

SEC Expands Definitions of 'Dealer' and 'Government Securities Dealer' to Adapt to Modern Market Practices

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On Feb. 6, the Securities and Exchange Commission (SEC) announced two new rules that expanded the definition of “dealer” and “government securities dealer” under the Securities Exchange Act of 1934 (Exchange Act). These updates mark a significant broadening of the definitions, aiming to adapt to evolving market practices and enhance oversight in the securities industry. Under the new final rules, any person who engages in activities as described will, absent an applicable exemption, be required to: (i) register with the SEC under Section 15(a) or Section 15(c) of the Exchange Act, as applicable; (ii) become a member of a self-regulatory organization (SRO) such as the Financial Industry Regulatory Authority; and (iii) comply with federal securities laws and regulatory obligations as well as applicable SRO and Treasury rules and requirements.

Background

In the final rules, the SEC expressed concern that recent advancements in electronic trading across securities markets have led to the emergence of certain market participants who play an increasingly significant liquidity-providing role in overall trading and market activity—a role that has traditionally been performed by entities regulated as dealers or government securities dealers under Sections 3(a)(5) and 3(a)(44) of the Exchange Act, respectively. However, some of these market participants, despite engaging in liquidity-providing activities and despite their significant share of market volume, are not registered as either dealers or government securities dealers.

Key Changes

The new rules set forth parallel qualitative standards, which are designed to identify market participants who take on significant liquidity-providing roles. Notably, the SEC did not include the initially proposed quantitative standards in the final rules. Under the final rules, any person

who engages in any of the following activities as part of a regular business would be a “dealer” or “government securities dealer”:

- 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
- 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

No presumption shall arise that a person is not a dealer or government securities dealer solely because that person does not engage in the activities identified in the final rules. The final rules exclude any person who has or controls total assets of less than \$50 million. The final rules further exclude investment companies registered under the Investment Company Act of 1940 as well as central banks, sovereign entities, and international financial institutions (as defined in the final rules).

Implications

The expanded definitions have several significant implications for market participants and regulatory compliance:

1. **Increased regulatory coverage:** By broadening the definitions of “dealer” and “government securities dealer,” the SEC aims to enhance regulatory coverage and oversight over securities market participants. This move is likely to lead to increased scrutiny and enforcement actions, as the SEC seeks to ensure compliance with these new regulatory requirements.

2. Clarity and transparency: The new rules are intended to provide greater clarity and transparency regarding the regulatory obligations of entities engaged in securities trading and dealing activities. Market participants can now better understand their regulatory responsibilities and take appropriate steps to ensure compliance with the updated definitions.

Conclusion

The new rules announced by the SEC expand the definitions of “dealer” and “government securities dealer.” Many different types of market participants are potentially implicated by these expanded definitions, including (but not limited to) family offices and investment fund managers that have more than \$50 million in assets under management. These market participants should

carefully review the new rules and assess the potential impact on their operations and whether they now need to register as a dealer or government securities dealer. Becoming a registered dealer or government securities dealer can result in heightened regulatory scrutiny and additional compliance costs.

The final rules will become effective 60 days following the date of publication of the adopting release. The compliance date for the final rules will be one year after the effective date of the final rules.

For further information on the matters discussed herein, please contact any of the attorneys listed or any other member of Lowenstein Sandler’s Investment Management Group.

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