Statement

Statement on Final Rules Regarding the Further Definition of a Dealer-Trader



Chair Gary Gensler

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Today, the Commission is considering whether to adopt final rules further defining a dealer and government securities dealer. I am pleased to support this adoption because it requires that firms that act like dealers register with the Commission as dealers, thereby protecting investors as well as promoting market integrity, resiliency, and transparency.

The registration, oversight, and regulatory regime for dealers is a cornerstone of the federal securities laws. It was amongst the first authorities that Congress gave the SEC as part of the Securities Exchange Act of 1934.

When dealers register, they become subject to a variety of important laws and rules that help protect the public, promote market integrity, and facilitate capital formation. Amongst these are meeting minimum capital requirements, reporting data to regulators, and keeping books and records. This regime benefits investors, issuers, and markets alike—and has done so for nearly 90 years.

Congress, though, in crafting the foundational securities laws from the 1930s had exempted Treasury securities—and thus government securities dealers—from these key provisions.

This all changed in the 1980s, in response to a dozen firms in the Treasury markets that had failed between 1982 and 1985. I actually recall vividly the failures of some of those firms. I was a young associate on Wall Street, and though I worked in the mergers and acquisitions department at the time, far from the trading floor, the news spread far and fast when Drysdale Government Securities failed in May of 1982.

I remember as my colleagues and I processed what had happened as well as its potential effects on the markets and potentially the economy. Drysdale, which was not registered or regulated as a dealer, had significant involvement in the U.S. Treasury markets. It also was highly leveraged. The firm had only $30 million in capital yet managed a portfolio as large potentially as $4 billion.[1]

In the ensuing years, it seemed like every couple of months, another unregulated government securities firm would collapse. These included E.S.M. Government Securities and others, none of which were regulated as securities dealers.

In response, President Ronald Reagan signed the Government Securities Act into law in 1986. The Act granted the SEC and other regulators important authorities to regulate dealers and brokers in this space.

Working with the SEC, the U.S. Department of Treasury put in place rules for government securities dealers. Yet in 2021, when I arrived at the SEC, I was told that though numerous firms have registered with the SEC as government securities dealers, some market participants have not. I think that leaves potential regulatory gaps and risk in the system.

The markets also have evolved in other ways, such as electronification, the use of algorithmic trading, and market participants transacting faster than ever before. Some market participants, such as principal-trading firms (PTFs) that use high-frequency trading strategies, started participating significantly in the Treasury cash market. In 2019, for example, PTFs represented around 60 percent of the volume on the inter-dealer broker (IDB) platforms in the Treasury markets.[2]

In essence, these PTFs and other firms are acting in a manner consistent with dealers in the securities markets. Nevertheless, despite these firms acting as de facto market makers, and despite their regularity of participation consistent with buying and selling securities or government securities "as a part of a regular business," a number of these firms have not registered with the Commission as dealers.

This deprives investors and the markets themselves of important protections—protections that benefit market integrity, resiliency, transparency, and more.

To fill this regulatory gap, today's rules will further define what it means to be engaged in a business of buying and selling securities "as a part of a regular business." They will do so for both dealers and government securities dealers by requiring entities engaging in "de facto market making" activity to register as dealers or government securities dealers.

Specifically, the rules further define "as a part of a regular business" to include "engag[ing] in a regular pattern of buying and selling securities," or "government securities," "that has the effect of providing liquidity to other market participants by":

- "Regularly expressing trading interest 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;" or
- "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."[3]

These measures are common sense. Congress did not intend for registration and regulatory requirements to apply to some dealers and not to others. Absent an exemption or exception, if anyone trades in a manner consistent with de facto market making, it must register with us as a dealer—consistent with Congress's intent.

In finalizing this adoption, we benefitted from public feedback on our proposed rules and made a number of adjustments. Let me just note three. First, with regard to these qualitative standards, the final rules we are considering today do not include an additional qualitative factor that had been proposed with regard to a firm regularly making roughly comparable purchases and sales of the same or similar securities in a day. Second, the final rules do not include the proposed quantitative standard for the further definition of a dealer in the Treasury markets. Third, the final rules adopt an anti-evasion provision rather than the proposed aggregation across legal entities.

The final rules promote an important cornerstone of the SEC's work to oversee the markets.

I'd like to thank the members of the SEC staff for their work on these final rules, including:

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[1] "Unraveling the mystery at Drysdale Government Securities, a company that had only $30 million in capitalization, is proving complicated. … On a $4 billion portfolio, which is the size of portfolio most analysts believe Drysdale was running, this strategy would have produced modest profits or losses." See Ron Scherer, "How Drysdale affair almost stymied US securities market" (May 27, 1982), available at https://www.csmonitor.com/1982/0527/052737.html. See also James L. Rowe Jr. and Merrill Brown, "Through Abrupt Personality Change, Tiny Wall Street Firm Demonstrates the Allure, and Danger, in Speculative Trading" (May 23, 1982), available at https://www.washingtonpost.com/archive/politics/1982/05/23/through-abrupt-personality-change-tiny-wall-street-firm-demonstrates-the-allure-and-danger-in-speculative-trading/532bf4ea-bdf2-4248-924b-d6a682907aba/. "On Tuesday, Drysdale Government Securities and Chase Manhattan, its chief trading agent, staggered the financial community with disclosure that Drysdale, with debts of $250 million after four months of operation, had failed to pay nearly $200 million in interest due the brokerage firms whose securities Drysdale borrowed and then traded. The default threatened solvency of several of the 30 securities firms involved, Wall Street officials said last week."

[2] Per the Adopting Release: "A Federal Reserve staff analysis concluded that PTFs were particularly active in the interdealer segment of the U.S. Treasury market in 2019, accounting for 61% of the volume on automated interdealer broker platforms and 48% of the interdealer broker volume overall." See FEDS Notes, "Principal Trading Firm Activity in Treasury Cash Markets," James Collin Harkrader and Michael Puglia (Aug. 4, 2020) ("[Principal trading firms] dominate activity on the electronic [interdealer broker] platforms (61%)."). See also FEDS Notes, "Unlocking the Treasury Market Through TRACE," (Sept. 28, 2018).

[3] See Rule 3a5-4(a)(1)(i), (ii) and Rule 3a44-2(a)(1)(i), (ii).