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## Traders Now May Be Dealers Under SEC'S New Dealer Rules

C. Dirk Peterson  
McIntyre & Lemon

In a 3-2 split vote at today's open meeting, the Securities and Exchange Commission ("SEC" or "Commission"), adopted controversial new rules that establish a liquidity or revenue test as part of a regular dealer business under the Securities Exchange Act of 1934 ("Exchange Act"). That is, the tests prescribed by the new dealer rules are intended to capture so-called "liquidity providers" primarily focused on the Treasury markets but they also sweep in certain traders in the equity markets. These market participants, some heretofore permissibly acting as unregulated traders, may now be regulated as registered "dealers" subject to Exchange Act and self-regulatory organization broker-dealer rules. The impact of the rules will be to register principal or proprietary trading firms, private trading funds, and other unregistered pools (*e.g.*, bank collective or common trust funds) that are captured by the rules' modified liquidity and revenue tests. Additionally, based on a previously obscure amendment to an Exchange Act rule adopted this past summer, the SEC now directs those traders captured by the dealer rules to mandatory membership in the Financial Industry Regulatory Authority, a costly and time-consuming (about six-month) administrative process.

The Commission announced modifications to the rules' liquidity tests by eliminating one of the proposed qualitative tests and the proposed quantitative test for Treasury securities. The new rules also eliminate the complicated aggregation tests in a modified definition of account. The Commission replaced those complex rules with anti-evasion proscriptions. Thus, the following liquidity tests will identify a regular dealer business to the extent the market participant:

- Regularly expresses trading interests that are at or near the best available prices on both sides of the market in the same security and that are communicated and represented in a way that makes them accessible to other market participants; or
- Earns revenue primarily by capturing the bid-ask spreads, by buying at the bid and selling at the offer, or receives any incentives offered by trading venues to liquidity-supplying trading interests.

The Commission also expanded slightly the exemption that, as proposed, applied solely to small market participants owning or controlling assets of less than \$50 million and investment companies registered with the SEC under the Investment Company Act of 1940. In addition to those exempt market participants, the exemption extends to certain central banks, sovereign entities (federal, state, and international central governments) but not to sovereign wealth funds, and international financial institutions that might be captured by the new liquidity or revenue tests. The SEC has posted the adopting release and other documents regarding the rule on its website:

**Final Rule:** [Further Definition of “As a Part of a Regular Business” in the Definition of Dealer and Government Securities Dealer in Connection with Certain Liquidity Providers](#)

[SEC.gov | SEC Adopts Rules to Include Certain Significant Market Participants as “Dealers” or “Government Securities Dealers”](#)

We will also will publish a more comprehensive analysis based on the Commission’s discussion in the adopting release. Please do not hesitate to contact C. Dirk Peterson at [dpeterson@mcintyrelf.com](mailto:dpeterson@mcintyrelf.com) for more information.

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**C. Dirk Peterson**

OF COUNSEL

☎ 202-659-3905

✉ [dpeterson@mcintyrelf.com](mailto:dpeterson@mcintyrelf.com)

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[mcintyrelf.com](http://mcintyrelf.com)