Statement

Statement on the Further Definition of a Dealer-Trader

Chair Gary Gensler

March 28, 2022

Today, the Commission unanimously proposed two rules further defining a dealer to help identify principal trading firms (PTFs) and firms conducting similar activities that must register with the SEC. 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. 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.

Section 3(a)(5) of the Securities Exchange Act of 1934[1] defines a dealer as someone who is engaged in the business of buying and selling securities for their own account. It also provides that if a person buys and sells securities for their own account but not as part of a regular business, they would fall within what is known as the "trader exception," and thus would not be considered a dealer.

More than 35 years ago, the SEC received authority from Congress to regulate government securities dealers and brokers. Between 1982 and 1985, a dozen firms — such as Drysdale Government Securities[2] and E.S.M. Government Securities[3] — failed. Thus, in 1986, Congress passed, and President Reagan signed into law, the Government Securities Act. For the first time, this law set up a federal regulatory regime specific to government securities dealers and brokers, including defining government securities dealers in section 3(a)(44), consistent with the long-standing statutory definition of dealer in section 3(a)(5), among other things.[4]

In the last couple of decades, electronification and the use of algorithmic trading have made transacting in this market faster than ever before. As a result, certain market participants, including PTFs (which some people call high-frequency trading firms) started participating significantly in markets such as the Treasury cash market. Today, for example, PTFs represent 50 to 60 percent of the volume on the interdealer broker platforms in the Treasury markets[5], and often account for a large percentage of total volume of the broader secondary markets.

Nevertheless, despite their significant market presence, and despite a regularity of participation consistent with buying and selling securities or government securities "as a part of a regular business," a number of these firms, including PTFs, are not registered as dealers or government securities dealers with the Commission. As a result, important protections to investors and the markets that result from registration and regulation under the Exchange Act, including those obligations that promote market stability, are inconsistently applied to firms engaged in similar activities.

Additionally, in recent years, we've seen a number of high-profile events in markets with significant participation by PTFs. Tremors in the Treasuries markets in 2014, 2019, and at the beginning of the COVID crisis in 2020 demonstrate the importance of the SEC's oversight of dealers, consistent with the statute.

Today's proposal draws upon our original '34 Act authorities, including the authority added in the 1986 statute. It would help ensure the SEC has oversight over PTFs and others engaged important liquidity-providing roles, such as market making.

Specifically, today's release proposes further defining a dealer and government securities dealer as one that engages "in a routine pattern of buying and selling securities that has the effect of providing liquidity to other market participants" by, for example:

- "Routinely making roughly comparable purchases and sales of the same or substantially similar securities in a day; or
- Routinely expressing trading interests 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
- 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."

In addition, with respect to the U.S. Treasury market, the proposal would include a quantitative measure, which would require persons that had at least $25 billion of trading volume in government securities in at least four of the previous six calendar months to register with the Commission.

The proposed rule further says it shouldn't be presumed that certain persons are not dealers solely because they don't meet the standards of the rules. Other patterns of buying and selling may have the effect of providing liquidity to other market participants or otherwise require a person to register under otherwise applicable precedent.

The proposed rules would not apply to a registered investment company or to a "person that has or controls total assets of less than $50 million."

I was pleased to support today's proposal and look forward to the public's feedback. I'd like to thank the members of the SEC staff who worked on this rule, including:

- Haoxiang Zhu, David Saltiel, Shauna Sappington, Emily Westerberg Russell, John Fahey, Joanne Rutkowski, Katherine Lesker, James Blakemore, Roni Bergoffen, Josh Nimmo, and Meredith MacVicar from the Division of Trading and Markets;
- Jessica Wachter, Greg Allen, Ilia Rainer, Amy Edwards, Oliver Richard, Robert Miller and Lauren Moore in the Division of Economic and Risk Analysis;
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- Ainsley Kerr, Mandy Sturmfelz, Joseph Sansone, Kristin Pauley, and Scott Thompson in the Division of Enforcement.

I also would like to thank our fellow member agencies of the Inter-Agency Working Group on Treasury Market Surveillance, including the U.S. Department of the Treasury, the Board of Governors of the Federal Reserve System, the Federal Reserve Banks of New York and Chicago, and the Commodity Futures Trading Commission for their valuable insights and collaboration on this proposal.

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[1]SEC, "Broker Dealer Registration," available at https://www.sec.gov/fast-answers/answersbdregishtm.html.

[2]*See* “How Drysdale affair almost stymied US securities market” (May 27, 1982), available at https://www.csmonitor.com/1982/0527/052737.html.

[3]*See* “E.S.M. Collapse: A Lesson In Safety” (March 8, 1995), available at https://www.nytimes.com/1985/03/08/business/esm-collapse-a-lesson-in-safety.html.

[4]*See* Department of the Treasury, SEC, and Board of Governors of the Federal Reserve System, “Joint Report on the Government Securities Market” (January 1992), available at https://www.treasury.gov/resource-center/fin-mkts/Documents/gsr92rpt.pdf.

[5]*See* DTCC, “More Clearing, Less Risk: Increasing Centrally Cleared Activity in the U.S. Treasury Cash Market” (May 2021), available at https://www.dtcc.com/-/media/Files/PDFs/DTCC-US-Treasury-Whitepaper.pdf. See FEDS Notes, “Principal Trading Firm Activity in Treasury Cash Markets,” James Collin Harkrader and Michael Puglia (August 4, 2020) (“[Principal trading firms] dominate activity on the electronic [interdealer broker] platforms (61%).”).