

SEC Rulemaking Update Expanded Definition of Dealer Final Rulemaking

On February 6, 2024, the Securities and Exchange Commission (**SEC**) adopted final rules that expand the definition of a “dealer” and “government securities dealer” under the Securities Exchange Act of 1934 to include market participants that take on significant liquidity-providing roles. Under the rulemaking, the SEC adopted two new rules to further define what it means to be engaged in the business of buying and selling securities “as a part of a regular business.” The SEC noted the need for rulemaking, due to advancements in electronic trading that have led to the emergence of certain market participants that play an increasingly significant liquidity-providing role in overall trading and market activity. Such activities would entail these participants to register as dealers. Under the new rules, with certain exceptions (including for registered investment companies) any person or entity that engages in the following activities would be considered a dealer or government securities dealer and would be required to register with the SEC and become a member of a self-regulatory organization (**SRO**).

- 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.

Proposed Rules 3a5-4 and 3a44-2 were designed to define the types of activities that would cause a person to be regarded as a de facto market maker and therefore subject to registration as a dealer under sections 15 and 15C of the Exchange Act. Specifically, under the Proposed Rules, a person would be engaged in buying and selling securities for its “own account” (as defined in the Proposed Rules) “as a part of a regular business” and so a dealer or a government securities dealer, if that person engages in a routine pattern of buying and selling securities (or government securities) that has the effect of providing liquidity to other market participants. The Proposed Rules further identified three types of activities that would be considered to have the effect of providing liquidity to other market participants: (i) routinely making roughly comparable purchases and sales of the same or substantially similar securities (or government securities) in a day; or (ii) 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 (iii) 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.

Many in the asset management industry expressed concern during the comment period that the definition of “own account” would inappropriately apply the dealer regime to private funds and registered investment advisers and that the proposed exclusion for registered investment companies should be expanded to registered investment advisers and to private funds managed by registered investment advisers. Commenters further expressed concern that the rulemaking exceeded the SEC’s authority and did not adequately address the economic implications of the rules. In the adopting release, the SEC noted modifications they made to more appropriately tailor the scope of the final rules to address various concerns raised by commenters and appropriately require only entities engaging in de facto market-making activity to register as dealers. Nevertheless, a legal challenge was promptly filed by various hedge fund industry groups in the U.S. District Court for the Northern District of Texas seeking to vacate the rulemaking, noting that the new rules were vague and overly broad and dramatically expanded to the long-standing definition of a dealer.

The effective date for the rule was April 29, 2024, and the compliance date is set for one year from the effective date. It will remain to be seen whether the court vacates the rulemaking as requested, or whether the SEC otherwise voluntarily stays or modifies the new rules.

See Final Rule – <https://www.sec.gov/rules/2022/03/further-definition-a-part-a-regular-business-definition-dealer-and-government>