), and comply with federal securities laws and regulatory obligations. In particular, the proposal addresses firms that assume certain dealer functions, including proprietary (or principal) trading firms. The proposed rules identify certain business activities that would cause persons engaging in such activities to be "dealers" or "government securities dealers" and subject to the registration requirements of Sections 15 and 15C of the Exchange Act (*Further Definition of "As a Part of a Regular Business" in the Definition of Dealer and Government Securities Dealer*, Release No. 34-94524, March 28, 2022).

"I was pleased to support this proposal because I believe it reflects Congress's statutory intent that firms engaging in important liquidity-providing roles in the securities markets, including in the U.S. Treasury market, be registered with the Commission," said SEC Chair Gary Gensler. "Further, requiring all firms that regularly make markets, or otherwise perform important liquidity-providing roles, to register as dealers or government securities dealers also could help level the playing field among firms and enhance the resiliency of our markets."

"Tremors" in the Treasuries markets. According to Gensler, principal trading firms (PTFs, also sometimes called high-frequency trading firms) represent 50 to 60 percent of the volume on the interdealer broker platforms in the Treasury markets, and often account for a large percentage of total volume of the broader secondary markets. Some are not registered with the SEC as dealers or government securities dealers. As a result, said Gensler, important investor and market protections are inconsistently applied, including obligations that promote market stability.

Gensler noted there have been several high-profile events in markets with significant participation by PTFs, including "tremors" in the Treasuries markets in 2014, 2019, and at the beginning of the COVID crisis in 2020.

The proposal would help ensure the SEC has oversight over PTFs and others engaged important liquidity-providing roles, such as market making, said Gensler.

Proposed requirements. New Rules 3a5-4 and 3a44-2 under the Exchange Act would further define the phrase "as a part of a regular business" in Sections 3(a)(5) and 3(a)(44) of the Act to identify certain activities that would cause persons engaging in such activities to be "dealers" or "government securities dealers" and subject to the registration requirements of Sections 15 and 15C of the Act, respectively.

As explained in a fact sheet, the proposal provides:

- Rules 3a5-4 and 3a44-2 would provide identical qualitative standards to identify market participants who assume certain dealer-like roles, particularly those who as act as liquidity providers;
- Rule 3a44-2 would set forth a quantitative standard according to which a person engaging in certain specified levels of activity would be deemed to be buying and selling government securities "as a part of a regular business," regardless of whether it meets any of the proposed rule's qualitative standards.

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- The proposed rules would exclude: (1) any person that has or controls total assets of less than $50 million; (2) an investment company registered under the Investment Company Act of 1940.

According to the SEC, the proposed rules do not seek to address all circumstances under which a person may be acting as a dealer or government securities dealer or to replace otherwise applicable interpretations and precedent. Further, the proposed rules do not create a presumption that a person is not a dealer solely because they do not engage in the identified activities.

Unless an exception or exemption applies, a market participant that engages in the identified activities would have to:

- Register with the Commission under Section 15(a) or Section 15C, as applicable;
- Become a member of a self-regulatory organization (SRO); and
- Comply with federal securities laws and regulatory obligations, including as applicable, SEC, SRO, and Treasury rules and requirements.

Commissioner Peirce comments. Commissioner Hester Peirce voted to issue the proposal, but said she has “deep reservations” about its breadth. Peirce said she does appreciate that there are concerns with the largest firms making markets in U.S. Treasury securities sitting outside of the dealer framework. However, she is not convinced the proposal gets the scope of its clarification of the dealer definition right. Peirce listed specific questions on which she would like to see commenters’ views, including the anticipated effect on liquidity in different markets and whether regulating these market participants as dealers would help address the types of market events seen over the past several years.

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