October 19, 2022

Vanessa A. Countryman, Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090
VIA ELECTRONIC MAIL: rule-comments@sec.gov

Re.: Further Definition of "As a Part of a Regular Business" in the Definition of Dealer and Government Securities Dealer, File Number S7-12-22

The Committee on Capital Markets Regulation (the "**Committee**") is grateful for the opportunity to provide comments to the U.S. Securities and Exchange Commission (the "**SEC**") on the above-captioned notice of proposed rulemaking (the "**Proposal**"), which would reshape the definitions of "dealer" and "government securities dealer" under the Securities Exchange Act of 1934 (the "**Exchange Act**").[1] We appreciate the SEC's consideration of our views, which we submit after the comment deadline in light of our members' continued concerns with the Proposal and its potential impact on the U.S. Treasury markets.

Founded in 2006, the Committee is dedicated to enhancing the competitiveness of U.S. capital markets and ensuring the stability of the U.S. financial system. Our membership includes thirty-seven leaders drawn from the finance, investment, business, law, accounting, and academic communities. The Committee is chaired jointly by R. Glenn Hubbard (Emeritus Dean, Columbia Business School) and John L. Thornton (Former Chairman, The Brookings Institution) and is led by Hal S. Scott (Emeritus Nomura Professor of International Financial Systems at Harvard Law School and President of the Program on International Financial Systems). The Committee is an independent and nonpartisan 501(c)(3) research organization, financed by contributions from individuals, foundations, and corporations.

The Committee has four significant concerns with the Proposal. First, if enacted, the Proposal would reduce liquidity in the U.S. Treasury markets potentially increasing the severity and frequency of significant volatility in such markets with negative implications for financial stability. Second, the Proposal disregards fundamental conflicts and incompatibilities with applying dealer regulation to advisers and private funds. Third, we believe the SEC has exceeded its statutory authority in issuing the Proposal, which is inconsistent with the language and historical understanding of the Exchange Act. Finally, the SEC fails to adequately assess the Proposal's costs and benefits.

This letter begins by briefly summarizing the Proposal. It then describes each of our five major concerns. It concludes by recommending that the SEC defer finalizing the Proposal until the SEC has provided a full analysis of its statutory foundations and of the Proposal's costs and benefits. At a minimum, the Proposal should be revised to omit the proposed quantitative test, significantly clarify the qualitative tests, and exempt advisers and private funds from the Proposal.

---

[1] U.S. SEC. & EXCH. COMM'N, *Further Definition of "As a Part of a Regular Business" in the Definition of Dealer and Government Securities Dealer*, Release No. 34-94524; File No. S7-12-22 (Mar. 28, 2022), https://www.sec.gov/rules/proposed/2022/34-94524.pdf ["**Proposed Rule**"].

I. Overview of the Proposal

Under the Exchange Act, a "dealer" or "government securities dealer" is defined to include a person that "is engaged in the business of buying and selling securities [or government securities]" for its "own account" "as part of a regular business."[2] A dealer is generally required to register with the SEC, become a member of a self-regulatory organization, and comply with various legal and regulatory requirements applicable to dealers.[3]

The Proposal would further define the term "as a part of a regular business" under the Exchange Act to require certain proprietary trading firms, investment advisers and private funds to register with the SEC as dealers and comply with the attendant legal and regulatory obligations.[4] The Proposal would not apply to registered investment companies.[5] The stated purpose of the Proposal is to apply the risk management and disclosure obligations that currently apply to dealers to these additional market participants to (according to the SEC) enhance the resiliency of liquidity providers and securities markets. The SEC claims the Proposal would do so by requiring a person to register as a dealer or government securities dealer if any of three new qualitative *tests* were satisfied.[6] Separately, it would require a person to register as a government securities dealer if a new quantitative *test* were satisfied.[7] Each of these four new tests is briefly summarized below.

Qualitative Tests

Under the Proposal, a person would be required to register as a dealer (or government securities dealer) if it "engages in a routine pattern of buying and selling securities [or government securities] that has the effect of providing liquidity to other market participants."[8] The Proposal identifies three types of activities that would be considered to have such an effect, thereby triggering registration requirements:

1) Routinely making roughly comparable purchases and sales of the same or substantially similar securities in a day; or
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; or
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.[9]

[2] *See* 15 U.S.C. § 78c(a)(5)(A); 15 U.S.C. § 78c(a)(44).
[3] *See* U.S. SEC. & EXCH. COMM'N, *Guide to Broker-Dealer Registration* (April 2008), https://www.sec.gov/reportspubs/investor-publications/divisionsmarketregbdguidehtm.html.
[4] Proposed Rule, *supra* note 1, at 4.
[5] Proposed Rule, *supra* note 1, at 33-34.
[6] Proposed Rule, *supra* note 1, at 30-31.
[7] Proposed Rule, *supra* note 1, at 31.
[8] Proposed Rule, *supra* note 1, at 42.
[9] Proposed Rule, *supra* note 1, at 42.

Quantitative Test

The Proposal would also require a market participant to register as a government securities dealer if its trading volumes in government securities exceeded a new, bright-line threshold. Under the Proposal, a person would need to register as a government securities dealer if "[i]n each of four out of the last six calendar months, [they] engaged in buying and selling more than $25 billion of trading volume in government securities."[10] This would require participants in the U.S. Treasury market, such as private funds that are the *customers* of dealers, to register as government securities dealers, if their monthly trading volume exceeds the $25 billion threshold.[11]

II. Analysis

A. The Proposal could result in substantial harm to U.S. Treasury markets.

The Proposal's breadth and vagueness is likely to result in restricted trading activity among important participants in the U.S. Treasury markets such as investment advisers and private funds, which would impair market quality and outcomes for investors.

The threshold of $25 billion in *monthly* trading volumes[12] is very low, considering that the Treasury market's *daily* trading volume is roughly $675 billion. Implicated firms, such as private funds that routinely transact in the U.S. Treasury market as part of long-term investment strategies, are therefore more likely to restrict their trading and investing activities in Treasuries to avoid exceeding the SEC's threshold.[13] Similarly, the Proposal's broad qualitative tests that would classify firms as dealers for activities that (in the SEC's view) "have the effect of providing liquidity to other market participants" are inherently opaque, leading to significant regulatory uncertainty and generally discouraging trading in Treasury markets by market participants seeking to stay outside of the dealer registration regime.[14]

The consequences for the U.S. Treasury markets of a pullback in liquidity from beneficial trading and investing activities could be substantial. For example, U.S. Treasury markets faced significant illiquidity in March 2020 during the COVID-19 crisis. Such events could become more severe and more frequent if fewer market participants are able to freely transact. Moreover, the U.S. Treasury market's continuing growth and the Federal Reserve's planned reduction of its Treasury holdings further exacerbate this illiquidity risk. Broader consequences for the financial system and economy could result. Less liquid, less efficient U.S. Treasury markets could ultimately increase funding costs for the U.S. government and jeopardize the central role that Treasuries play in the global financial system.

---

[10] Proposed Rule, *supra* note 1, at 68-69.
[11] *See* Proposed Rule, *supra* note 1, at 70.
[12] Specifically, a firm must register as a dealer if "[i]n each of four out of the last six calendar months, [it] engaged in buying and selling more than $25 billion of trading volume in government securities." Proposed Rule, *supra* note 1, at 68-69.
[13] MANAGED FUNDS ASSOCIATION, *Letter to U.S. Sec. & Exch. Comm'n (File No. S7-12-22)*, at 3-4 (May 27, 2022), https://www.sec.gov/comments/s7-12-22/s71222-20129911-296085.pdf.
[14] Proposed Rule, *supra* note 1, at 42.

B. The Proposal disregards fundamental conflicts and incompatibilities with applying dealer regulation to advisers and private funds.

The Proposal disregards fundamental conflicts and incompatibilities with applying dealer regulation to advisers and private funds; this oversight would create significant costs for market participants and the U.S. Treasury markets.

Private funds and investment advisers are *customers* of broker-dealers and receive a variety of key customer protections as a result. For example, brokers are subject to a best execution obligation with respect to customer orders,[15] suitability requirements for recommendations to customers,[16] and obligations to provide customers with fair prices.[17] Similarly, SEC Rule 15c3-3 requires a broker-dealer to take certain heightened asset protection measures with respect to customer funds and securities.[18] Critically, these regulatory protections turn on an entity's "customer" status, and registered dealers do *not* qualify as "customers" under the rules.[19] Therefore, a private fund required to register as a dealer would forfeit these protections, to the detriment of the fund and its underlying investors.

Requiring certain funds to register as dealers could also jeopardize their ability to invest in U.S. IPOs. Under FINRA Rule 5130, a broker-dealer is generally prohibited from selling U.S. initial public offerings to an account in which a "restricted person" has a beneficial interest.[20] Registered dealers constitute "restricted persons" under this rule,[21] so funds subject to the Proposal would not be permitted to take part in such offerings.

Implicated firms, such as private funds that are important customers in the U.S. Treasury market, are therefore likely to seek to stay outside of the dealer registration regime, which means curtailing current activities in the Treasury market given the breadth and vagueness of the Proposal.

C. The Proposal raises significant issues for bank holding companies without examining or addressing those issues.

Although the Proposal focuses on principal trading firms, the Proposal could have severe (if unintended) consequences for bank holding companies ("**BHCs**"), and the Proposal does not examine or address these significant consequences.[22]

---

[15] *See* FIN. IND. REG. AUTH., *FINRA Rule 5310: Best Execution and Interpositioning* (last amended May 9, 2014), https://www.finra.org/rules-guidance/rulebooks/finra-rules/5310.
[16] *See* FIN. IND. REG. AUTH., *FINRA Rule 2111: Suitability* (last amended June 30, 2020), https://www.finra.org/rules-guidance/rulebooks/finra-rules/2111.
[17] *See* FIN. IND. REG. AUTH., *FINRA Rule 2121: Fair Prices and Commissions* (last amended May 9, 2014), https://www.finra.org/rules-guidance/rulebooks/finra-rules/2121.
[18] *See* 17 C.F.R. § 240.15c3-3.
[19] *See, e.g.*, 17 C.F.R. § 240.15c3-3(a)(1).
[20] FIN. IND. REG. AUTH., *FINRA Rule 5130: Restrictions on the Purchase and Sale of Initial Equity Public Offerings* (last amended Jan. 1, 2020), https://www.finra.org/rules-guidance/rulebooks/finra-rules/5130.
[21] *Id.* at Section (i)(10).
[22] *See* SEC. IND. AND FIN. MKTS ASS'N, *Letter to the U.S. Sec. & Exch. Comm'n re: File No. S7-12-22* (May 27, 2022), https://www.sec.gov/comments/s7-12-22/s71222-20130062-296717.pdf.

First, BHCs typically engage in securities trading across a wide range of subsidiaries for a number of reasons, such as investment, hedging, and liquidity management. Subject to limited exceptions, the Proposal would require BHC subsidiaries to aggregate their trading activities with affiliates under common control when determining whether they meet the qualitative or quantitative tests for dealer registration.[23] As a result, even if no *single* subsidiary is engaged in dealing activity, if a BHC's *aggregated* subsidiaries meet the qualitative or quantitative test, then *each* subsidiary could be required to register as a dealer.[24] For example, if one subsidiary purchases a security for investment purposes and another subsidiary shorts that security to hedge against risk, then neither subsidiary alone is acting as a dealer; but if you aggregate the purchase and sale together, then they could be "roughly comparable purchases and sales" of the same security on the same day under the qualitative test.[25] The Proposal has not examined the significant and unnecessary burden aggregation could impose on BHCs, including how this burden may conflict with other regulatory and supervisory frameworks applicable to BHCs.

Second, BHCs regularly purchase and sell securities to carefully manage their balance sheets, liquidity profiles, and collateral, including in inter-affiliate transactions designed to centrally manage cash and risk within the consolidated organization. Although these activities are not designed or intended to provide liquidity to other market participants, the Proposal appears to capture them in its tests for dealer registration and extend dealer registration requirements to them. The Proposal does not examine whether these activities should be treated as "dealer" activities, the cost of treating them as such, and the way in which doing so raises issues under the Volcker Rule.[26]

D. The Proposal exceeds the SEC's statutory authority and departs from past practice.

While the SEC has the authority to define terms in the Exchange Act,[27] we believe the agency has exceeded its authority in issuing the Proposal, which defies historical precedent and the plain language of the Exchange Act and would conflict with longstanding legal and regulatory interpretations of the terms "dealer" and "government securities dealer."

The Exchange Act provides an exception to its definition of "dealer" for "a person that sells securities… for such person's own account, either individually or in a fiduciary capacity, but not as part of a regular business."[28] The SEC has never viewed one aspect of a firm's trading activity as determinative.[29] And, unsurprisingly, a dealer (like a broker) has traditionally been viewed as an entity whose trading activities are for the purpose of serving customers.

---

[23] Proposed Rule, *supra* note 1, at 78-79.
[24] *See* SEC. IND. AND FIN. MKTS ASS'N, *Letter to the U.S. Sec. & Exch. Comm'n re: File No. S7-12-22*, at 3 (May 27, 2022), https://www.sec.gov/comments/s7-12-22/s71222-20130062-296717.pdf.
[25] Proposed Rule, *supra* note 1, at 42.
[26] *See* SEC. IND. AND FIN. MKTS ASS'N, *Letter to the U.S. Sec. & Exch. Comm'n re: File No. S7-12-22*, at 7 (May 27, 2022), https://www.sec.gov/comments/s7-12-22/s71222-20130062-296717.pdf.
[27] *See* 15 U.S.C. § 78c(b).
[28] *See* 15 U.S.C. 78c(a)(5)(B); 15 U.S.C. 78c(a)(44)(A).
[29] *See* U.S. SEC. & EXCH. COMM'N, *Guide to Broker-Dealer Registration*, at Section II.B (April 2008), https://www.sec.gov/reportspubs/investor-publications/divisionsmarketregbdguidehtm.html. *See also* Robert L.D. Colby, Lanny A. Schwartz, Zachary J. Zweihorn, *What Is a Broker-Dealer?*, at 2-63 (July 25, 2016), https://www.davispolk.com/sites/default/files/whats_a_broker_dealer_2.pdf ("The practical distinction between a 'trader' and a 'dealer' is often difficult to make and depends substantially upon all of the relevant facts and circumstances of a given situation.").

Yet the SEC now departs radically from this historical understanding and proposes to create four irrebuttable "tests," each of which could alone trigger dealer registration requirements. The *quantitative* threshold, which incorporates no substantive analysis of the nature of a firm's trading activity, represents a particularly significant departure from precedent. Indeed, the SEC has itself issued no-action letters that expressly reject a volume-based dealer designation.[30] More troubling, a volume-based threshold is unsupported by the language of the Exchange Act. The statute's definition of dealer refers to "buying **and** selling" securities—a dealer does not trade on only one side of the market, and courts have made clear that the word "and" indicates a degree of "temporal proximity" between the purchases and sales.[31] However, the SEC's quantitative test would impose dealer registration requirements on an investor whose "trading volume" in government securities in four of the past six months exceeded $25 billion, even if 99% of its orders were buys and only a single order to sell was entered each month. This new definition bears little resemblance to the dealers that Congress, the courts, and the SEC have traditionally sought to regulate and is at odds with the statutory text.

E. The SEC fails to adequately assess the costs and benefits of the Proposal.

The SEC's cost-benefit analysis does not address the costs to impacted market participants and even greater indirect impact on the U.S. Treasury markets if impacted entities restrict their trading activities in response to the Proposal, which could significantly undermine the resiliency and efficiency of the U.S. Treasury markets.[32]

In addition, the Proposal overstates its purported benefits. The SEC asserts that the Proposal will "promote the financial and operational resilience of individual liquidity providers in securities markets" and "improve transparency," among other benefits.[33] However, it fails to specifically describe how dealer registration is necessary to achieve these objectives and overlooks the role of existing regulatory frameworks in furthering these goals. For example, the Proposal does not consider how existing regulatory requirements applicable to investment advisers (such as examination, custody, and registration requirements) already contribute to resiliency and transparency, or how applying dealer requirements to these advisers could in certain respects be duplicative. Similarly, it does not recognize that private funds primarily trade with or through registered broker-dealers—these transactions are therefore already subject to risk management requirements and reported by the transacting broker-dealers. The SEC fails to identify the incremental benefit of directly imposing such requirements on private funds.

III. Conclusion

In light of the Proposal's significant, unjustified costs and questionable statutory authority, the Committee recommends that the SEC defer finalizing the Proposal until it has publicly released

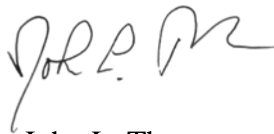
[30] *See* U.S. SEC. & EXCH. COMM'N, *SEC Staff No-Action Letter re: United Trust Company* (Sept. 6, 1978) ("the level of a firm's activity with respect to . . . securities is not the measure of whether it is 'engaged in the business' of buying and selling . . . securities for its own account"); U.S. SEC. & EXCH. COMM'N, *SEC No-Action Letter re: US Savings Association of Texas* (Apr. 2, 1987) (discussing the Congressional record).
[31] *See e.g.*, Lake Building Products, Inc. v. Secretary of Labor, 958 F.3d 501, 505 (6th Cir. 2020).
[32] Proposed Rule, *supra* note 1, at 95 et seq.
[33] Proposed Rule, *supra* note 1, at 96.

full analyses of the Proposal's statutory foundations, as well as its costs and benefits. At a minimum, the Proposal should be revised to omit the proposed quantitative test, significantly clarify the qualitative tests, and exempt advisers, subsidiaries of bank holding companies and private funds.

* * *

Thank you very much for your consideration of the Committee's position. Should you have any questions or concerns, please do not hesitate to contact the Committee's President, Professor Hal S. Scott (hscott@law.harvard.edu), or its Executive Director, John Gulliver (jgulliver@capmktsreg.org), at your convenience.

Respectfully submitted,



John L. Thornton
CO-CHAIR

Hal S. Scott
PRESIDENT

R. Glenn Hubbard
CO-CHAIR