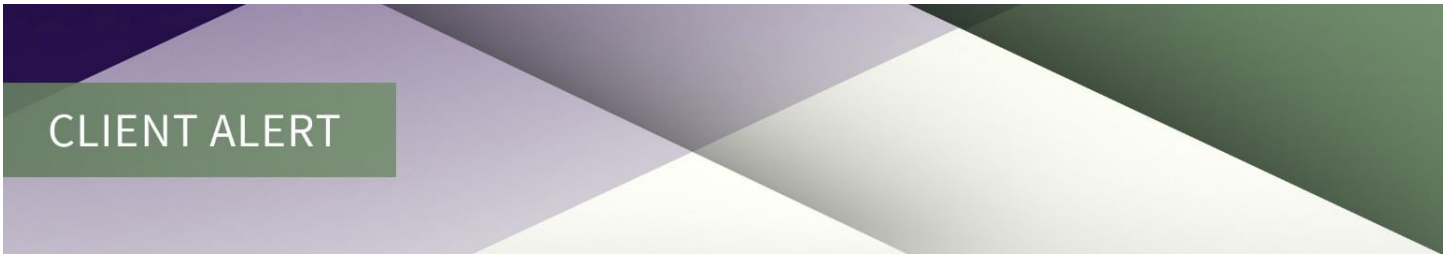

Proposal to Require Proprietary Traders and Private Funds to Register as Dealers

June 27, 2022

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In late March 2022, the Securities and Exchange Commission (the "SEC") proposed two rules (the "Proposed Rules") that would establish activity-based standards related to trading U.S. Treasury securities and other securities that, if triggered, would require a number of proprietary trading firms and individuals, private funds and, in some cases, investment advisers (collectively, "traders") to register with the SEC as dealers or as government securities dealers.[1] In addition to requiring traders to register, the Proposed Rules would require them to become members of the Financial Industry Regulatory Authority, Inc. ("FINRA") or another self-regulatory organization, comply with SEC and FINRA rules and, in the case of traders in U.S. Treasury securities, comply with the rules of the U.S. Department of the Treasury. The Proposed Rules, *i.e.*, Rules 3a5-4 and 3a44-2 under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), would accomplish these regulatory changes by interpreting the phrases "as part of a regular business" and for such person's "own account" as those phrases are used in the statutory definitions of "dealer" and "government securities dealer."[2] The Proposed Rules would add qualitative and, in the case of trading in U.S. Treasury securities, quantitative activity-based standards to the existing qualitative standards or tests that trigger registration.

1 *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) (the "Proposing Release"), available here, 87 Fed. Reg. 23,054 (Apr. 18, 2022) (to be codified at 17 C.F.R. pt. 240), available here.

2 *See* Sections 3(a)(5)(B) and 3(a)(44)(A) of the Exchange Act, which establish the definitional parameters for when a person is engaged in activity that triggers registration under Section 15 or Section 15C of the Exchange Act.

Background

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" (emphasis added). Similarly, Section 3(a)(44) of the Exchange Act provides, in relevant part, that the term "government securities dealer" means "any person *engaged in the business* of buying and selling government securities *for his own account*, through a broker or otherwise"[3] (emphasis added). In the Proposing Release, the SEC explains that courts and the SEC have historically looked to the following as key components of the term "engaged in the business" and, thus, indicia of dealer status: (1) acting as a market maker or specialist on an organized exchange or trading system; (2) acting as a de facto market maker or liquidity provider; (3) holding oneself out as buying or selling securities at a regular place of business; and (4) regular participation in both purchases and sales of the same securities.[4]

The Exchange Act excludes from the definition of dealer and government securities dealer any "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." The Proposing Release notes that, while traders and dealers engage in the same core activity, *i.e*., buying and selling securities for their own account, they differ in their level of activity. Dealers often buy and sell contemporaneously and may enter into offsetting transactions to mitigate risk whereas traders generally hold investments unhedged, for an extended period of time.[5]

In the Proposing Release, the SEC explains that the Proposed Rules are needed in light of the significant role that unregulated entities, such as proprietary trading firms ("PTFs") and private funds, now play in providing market liquidity and carrying out activities traditionally performed by dealers. In particular, the rise in electronic trading has allowed unregulated entities to serve as liquidity providers across a range of asset classes, and the Proposing Release cites to a 2020 report from the staff at the Board of Governors of the Federal Reserve estimating that PTFs account for 61 percent of the total trading activity in U.S. Treasuries on interdealer broker platforms.[6] The Proposing Release notes that the prominence of these entities has resulted in an uneven playing field in which some key participants are not required to register. The Proposing Release concludes that the current lack of regulation makes it difficult for regulators and market observers to detect, investigate, understand and address market events, such as the "flash rally" of October 2014.[7] It also explains the SEC's view that requiring registration of PTFs and other entities would "provide regulators with a more

3 15 U.S.C. 78c(a)(44).

4 Proposing Release at 19, 87 Fed. Reg. at 20,058-59.

5 Proposing Release at 20, 87 Fed. Reg. at 23,059.

6 Proposing Release at 7, 87 Fed. Reg. at 23,055.

7 Proposing Release at 10, 87 Fed. Reg. at 23,056.

comprehensive view of the markets through regulatory oversight and would enhance market stability and investor protection."[8]

The Proposing Release notes that the SEC had originally raised the possibility of requiring PTFs to register as dealers in its 2010 Equity Market Structure Concept Release. The Proposing Release points as well to a release published by the U.S. Department of the Treasury in 2016 seeking public comment on the evolution of the market for U.S. Treasury securities and raising the possibility of requiring registration as dealers of a broad scope of unregulated market participants, including persons engaged in automated trading or conducting a large trading volume. The SEC notes that commenters expressed support for registration of unregulated traders and cites, in particular, a comment letter stating "principal trading firms have played an increasingly larger role in offering liquidity in these markets, and have become de facto market makers."[9]

The Proposed Rules

Persons Covered

The dealer registration requirement under the Proposed Rules generally would apply to any "person" as defined in Section 3(a)(9) of the Exchange Act, *i.e.,* any natural person, company, government or political subdivision, agency or instrumentality of a government that engages in the activities described in the applicable rule. However, the Proposed Rules would exclude any such person that has or controls total assets of less than $50 million or that is registered with the SEC as an investment company under the Investment Company Act of 1940, as amended.

Investment advisers registered with the SEC under the Investment Advisers Act of 1940, as amended (the "Advisers Act") are not explicitly excluded from registration under the Proposed Rules, but for purposes of determining the applicability of the requirements, a registered investment adviser would generally not be required to aggregate its own trading activities with the trading activities of its clients. However, the Proposed Rules' definition of a person's "own account," discussed in more detail below, would require a registered investment adviser to aggregate accounts managed by the adviser if the accounts are managed under a "parallel account structure."

The Proposed Rules would not exclude private funds from the definition of a "person" that would be subject to the registration requirements if the tests for dealer activity are triggered. The SEC explains that, although registered private fund advisers are regulated under the Advisers Act and information regarding private fund activities is reported on Form

[8] Proposing Release at 4, 87 Fed. Reg. at 23,054. *See also* Proposing Release at 24, 87 Fed. Reg. at 23,060 ("Not only does such a regulatory gap mean inconsistent oversight of market participants performing similar functions either in the same market or across asset classes but . . . the activity of significant market participants that are not registered may pose certain risks to the markets.").

[9] Proposing Release at 24, 87 Fed. Reg. at 23,060, *citing* Letter from Stuart Kaswell, Executive Vice President and Managing Director, General Counsel, Jiri Krol, Deputy CEO, Global Head of Government Affairs, Alternative Investment Management Association (Apr. 22, 2016).

PF, that information differs from the information that the SEC collects from dealers. Moreover, the SEC states that dealer registration enhances regulatory oversight of market participants' trading activities and interactions with the market overall, and provides needed protections to investors.

Whether a person engages in the buying and selling of securities for its own account "as part of a regular business," would be defined under the Proposed Rules by reference to a series of qualitative, activity-based standards in determining whether a person would be required to register as either a dealer or a government securities dealer. In addition, Rule 3a44-2, applicable to government securities dealer registration only, would add a second quantitative test that, by itself, could trigger a registration requirement under that rule. Together, these activity-based standards would determine whether persons covered by these rules must register as dealers, including persons that historically have relied on the "trader" exception from registration.[10]

Qualitative Test

The SEC explains that the Proposed Rules build upon existing statements by the SEC and the courts to define the standards for determining when a person that is engaged in buying and selling securities for its own account is doing so "as a part of a regular business" within the meaning of Sections 3(a)(5)(B) and 3(a)(44)(A) of the Exchange Act. Thus, under the Proposed Rules, a person that is engaged in buying and selling securities for its own account would be considered to be engaged in such activity "as a part of a regular business" if that person engages in a routine pattern of buying and selling securities that has the effect of providing liquidity to other market participants (the "Qualitative Test"). The Qualitative Test would include three types of activities described in the Proposed Rules that the SEC views as having the effect of providing liquidity to other market participants:

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

The SEC cautions that there would be no presumption that a person is not a dealer solely because that person does not engage in the activities described in the Proposed Rules. The SEC states that other patterns of buying and selling

[10] Proposing Release at 29, 87 Fed. Reg. at 23,061.

securities may have the effect of providing liquidity to other market participants or otherwise require a person to register under the Proposed Rules in accordance with applicable precedent.

The proposed standard—that the activity "has the effect of providing liquidity to other market participants"—is broader than the historical focus on market makers and would include not only passive liquidity-providing activity but also include trading strategies that "permit a person to earn revenue from the act of buying and selling [securities] itself."[11] The SEC notes in the Proposing Release that the "frequency with which a person buys and sells" securities is a characteristic that is determinative of dealer status.[12]

The three types of activities that would be considered to have the effect of providing liquidity to other market participants under the Qualitative Test are described in more detail below.

Activity 1: Routinely making roughly comparable purchases and sales of the same or substantially similar securities

Under the first enumerated activity, a person that, trading for its own account, *routinely* makes *roughly comparable* purchases and sales of *the same or substantially similar* securities in a day would be deemed to be engaged in a pattern of trading that "has the effect of providing liquidity to other market participants" and would therefore require registration as a dealer (emphasis added).

The term "routinely, as used here, refers to the frequency of such trades. The SEC explains that "routinely" would mean "more frequent than occasional but not necessarily continuous."[13] The SEC states that this term will be useful in separating persons that engage in isolated or sporadic securities transactions from persons whose regularity of participation in securities transactions demonstrates that they are acting as dealers.

The term "roughly comparable" is intended to capture purchases and sales of securities that are similar enough, in terms of dollar volume, number of shares, or risk profile, to permit liquidity providers to maintain near market-neutral positions by netting one transaction against another transaction.[14] The Proposing Release notes that a person that closes or offsets most positions on the same day as it opens the positions will generally be deemed to have made "roughly comparable

11 Proposing Release at 45-46, 87 Fed. Reg. at 23,066.

12 Proposing Release at 50, 87 Fed. Reg. at 23,067.

13 Proposing Release at 47, 87 Fed. Reg. at 23,066.

14 Proposing Release at 48, 87 Fed. Reg. at 23,066.

purchases and sales."[15] However, the Proposing Release also states that to be "roughly comparable," the dollar volume or number of shares of, or risk offset by, the purchases and sales need not be exactly the same.

The securities traded under this test must be the same or "substantially similar." Generally speaking, the SEC indicates that securities of the same class and having the same CUSIP, terms, conditions, and rights would be deemed to be the "same."[16] Whether one security is "substantially similar" to another would depend upon the particular facts and circumstances. According to the Proposing Release, factors relevant to the analysis would include the following: (1) whether the fair market value of each security primarily reflects the performance of a single firm or enterprise or the same economic factor or factors, such as interest rates; and (2) whether changes in the fair market value of one security would reasonably be expected to approximate, directly or inversely, changes in, or a fraction or a multiple of, the fair market value of the second security.

Activity 2: 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

Under the second enumerated activity, a person that *routinely* expresses *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* would be engaged in a pattern of trading in securities or government securities that "has the effect of providing liquidity to other market participants," and therefore would be a dealer (emphasis added).

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[15] Furthermore, the SEC states that it assumes a "daily buy-sell imbalance between two identical or substantially similar securities, in terms of dollar volume, below 10 percent or, alternatively, 20 percent may be indicative of purchases and sales that are 'roughly comparable' . . . ." Proposing Release at 49 n.136, 87 Fed. Reg. at 23,066 n.136.

[16] According to the Proposing Release, the following are nonexclusive examples of purchases and sales of "substantially similar" securities: (1) selling a Treasury security and buying another Treasury security in the same maturity range, as used by the Federal Reserve Bank of New York's Open Market Operations (for example, selling a 4.5-year Treasury security and buying a 5-year Treasury security, or a 9.5-year Treasury security versus a 10-year Treasury security); (2) buying an exchange-traded fund and selling the underlying securities that make up the basket of securities held by the exchange-traded fund that was purchased; (3) buying a European call option on a stock and selling a European put option on the same stock with the same strike and maturity; and (4) buying an OTC call option on a stock and selling a listed option on the same stock with the same strike and maturity. Proposing Release at 51-52, 87 Fed. Reg. at 23,067. On the other hand, the Proposing Release provides the following examples of purchases and sales of securities that are not "substantially similar": (1) buying stock in one company and selling stock in another company in the same industry; (2) buying stock and selling bonds issued by the same company; and (3) buying cash Treasury securities and selling Treasury futures. Proposing Release at 52, 87 Fed. Reg. at 23,067.

As with the first activity, discussed above, the term "routinely" means more frequent than occasional but not necessarily continuous. The Proposing Release notes that the term is not intended to encompass persons engaging in isolated or sporadic activity of the type described.[17]

The SEC explains that the term "trading interest" is used rather than "quotation," which is the term historically used in connection with market maker activity. The SEC notes that the term "trading interest" is broader than the term "quotation" and would reflect the "prevalence of non-firm trading interest offered by market places today, and account for the varied ways in which developing technologies permit market participants to effectively make markets."[18] The SEC recently proposed to define the term "trading interest" in the context of Rule 300 of Regulation ATS as "an order, as defined in paragraph (e) of [Rule 300 of Regulation ATS], or any non-firm indication of a willingness to buy or sell a security that identifies at least the security and either quantity, direction (buy or sell), or price."[19]

For a person to be deemed to be engaged in dealer activities under the second prong of the Qualitative Test, the trading interests would have to be provided on a regular basis "at or near the best available prices on both sides of the market" and communicated in a manner that makes them accessible to other market participants. The SEC explains that the phrase "best available prices on both sides of the market" describes the activity of liquidity-providing dealers, which help determine the spread between the best available bid price and the best available ask price for a given security, while emphasizing the requirement that a liquidity provider both buy and sell securities in order to fall within the Proposed Rule.[20] The SEC also explains that a market participant that routinely communicates these trading interests and makes them available to other market participants would be considered to have engaged in a routine pattern of trading that has the effect of providing liquidity to other market participants.[21]

Activity 3: 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

Under the third enumerated activity, a person trading for its own account would be treated as a dealer if it *earns 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* (emphasis added). The SEC intentionally uses the phrase "earning revenue" to make it clear that the person's trading strategy need not be profitable to result in dealer status. The SEC explains that trading in a

17 Proposing Release at 47-48, 87 Fed. Reg. at 23,066.

18 Proposing Release at 55, 87 Fed. Reg. at 23,068.

19 Proposing Release at 55, 87 Fed. Reg. at 23,068. Paragraph (e) of Rule 300 of Regulation ATS defines an "order" to mean "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." 17 C.F.R. 242.300(e).

20 Proposing Release at 56, 87 Fed. Reg. at 23,068.

21 Proposing Release at 56-57, 87 Fed. Reg. at 23,068.

manner designed to profit from spreads or liquidity incentives, rather than with a view toward appreciation in value, is a fundamental characteristic of a market maker or liquidity provider. In the Proposing Release, the SEC states that quotations near or at the market for a short sale in a security may provide an indication of bona-fide market making for purposes of Regulation SHO, and suggests the same might be true for purposes of the dealer definition.[22] The Proposing Release states that a person that derives the "majority" of its revenue from these sources would likely be in a regular business of buying and selling securities or government securities for its own account. Finally, the Proposed Rule's reference to "trading venues" is intended to reach dealer activity wherever that activity occurs, whether on a national securities exchange, an ATS, a Communication Protocol System, or another form of trading venue.[23]

Quantitative Test

Proposed Rule 3a44-2 would include both the Qualitative Test discussed above and a quantitative standard for purposes of determining whether a person meets the definition of a government securities dealer (the "Quantitative Test"). The Quantitative Test is a bright-line test and would apply regardless of whether the person meets any of the standards contained in the Qualitative Test. Proposed Rule 3a44-2 otherwise would use the same definition of "person," the same exclusions for persons with less than $50 million in assets and for registered investment companies, and the same provisions regarding registered investment advisers.

Under the Quantitative Test, a person would be deemed to be acting as a government securities dealer if, as a part of a regular business that person purchases and sells for its own account, in each of four of the last six calendar months, more than $25 billion of trading volume in government securities as defined in Section 3(a)(42)(A) of the Exchange Act.[24] In determining whether the $25 billion threshold is met, the Proposing Release states that a market participant would include transactions in U.S. Treasury securities that are currently reported to TRACE (Treasury bills, notes, floating rate notes, bonds, TIPS, and STRIPS) and would exclude auction awards and repurchase or reverse repurchase transactions in U.S.

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22 Proposing Release at 56 n.154, 87 Fed. Reg. at 23,068 n.154.

23 The SEC has recently proposed to define the term "trading venue" to mean: "a national securities exchange or national securities association that operates an SRO trading facility, an ATS, an exchange market maker, an OTC market maker, a futures or options market, or any other broker-or dealer-operated platform for executing trading interests internally by trading as principal or crossing orders as agent." Proposing Release at 60-61, 87 Fed. Reg. at 23,069. The definition is designed to capture a broad array of trading venues, ranging from national securities exchanges and ATSs to Communication Protocol Systems (i.e., electronic systems that offer the use of non-firm trading interest and make available communication protocols to bring together buyers and sellers of securities but do not fall within the current definition of an "exchange."). Proposing Release at 61, 87 Fed. Reg. at 23,070.

24 Section 3(a)(42)(A) of the Exchange Act defines government securities to mean securities which are direct obligations of, or obligations guaranteed as to principal or interest by, the United States. See 15 U.S.C. 78c(a)(42)(A). The SEC notes in the Proposing Release that "PTFs dominate the interdealer U.S. Treasury market, representing 61 percent of the trading activity on the electronic IDB platforms and 48 percent of the total interdealer market." Proposing Release at 70, 87 Fed. Reg. at 23,072.

Treasury securities.[25] The Proposing Release explains that the need to link dealer status to trading quantity is "most acute" in respect to trading of U.S. Treasury Securities because access to that market is not dependent on being a broker-dealer. The SEC explains that, by contrast, a quantitative test may not be needed in determining dealer status in relation to equity securities since direct access to exchange trading, where a substantial amount of the equity trading volume takes place, is limited to broker-dealers.

Definition of "own account"

Under the Proposed Rules, a person's "own account" would encompass any account that is:

(i) held in the name of that person; or

(ii) held in the name of a person over whom that person exercises control or with whom that person is under common control, but excluding:

(A) an account in the name of a registered broker, dealer, or government securities dealer, or a registered investment company; or

(B) with respect to an investment adviser registered under the Advisers Act, an account held in the name of a client of the adviser unless the adviser controls the client as a result of the adviser's right to vote or direct the vote of voting securities of the client, the adviser's right to sell or direct the sale of voting securities of the client, or the adviser's capital contributions to or rights to amounts upon dissolution of the client; or

(C) with respect to any person, an account in the name of another person that is under common control with that person solely because both persons are clients of an investment adviser registered under the Advisers Act unless those accounts constitute a parallel account structure; or

(iii) held for the benefit of those persons identified in (i) and (ii) above.

The Proposed Rules would incorporate the definition of "control" under Exchange Act Rule 13h-1.[26]

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[25] Proposing Release at 72, 87 Fed. Reg. at 23,072.

[26] Exchange Act Rule 13h-1(a)(3) states that control (including the terms controlling, controlled by and under common control with) means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of securities, by contract, or otherwise. For purposes of this section only, any person that directly or indirectly has the right to vote or direct the vote of 25 percent or more of a class of voting securities of an entity or has the power to sell or direct the sale of 25 percent or more of a class of voting securities of such entity, or in the case of a partnership, has the right to receive, upon dissolution, or has contributed, 25 percent or more of the capital, is presumed to control that entity." 17 C.F.R. 240.13h-l(a)(3). The definition of control in Rule 13h-1 is based on the definition

Treatment of Managed Accounts and Funds as "Dealers" due to a Parallel Account Structure

Under the Proposed Rules, a person under common control with another person solely because both persons are clients of a registered investment adviser would not aggregate their trading activities and volume to determine if each meets the Proposed Rules, unless those accounts constitute a "parallel account structure." The term "parallel account structure" is defined in the Proposed Rules to mean a structure in which one or more private funds, accounts, or other pools of assets managed by the same investment adviser pursue substantially the same investment objective and strategy and invest side by side in substantially the same positions.[27] The proposed requirement to aggregate the trading activity in accounts that are managed in a parallel account structure is intended to prevent a registered investment adviser from avoiding the requirements of the Proposed Rules by dividing trading among multiple clients such that their respective trading activities failed to meet the Qualitative Test or the Quantitative Test.

Although a person that meets the Qualitative Test or the Quantitative Test in the Proposed Rules is not subject to the Proposed Rules if such person has or controls total assets of less than $50 million, the SEC's approach to account aggregation could affect such persons. In particular, the accounts of persons under the $50 million threshold must be considered for purposes of determining whether another person's trading activities or volume falls within the qualitative or quantitative standards. Consequently, a person must consider for aggregation purposes any accounts (including those under $50 million) that are controlled by, or under common control with, that person. The Proposing Release states that the SEC believes that requiring aggregation of accounts of those persons that have or control less than $50 million in total assets would prevent the organizing of corporate structures for the purpose of avoiding dealer registration. In the Proposing Release, the SEC also expresses concern that a registered investment adviser could create a parallel fund structure in which one or more private funds pursue substantially the same investment objective and strategy and invest side by side in substantially the same positions as another private fund but avoid dealer registration because each fund, on a stand-alone basis, does not meet the Qualitative Test or Quantitative Test, even though the funds' trading activities in the aggregate are part of a single trading strategy.

No Presumption

The Proposed Rules do not seek to address all persons that may be acting as dealers or government securities dealers under otherwise applicable interpretations and precedent. As such, a person that does not meet the conditions set forth in the Proposed Rules may nonetheless be a dealer if it is otherwise engaged in a regular business of buying and selling securities for its own account by, for example, acting as an underwriter. The SEC notes that liquidity providers should typically be viewed as dealers.

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of control in Form 1 (Application for the Registration or Exemption from Registration as a National Securities Exchange) and Form BD (Uniform Application for Broker-Dealer Registration).

[27] Proposing Release at 83, 87 Fed. Reg. at 23,075.

Trader Exception and other Exceptions from Dealer Registration

In the Proposing Release, the SEC confirms that existing statutory and regulatory exceptions from dealer and government securities dealer registration would continue to apply if the Proposed Rules were adopted. For example, the SEC notes in the Proposing Release that a foreign broker-dealer operating pursuant to Rule 15a-6 under the Exchange Act (or under the analogous exemption under the Treasury rules for foreign government securities dealers) would not be required to register as a dealer (or government securities dealer) even though the activity-based standards provided under the Proposed Rules were met.[28]

Although the Proposing Release acknowledges that the statutory exception for traders would continue to apply to exclude individuals and firms from dealer registration, the language in the Proposed Rules, as well as the language in the Proposing Release, appears to interpret the exception more narrowly than it has been interpreted in the past. In addition, many of the SEC's descriptions of "trader" activity are open-ended and ambiguous. For example, the SEC notes that traders do not make markets in securities and trade with less frequency than dealers. However, the discussion later indicates that a person may be a "dealer" and not a trader even though the person does not intend to serve as a liquidity provider if the person's activities have the effect of providing liquidity.[29]

Compliance Period

The SEC proposes to provide a one-year compliance period from the effective date of any final rules for persons captured by the Proposed Rules to apply for dealer registration, and for the relevant self-regulatory organizations to conduct their review of the new member applications.

Conclusion

If adopted substantially as set forth in the Proposing Release, the Proposed Rules would significantly expand the range and number of market participants required to register as dealers or government securities dealers under the Exchange Act.

During the recently ended comment period, the SEC received forty-eight letters, many of which were critical of the proposal. A common theme in the comment letters is that the Proposed Rules would reduce market liquidity and potentially drive participants away from the securities markets and into the futures markets.[30] Commenters also indicated

[28] Proposing Release at 11, 87 Fed. Reg. at 23,056.

[29] Proposing Release at 31, 87 Fed. Reg. at 23,062.

[30] *See, e.g.*, AlphaWorks Capital Management, Comment Letter (May 27, 2022).

that the Proposed Rules rely on ambiguous definitions that could have unintended, adverse consequences for market participants.[31]

Given the generally negative reception shown by the market to the Proposed Rules as well as the large number of rulemakings that the SEC has proposed in recent months, it is not clear whether the Proposed Rules will be adopted substantially as proposed and, if so, when this would happen. If adopted as proposed, however, the Proposed Rules and attendant threat of substantially enhanced regulation of trading activities is likely to have a chilling effect on the market activities of many participants who should be expected to revamp their activities to fall outside of the expanded concepts of dealer status. Such an outcome is likely to reduce available liquidity in the markets, particularly in times of turmoil as we have recently witnessed, when certain private funds and institutional investors have stepped in to provide investment to distressed entities and greater liquidity to the market generally.

If you have any questions regarding this client alert, please contact the following attorneys or the Willkie attorney with whom you regularly work.

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[31] *See, e.g.*, Virtu Financial, Inc., Comment Letter (May 27, 2022).