

CLIENT ALERT

What's the Deal? SEC Expands "Dealer" Definition

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On February 6, 2024, the Securities and Exchange Commission (SEC) in a 3-2 vote adopted new Rules 3a5-4 and 3a44-2 (collectively, the "New Rules"), which expand the definition of a "dealer" and "government securities dealer" under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). In short, the final rules require market participants that take on significant liquidity-providing roles to register with the SEC, become members of a self-regulatory organization, and comply with federal securities laws and regulatory obligations.

Existing Section 3(a)(5) of the Exchange Act, defines a "dealer" as "any person engaged in the business of buying and selling securities . . . for such person's own account through a broker or otherwise." Moreover, the Exchange Act excludes from the definition of "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" (emphasis added). The Exchange Act provides similar language for government securities dealers.

The New Rules narrow the above exception by clarifying the language "as a part of a regular business" by effectively establishing two qualitative standards. Specifically, a person that buys and sells securities "for its own account" is engaged in that activity "as a part of a regular business" if such person engages in a regular pattern of buying and selling securities that has the effect of providing liquidity to other market participants by:

- Regularly expressing trading interests that is at or near the best available prices on both sides of the market and 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 a liquidity-supplying trading interest.

The New Rules define "own account" as any account held in the name of or for the benefit of the applicable person. The New Rules exclude any persons who have or control total assets of less than \$50 million, registered investment companies, central banks, sovereign entities, and "international financial institutions" (as defined in the New Rules). Notably, there is no carveout for registered investment advisers or their private funds. The New Rules' adopting release notes that hedge funds are more likely to meet the New Rules' definition of dealing, although private equity funds and liquidity funds are less likely. Additionally, the New Rules emphasize that there is no presumption that a person is not a "dealer" solely because they do not satisfy the requirements of the New Rules.

The New Rules will become effective 60 days following the publication of the adopting release in the Federal Register. Firms that, by operation of the New Rules, must register as dealers with the SEC must do so within one year of the effective date of the New Rules.

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