Statement

Statement on Adopting Changes to the Definition of Dealer and Government Securities Dealer



Commissioner Caroline A. Crenshaw

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The Securities Exchange Act of 1934 ("Exchange Act") provides the SEC with broad authority over the securities industry, including the power to register, regulate, and oversee participants in the securities markets. [1]

The dealer regulatory regime is a key component of the U.S. Federal securities laws, and dealers perform important market functions such as absorbing order imbalances (i.e., when a market receives more buy orders than sell orders at one point in time, or vice versa) and providing liquidity to buyers and sellers in the market. Under the Exchange Act, the SEC has the authority to define the terms used in the statutory definition of "dealer" and oversee and regulate registered dealers.[2] The Exchange Act defines a dealer as any person engaged in the business of buying or selling securities for their own account.[3] Dealers help facilitate investor trading because dealers are willing to trade for their own account as principals when investors cannot immediately find other investors with whom to trade.[4] In this way, dealers provide the service of immediate trading.[5] The Commission has long identified the provision of liquidity , including acting as a "market maker" or "a de facto market maker," as a factor that indicates "dealer" status.[6]

In recent years, advancements in electronic trading have resulted in certain market participants playing an increasingly significant role in providing liquidity.[7] Of course, increased liquidity can be positive, but when the providers of significant liquidity are not compelled to comply with registration requirements, it raises concerns. For example, if a liquidity provider that is a substantial market participant fails, then its disorderly exit from a securities position (or even the market more generally) could push market prices away from fundamental value and potentially harm traders across markets.[8] Because a significant liquidity provider can harm others to whom it is not directly related, its failure has the potential to impose significant costs on other parties.[9] There is a clear loophole here: market participants with a significant share of market volume are engaging in activities like those performed by dealers, without being registered as dealers.[10] This has left both investors and the markets without important protections such as limitations on financial risk, reporting and disclosure requirements, and other benefits that would result from registration and regulation under the Exchange Act – regulation designed for this specific dealer activity.

The rules we are considering today would help close this regulatory loophole and level the playing field by subjecting market participants that perform similar dealer functions to a common regulatory regime. The regulatory regime for registered dealers includes, among other things, books and records requirements,[11] reporting and disclosure requirements (including audited financial statements[12] and the identities of owners, directors, and managers[13]), the Net Capital Rule,[14] and operational integrity rules.[15] These requirements

help enhance market stability by giving regulators increased insight into firm-level and aggregate trading activity, which helps regulators to evaluate, assess, and address market risks.[16] In addition, registered dealers are also subject to the Commission's authority to conduct examinations and impose sanctions,[17] and are also subject to the rules, examination authority, and enforcement authority of relevant self-regulatory organizations.[18] Moreover, registered dealers and government securities dealers are required to comply with all applicable securities laws, which include antifraud and anti-manipulation provisions.[19] Although the regulatory regime differs somewhat for market participants that transact only in government securities, firms that are government securities dealers (including registered broker-dealers trading government securities) must also comply with rules adopted by the U.S. Treasury, including rules relating to financial responsibility, recordkeeping, financial condition reporting, and risk oversight.[20]

On the whole, the regulatory requirements that apply to dealers, including today's rules, provide fundamental protections that contribute to fair, orderly, and efficient markets. The rules will also apply consistent regulation to market participants that regularly provide significant liquidity. Today's rules thus begin to level the competitive playing field between liquidity provision conducted by entities that are currently registered as dealers and those that are not.[21] Registration should enable more comprehensive regulatory oversight of those participants.

I'd like to thank the staff of the Division of Trading and Markets, the Division of Economic and Risk Analysis, and the Office of the General Counsel for all their hard work on this release. I'm pleased to support today's rule. Thank you.

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[1] 15 U.S.C. § 78a-78pp.

[2] This statement also applies to government securities dealers. 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, Rel. No. 34-99477 (Feb. 6, 2024) (hereinafter "Adopting Release") at 5.

[3] See section 3(a)(5)(A) of the Exchange Act, 15 U.S.C. 78c(a)(5)(A).

[4] See Stoll, Hans R., The Supply of Dealer Services in Securities Markets, Vol. 33, No. 4, Journal of Finance, 1133 (Sept. 1978) available at https://www.jstor.org/stable/2326945.

[5] See id.

[6] See Further Definition of "As a Part of a Regular Business" in the Definition of Dealer and Government Securities Dealer, Exchange Act Release No. 94524 (Mar. 28, 2022), 87 FR 23054 (Apr. 18, 2022) (hereinafter "Proposing Release") at 9. Acting as a "de facto market maker" entails market professionals or the public looking to the firm for liquidity. See id. at n.23.

[7] See id. at 1.

[8] See Adopting Release at 127.

[9] See id.

[10] This statement applies to both dealers and government securities dealers. See sections 15 and 15C of the Exchange Act, respectively.

[11] See Adopting Release at 12, 101.

[12] See 17 CFR 240.17a-5(d)(1)(i)(A) ("Rule 17a-5(d)(1)(i)(A)").

[13] See Adopting Release at 101; see also Form BD.

[14] See Adopting Release at 101. The Net Capital Rule requires dealers to hold liquid assets in excess of their unsubordinated liabilities. Id. at n.358.

[15] See id. at 12. See, e.g., Market Access Rule (promotes market integrity by reducing risks associated with market access by requiring financial and regulatory risk management controls reasonably designed to limit financial exposures and ensure compliance with applicable regulatory requirements). Id. at n.26.

[16] See Adopting Release at 13.

[17] See id. at 101.

[18] See id.; see also Exchange Act section 15(b) (regarding Commission authority to sanction brokers and dealers); section 15C(c) (regarding Commission authority to sanction government securities dealers that are registered with it); and section 17(b) (broker-dealer recordkeeping and examination). See also section 15C(g) (restricting the authority of the Commission with respect to government securities dealers that are not registered with the Commission). See Adopting Release at n.367.

[19] See Adopting Release at 13, 101. See also section 17(a) of the Securities Act of 1933, 15 U.S.C. § 77q; section 10(b) of the Exchange Act, 15 U.S.C. § 78j; sections 15(c)(1) and (2) of the Exchange Act, 15 U.S.C. 78o(c)(1) and (2), and rules promulgated thereunder. Section 15(c) of the Exchange Act prohibits broker-dealers from effecting any transaction in securities by means of any manipulative, deceptive, or other fraudulent device or contrivance. See Adopting Release at n.28.

[20] See Adopting Release at 13. Under Title I of the GSA, all government securities brokers and government securities dealers are required to comply with the requirements in Treasury's GSA regulations that are set out in 17 CFR parts 400 through 449, as well as all other applicable requirements. See id. at n.29.

[21] See id. at 4, 96.