ELEMENT CAPITAL

May 27, 2022

Via Electronic Submission
Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, D.C. 20549-1090

Re: Release No. 34-94524; File No. S7-12-22; Further Definition of "As a Part of a Regular Business" in the Definition of Dealer and Government Securities Dealer

I. INTRODUCTION

Element Capital Management LLC ("Element Capital" or "Element") welcomes the opportunity to comment on the Securities and Exchange Commission (the "Commission" or the "SEC") Release No. 34-94524, File No. S7-12-22; "*Further Definition of "As a Part of a Regular Business" in the Definition of Dealer and Government Securities Dealer*" (the "Release"), which propose to enact Rules 3a5-4 ("Rule 3a5-4") and 3a44-2 ("Rule 3a44-2", and together with Rule 3a5-4, the "Proposed Rules") under the Exchange Act of 1934, as amended (the "Exchange Act").

1.1 About Element Capital

Element Capital is registered as an investment adviser with the SEC and as a commodity pool operator with the Commodity Futures Trading Commission. Its affiliate, Element Capital Partners LLP, is authorized and regulated by the U.K. Financial Conduct Authority. Element Capital manages the Element Capital Master Fund Limited and its associated feeder funds (collectively, the "Element Capital Fund"). The Element Capital Fund launched in 2005 and employs a global macro investment strategy. Element Capital expresses its macro views using primarily fixed income, foreign exchange and equity instruments. Investors in the Element Capital Fund are principally institutional investors, including, but not limited to, corporate and public pension funds, sovereign wealth funds, endowments, foundations, family offices and fund of funds.

1.2 Element Capital's concerns about the Proposed Rules

Element Capital has significant concerns with the Proposed Rules. Above all, we are concerned that the Proposed Rules (a) blur the line between dealers and traders by materially changing what constitutes dealer activity without regard for significant differences in market function and established judicial and SEC precedent; (b) will result in significant unintended

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consequences, including harmful impact on U.S. securities markets generally due to reductions in liquidity, less efficient price discovery and increased cost of capital-raising for companies and the U.S. government and (c) impose very large costs and other negative impacts on private funds and their investors with little discernible benefit.

Element Capital's principal belief is that the Proposed Rules are in many respects overbroad, and in other respects, either not properly designed to achieve the SEC's purpose or completely unnecessary. Our assessment of the Commission's purpose behind the Proposed Rules suggests that meaningfully less burdensome alternatives exist to achieve those purposes. We offer some ideas as to alternatives below.

Element Capital also believes that if the Commission chooses to adopt the Proposed Rules, then specific modifications to the Proposed Rules will be required to improve their effectiveness, mitigate adverse consequences, and reduce costs. We offer those specifics below.

Part II and III of this letter presents our comments regarding the Proposed Rules and our recommendations for improvement. Part IV concludes this letter with our offer of assistance to the Commission.

II. COMMENTS TO THE PROPOSED RULES

2.1 The Proposed Rules blur the definitional line between a dealer and a trader and remove certainty from the marketplace

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." Section 3(a)(5), however, specifically excludes "[…] a 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.) Section 3(a)(44) of the Exchange Act defines "Government Securities Dealer" in a materially similar way.

Traditionally, the Commission and its Staff has interpreted the phrase "not as part of a regular business" to differentiate between traders and dealers. In multiple instances, the Commission and its Staff has noted the distinction between a "trader", who trades securities for his/her own account, on a speculative view, and who profits from market movements that are consistent with such view, and a dealer, who acts as a market intermediary and seeks to make a commission or mark-up in a manner that is agnostic to the market movement of the underlying instrument. This guidance has served the industry well for decades and is generally well-understood by market participants and practitioners of securities law.[1]

[1] For example, in a seminal 1987 "no action" letter, SEC Staff outlined 10 factors that differentiate a trader from a dealer:
(1) issuance or origination of securities that would qualify as government securities under the Exchange Act, as amended;
(2) participation in a selling group or underwriting government securities;

The Commission differentiates between dealers and traders because these are, at their core, different marketplace functions, rooted in different interests. The trader profits from the pursuit of a successful investment strategy, while the dealer profits from the function of effecting transactions. In this regard, the Commission has repeatedly described the dealer's interest as a "salesman's stake", and noted that dealer registration, and its many burdens, exist to protect investors from those who profit solely from the occurrence of a transaction, without regard to the success or failure of the underlying investment strategies.[2]

Dealer regulation has been designed to regulate the dealer's incentives. Application of dealer registration and its corresponding rule set to those who act otherwise in the marketplace will create unnecessary regulation and unintended consequences. The Commission has always considered the dealer's function together with the dealer's incentive when designing dealer regulation.

The Proposed Rules would revise the definition of "dealer" by deeming certain activity to constitute "part of a regular business" for purposes of Section 3(a)(5) of the Exchange Act. The two Proposed Rules would set forth qualitative standards designed to identify market participants who assume certain dealer-like roles, in particular seeking to identify those who as act as "liquidity providers" in the markets. These qualitative standards identify 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;

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

(3) purchasing or selling government securities as principal from or to customers;
(4) carrying a dealer inventory;
(5) quotation of a market in government securities or publication of any quotes;
(6) advertising or otherwise holding itself out as a government securities dealer, such as holding itself out as being willing to buy and sell particular government securities on a continuous basis;
(7) rendering any incidental investment advice;
(8) extending or arranging for the extension of credit to others in connection with government securities;
(9) running a book of repurchase and reverse repurchase agreements on government securities;
(10) using an interdealer broker to effect any government securities transactions.
See SEC Staff "no action" letter regarding the Continental Grain Company (October 28, 1987).

[2] *See, e.g.,* SEC Staff letter to G. Nelson Mackey, Jr., Brumberg, Mackey & Wall, P.L.C. (May 17, 2010). *See also*, "*Regulating in the Dark: What We Don't Know About Finders Can Hurt Us*" speech by Commissioner Allison Herren Lee (Oct. 7, 2020) ("[M]any of the past no-action letters in this space emphasize this point, stating: "Registration helps to ensure that persons who have a 'salesman's stake' in a securities transaction operate in a manner that is consistent with customer protection standards governing broker-dealers and their associated persons.")

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. (Items (i) through (iii) above, the "Qualitative Standards")

We are concerned that the Qualitative Standards, standing alone, do not differentiate between traders and dealers, and will necessarily therefore impose dealer registration in circumstances where it is unwarranted. As a specific matter, we find the drafting of the Qualitative Standards lacking in clarity in multiple important ways. For example:

- The Proposed Rules will deem a person who "routinely" makes "roughly comparable" purchases and sales of "the same or substantially similar" securities in a day to be a dealer. We believe that the terms "routinely", "roughly comparable", and "substantially similar" are each vague, and the cumulative effect of using all three in the same Qualitative Standard is to render this Qualitative Standard very difficult to interpret. Without revision to, and clarification of, these vague terms, this Qualitative Standard will clearly capture many short-term investment strategies engaged in by traders that are not indicative of dealer functions.

- We also believe that the use of the term "routinely" in the Qualitative Standard is inherently ill-suited to the task at hand, in that "routine" trading can indicate market making, which implies a dealer function, but can also indicate the day-to-day activity of a private fund's trading desk. Our recommendation is that the use of the word "routinely" must be supplemented with some clarity as to the function of the person trading "routinely".

- The use of the terms "roughly comparable" and "substantially similar" are also inherently vague and require further clarification and definition. The problem with the use of these terms is that the Commission seeks to identify trades that serve a subjective purpose – dealer function – but does so by using terms that are meant to create an objective category: roughly comparable purchases and sales of the same or substantially similar securities. The mismatch between the subjective purpose and the objective standard will of necessity be overinclusive.

- The Proposed Rules will include a person who is "routinely expressing trading interests that are at or near the best available prices on both sides of the market". Our view is again that the use of the word "routinely" establishes a poor test that will necessarily be overinclusive, as it seeks to identify a functional category based on a standard that is subject to broad interpretation. Again, our recommendation is that the use of the word "routinely" must be supplemented with some clarity as to the function of the person trading "routinely".

- As part of the Qualitative Tests, a person could be deemed to be a "dealer" on the basis of "capturing any incentives offered by trading venues to liquidity-supplying trading interests". In this regard we note that such arrangements are often organized in a manner that allows traders (or their investment advisers) to reduce overall commissions and fees paid by directing liquidity-providing trades to specific venues. The optimization of commission costs by an investment adviser on behalf of investors, or by a trader acting on his or her own behalf, should not by itself require registration as a dealer for a person who is otherwise a trader.

While a broad reading of the Qualitative Standards will necessarily include persons who are not dealers in the registrable category, a more tailored reading of the Qualitative Standards reveals their unnecessary nature: a person who earns her or his compensation principally from capturing bid-ask spreads may, depending on the specific facts, have the "salesman's stake" that has traditionally been identified by the Commission as the root of dealer registration. At the same time, we note that courts, and the Commission, have always understood dealer status to be based on the facts and circumstances of a person's conduct.[3] As recommended below, the Commission is already well-placed to identify, analyze, and if appropriate compel the registration status of such persons.

2.2 The Proposed Rules will result in significant unintended consequences, including harmful impact on U.S. securities markets generally

While some market participants may decide to bear the regulatory burdens and costs of dealer registration under the Proposed Rules, we believe that many market participants, including registered investment advisers to private funds, may decide or be compelled to cease, modify or curtail their trading activity so they would not be required to register as dealers or government securities dealers under the Proposed Rules. Particularly with respect to government securities and the Quantitative Test set forth in the Proposed Rules, if these large traders reduce or cease their trading activity it could increase the cost of funding for the U.S. government, and leave the Treasury market vulnerable to short term volatility, disruption and dysfunction, which will impact other markets, including the equity markets. Recent economic conditions, rising interest rates and inflation not seen in several decades have created significant uncertainty and have already significantly impacted liquidity in the Treasury market. Regulations that may cause large market participants to modify or cease certain trading activities should be carefully crafted to avoid unnecessary further negative consequence to markets.

[3] *See, e.g.,* "Statement Regarding Neovest, Inc.", Commissioner Hester M. Pierece (June 29, 2001) ("Receiving transaction-based compensation and soliciting customers are relevant to determining that an entity is a broker only to the extent that they occur in connection with broker activity. That a firm receives transaction-based compensation in connection with securities-related activities may indicate that it is "engaged" in a "business," but absent a showing that that business is the effecting of securities transactions on behalf of others, transaction-based compensation does not make a firm a broker. In at least two cases, courts have rejected the Commission's argument that a person who received transaction-based compensation in connection with securities transaction was a broker by virtue of that compensation.") (Footnote omitted.) *currently available at* https://www.sec.gov/news/public-statement/peirce-statement-neovest-062921.

2.3 The exceptions found in the Proposed Rules are too narrow

The Proposed Rules contain two exceptions.

(i) A person that has or controls total assets of less than $50 million; or

(ii) An investment company registered under the Investment Company Act of 1940.

In our view these exceptions are too narrow. First, the Commission has noted that the "frequency and nature" of the activities of persons who own or invest less than $50 million "are less likely to pose the types of financial and operational risks to the market that may be associated with … dealer-like activity."[4] Element Capital believes that, with respect to traders, this threshold appears to be too low. Our principal recommendation is that the Commission conduct thorough research into an appropriate *de minimis* threshold.

Second, the Commission notes that the "regulatory framework" to which registered investment companies are subject justifies the exclusion of these entities. However, Element Capital believes that the current regulatory environment and framework for registered investment advisers is also very robust, and therefore recommends that registered investment advisers and the private funds they advise should also be excluded from the Proposed Rules.

Specifically, the Investment Advisers Act of 1940, as amended (the "Investment Advisers Act") imposes a comprehensive regulatory regime, which includes requirements regarding custody of assets, recordkeeping, transactions with affiliates and other conflicts of interest, and, critically, imposes a fiduciary duty on the investment adviser, among other things. In their trading activity, registered investment advisers, like broker-dealers, must seek best execution on behalf of their clients and are subject to antifraud rules. In addition, the fiduciary duty standard to which registered investment advisers are subject under the Investment Advisers Act is a higher standard than the standard applicable to dealers. Registered investment advisers are required to register under the Investment Advisers Act, and must adopt, implement and review at least annually written policies and procedures, including a code of ethics, reasonably designed to prevent violations of the Investment Advisers Act and other federal securities laws. Registered investment advisers to private funds also must periodically report to the Commission on Form PF, which provides a high level of transparency regarding many aspects of the investment operations, portfolio holdings, risk metrics and counterparty exposures, among other things, of the private funds they advise. In particular, large private fund advisers must file Form PF quarterly with the Commission. Moreover, registered investment advisers are subject to regulatory examinations and inspections by the Commission. As a result, the Commission has extensive oversight of registered investment advisers and broad insight into their operations and activities.

In light of the regulatory structure that governs registered investment advisers, which addresses, among other things, the types of concerns the Commission seeks to address in

[4] *See* the Proposing Release at text accompanying footnote 101.

the Proposed Rules, we recommend that the Commission exclude registered investment advisers and the private funds they advise from the application of the Proposed Rules.

2.4 The application of the Proposed Rules to non-U.S. entities creates difficulties

If the Commission determines to proceed with adoption of the Proposed Rules, it will be important for the Commission to outline the territorial application of the Proposed Rules. In particular, we respectfully request that the Commission provide guidance regarding the application of the Proposed Rules to non-U.S. persons, including non-U.S. investment vehicles ("Offshore Funds").

With respect to Offshore Funds, we recommend that the Commission exclude from the application of the Proposed Rules any Offshore Fund that <u>either</u> (a) conducts business with a U.S.-registered, U.S.-resident broker-dealer, or (b) conducts business with a U.S.-registered, U.S.-resident investment adviser, including if the U.S. registered investment adviser has discretion over the activities of the Offshore Fund. Failure to offer this clarification could cause Offshore Funds to avoid U.S. service providers to the great disadvantage of the U.S. financial industry. Clarification of this nature is also consistent with the Commission's Regulation S,[5] and with Commission Rule 15a-6 and interpretive guidance thereunder.[6]

2.5 Persons who are required to register solely as a result of the application of the Proposed Rules will require relief from certain SEC and FINRA regulation

In addition to clarification of the territorial ambit of the Proposed Rules, we note that various SEC and FINRA regulations regarding the activities of dealers are fundamentally incompatible with the activities of investment advisers, often as a result of the application of an investment adviser's fiduciary duties. We therefore recommend that Commission and FINRA Staff conduct a top-to-bottom review of whether and how the comprehensive web of broker-dealer regulation will apply to registered investment advisers and/or the private funds they advise who are required to register as dealers solely by operation of the Proposed Rules ("**<u>Required Registrants</u>**"). For example, even a cursory review of the panoply of broker-dealer regulation suggests the need to consider exceptions from the application of the following rules for Required Registrants:

- Licensing of personnel who structure private placements on behalf of Required Registrants with the Series 79 license. The investment banking representative's license seeks to register those who act in the capacity of an intermediary with respect to investment banking activities, not those who are structuring private placements on behalf of investment advisory clients.

[5] *See* Regulation S at Rule 902(k)(2).

[6] *See* SEC Staff "no action" letter to Giovanni Prezioso dated January 30, 1996 (known as the "Seven Firms Letter").

- Licensing of personnel who act on behalf of Required Registrants in a capacity that might otherwise require registration as a Securities Trader under FINRA Rule 1220(b)(4). Again, this licensing seeks to regulate intermediary activity and is incompatible with the fiduciary duty of an investment adviser.

- Application of FINRA Rules 2241 and 2242, and licensing of associated persons of Required Registrants (or their investment advisers) as research analysts, unless such persons provide single-name equity or fixed-income research to third-parties in a broker-dealer capacity, *i.e.*, where any advice provided in securities research is ancillary to a sales and trading function.

- Application of Regulation NMS Rule 611 to cross-trades effected on behalf of a Required Registrant by its investment adviser.

- Application of the net capital Rule 15c3-1 to Required Registrants (see discussion below).

- Registration of a collective investment vehicle as a dealer will create uncertainty as to the status of such person under the New Issues Rule, FINRA Rule 5130, which prohibits broker-dealers from receipt of IPO allocations, but permits collective investment vehicles to receive IPO allocations based on their beneficial ownership.

- Dealer definition will deprive Required Registrants of customer status under Rule 15c3-3.

- Application of the possession and control requirements of the customer protection rule, Rule 15c3-3, in situations where hypothecation of securities may be in the best interests of an investment advisory client.

When rules are applied to categories of registrants to which they were not intended, unintended consequences are the result. Without a comprehensive, top-to-bottom review of the SEC and FINRA rulebooks to identify and mitigate unintended consequences of the Proposed Rules, we believe that those unintended consequences may result in confusing and conflicting regulatory obligations with respect to Required Registrants.

2.6 *The Proposed Rules vastly understates the costs of dealer registration*

2.6.1 The costs of initial registration for large entities are enormous, and the operational challenge of such a registration process is daunting for individual firms and in the aggregate.

As noted above, one reality of the Proposed Rules is that Required Registrants will be large trading entities. As a practical matter the registration of large trading entities — and particularly the FINRA membership process — is a lengthy and complex matter, requiring the submission of dozens of documents and the demonstration of a high level of sophistication by the

prospective general securities principals, the prospective Chief Compliance Officer, and the prospective Financial and Operations Principal ("FinOp"). FINRA often issues as many as 100 comments to a large trading entity seeking registration, in addition to the review of dozens of documents and the interview of key principals in a pre-membership interview. Further, Required Registrants are likely to use complex technology that may need to be adapted to comply with the panoply of trading rules that apply to dealers. We are informed that it is FINRA's practice, as part of the new member process, to require demonstration of critical proprietary software and/or algorithms of prospective members. Finally, the registration of large trading entities may require personnel of registered investment advisers to complete as many as three or four examinations each, all while fulfilling their roles and responsibilities as supervised persons of the applicable registered investment adviser.

The Commission's estimates of initial and ongoing costs of dealer registration[7] are very low—in each case, off by multiples. Further, the Commission's estimate of initial costs does not appear to take into account entire categories of costs, such as (a) the drain on time and management resources that will attend to a complex business and operational change process such as grafting the universe of dealer regulation onto Required Registrants, or (b) the time and resource drain of multiple licensing examinations for management of the Required Registrant.

2.6.2 Imposition of the net capital rule on a private pool of capital will materially affect the activities of Required Registrants.

Special attention needs to be paid to the application of the net capital rule, Rule 15c3-1, to Required Registrants. This is because the application of the net capital rule to private fund trading activities has the potential to materially impact their trading activities. Specifically, the net capital rule imposes deductions from regulatory capital, or "haircuts" on positions held on dealers' balance sheets. These deductions are a meaningful cost to a dealer's business, often requiring the freezing of real capital in order to support the notional risk haircut. Notably, *the Proposing Release never analyzes the impact of the net capital rule on the cost of Required Registrants' trading*.[8] This is a material oversight in the Economic Analysis of the Proposed Rules.

The Commission also notes that Required Registrants will incur a burden to provide notices of withdrawals under the net capital rule, without considering the burden on Required Registrants that are structured as private investment funds that will arise from the imposition of

[7] The Commission estimates initial and ongoing costs of registration as $600,000 (one time) and $268,000 (annually), respectively. *See* the Proposing Release at text accompanying footnote 268. With respect, these costs are low in every respect, and do not reflect the real costs of registration for a large trading entity. In terms of quantum of costs, the estimate of ongoing costs appears to neglect, among many costs, the prospective cost of additional compliance personnel, whether through hiring or through the use of compliance consultants.
[8] The Proposing Release looks at the burden of the net capital rule from the perspective of required notices under the net capital rule, without ever trying to measure the costs and burdens of maintenance of regulatory capital. This is like trying to measure the traditional costs of car ownership without considering the cost of maintenance, repairs, and gasoline.

new withdrawal "gates" on their investors. This is also a material oversight in the Economic Analysis of the Proposed Rules.

We believe that considerable study is required to accurately assess the impact of the net capital rule on Required Registrants.

2.6.3 The cumulative impact on private funds and their investors of unnecessary dealer registration will be substantial.

We believe it would be both wise and appropriate for the Commission to consider the Proposed Rules together with the impact of other regulations, and other pending rulemaking, on Required Registrants. In short, our view is that the imposition of the entire panoply of dealer regulation on certain trading firms, while at the same time increasing the burdens on such firms in other areas, will be, at best, a meaningful burden. In particular, we note that the recent implementation of CAT reporting, the forthcoming overhaul of advertising regulation for investment advisers, and the Commission's recent rule proposals regarding Regulation ATS, private fund advisers, and beneficial ownership reporting, to name a few, will combine to materially increase the burden on Required Registrants. There is no effort in the Proposing Release to consider the cumulative burden on Required Registrants of the Proposed Rules with other relevant rules. We view this absence as inappropriate for Proposed Rules that are specifically designed to extend the ambit of an entire regulatory regime onto those who are already subject to a different and comprehensive regulatory regime.

2.7 The Proposed Rules neglect the substantial regulatory framework already in place

As noted above, we recommend that the Commission exclude Required Registrants from the application of the Proposed Rules. We state above the reasons for our conclusion that investment adviser registration has evolved to a point that it provides the Commission more than sufficient regulatory authority over the trading of Required Registrants that are, or that are managed by, registered investment advisers, and especially registered investment advisers to private funds that are required to file Form PF.

2.8 The regulatory improvements that the Commission is seeking are already within the Commission's authority

As discussed above, the analysis of reasonably available alternatives to the Proposed Rules is lacking in that it does not consider whether the Commission's current authority allows for sufficient regulation of Required Registrants.[9] For example, as noted above, the

[9] Specifically, the Proposing Release notes the consideration of the following alternatives: (1) raise or lower the quantitative factor; (2) replace qualitative standards with quantitative standards; (3) remove the exclusion for registered investment companies; (4) remove the exclusion from aggregation for registered investment adviser client accounts where the advisers only have investment discretion; (5) exclude registered investment advisers; (6) exclude private funds; and (7) require private funds and private fund advisers to report transactions. *See* the Proposing Release at text accompanying footnote 293. None of these considerations appear to have considered the use of existing tools by the Commission to better regulate persons of concern.

Commission can already require the registration of any person who is acting in the capacity of a dealer. Given this fact, the imposition of the entire universe of rules relating to dealers (including a requirement to retain investors' capital against notional regulatory capital requirements) on an arbitrary group of traders — some included solely because of trading volumes — is by definition overbroad and unnecessary relative to the relatively simple and efficient alternative of the Commission making inquiries with the proprietary trading firms (PTFs) referenced in the Proposed Rules that the Commission believes are acting as dealers without registering as such. Moreover, to the extent that any Required Registrant is itself, or is managed by, a registered investment adviser, the Commission has extensive regulatory authority. The Proposing Release makes no analysis of how many prospective Required Registrants are, or are managed by, registered investment advisers.

III. THE USE OF A QUANTITATIVE STANDARD IS OVERBROAD, AND THE THRESHOLD IS TOO LOW

For similar reasons, we believe that the use of a Quantitative Standard with respect to trading in government securities is overbroad. First, the Commission has for decades noted the functional differences between traders and dealers, and has never before suggested that volume of trading, in the absence of any other fact, warrants dealer registration and its burdensome attendant costs. Element Capital is supportive of smart regulation that protects investors but believes that it is neither in the interests of the market nor in the interests of investors to regulate government securities traders as dealers on the sole basis of trading volume.

Second, the use of an arbitrary volume test defining "dealer" for purposes of the Exchange Act raises important questions regarding the delegated authority of the Commission in this regard. When defining terms under the Exchange Act, the Commission must do so in a manner that is consistent "with the provisions and purposes" of the statute.[10] By proposing a single-factor, quantitative standard as a mechanism to irrefutably establish "dealer" status, the Commission risks exceeding the scope of its authority by defining this term in a manner inconsistent with the purposes of the statutory provisions under Section 3(a)(5) or Section 3(a)(44) of the Exchange Act. In its proposing release, the Commission acknowledges that the statutory language intends to differentiate traders from parties performing the function of a "dealer."[11]. The Proposed Rules' assignment of dealer status based exclusively on trading volume – without any consideration of the role of the trading party, the nature and purposes of the trades, and whether there was risk associated with the trades – potentially undercuts the acknowledged statutory purpose of maintaining a functional distinction between the roles of traders and dealers.

Under Chevron USA Inc. v. NRDC,[12] statutory interpretations posited by federal agencies must be reasonable and cannot be in excess of their authority. Enhanced scrutiny of the proposed single-factor, quantitative standard is warranted under Chevron in light of the long-

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[10] 15 U.S.C. § 78c(b)
[11] *See* the Proposing Release at [*].
[12] 467 U.S. 837 (1984)

standing interpretation – including by the Commission itself – that a holistic analysis of numerous factors is necessary to determine whether a market participant is acting as a "dealer."[13]

To the extent that the Commission chooses to proceed with the Proposed Rules, Element Capital believes that the very facts provided by the Commission regarding the Treasury market[14] speak to the need to raise the threshold of $25 billion of trading volume in government securities in each of four out of the last six calendar months (the "Quantitative Standard")[15]. According to data published by SIFMA and sourced from the Federal Reserve Bank of New York[16], the average daily transaction volume in the Treasury markets during the 16-month period including all of 2021 and January-April 2022 was approximately $637 billion, which equates to approximately $12.7 trillion average monthly transaction volume (assuming 20 trading days per month). Therefore, over such period, a threshold of $25 billion of monthly trading volume in government securities represents only 0.196%, or less than 20 basis points, of average monthly trading volume. Although we believe that the Quantitative Standard alone is inappropriate, by analogy to any reasonable materiality standard, it is even harder to justify a Quantitative Standard that is less than one percent (1%) of the monthly trading volume in the Treasury markets, measured on an ongoing basis.

Further, to the extent the Commission chooses to proceed with the Proposed Rules, Element Capital believes that some market-based factors that would be indicative of dealer activity must become part of the Quantitative Standard. In particular, trading activity that results in overnight investment positions (directional exposure) in government securities should be excluded from the Quantitative Standard for purposes of the Proposed Rules. This is consistent with the idea that dealers, in their intermediary functions, are not regular risk-takers.[17] Consistent with the position above, a person who is, for example, market making is rightly regulated as a dealer.

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[13] See, e.g., Continental Grain Co., *ibid,* 1987 WL 108902 (SEC No-Action Letter Nov. 6, 1987) (citing 10 factors relevant to the analysis of whether a party is acting as a dealer); Acqua Wellington North American Equities Fund, Ltd., SEC No-Action Letter, 2001 WL 1230266 (Oct. 11, 2001) (emphasizing the investor-type risks present that distinguished the firm from a dealer, including the absence of assurance of any active trading market for re-sale of the acquired securities).

[14] *See* the Proposing Release at text accompanying footnotes 5 *et seq*.

[15] *See* Proposed Rule 3a44-2(a)(2).

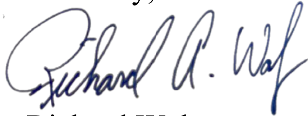
[16] *See* SIFMA, US Treasury Securities Statistics (May 5, 2022), *available at* https://www.sifma.org/resources/research/us-treasury-securities-statistics/#:%7E:text=Average%20Daily%20Trading%20Volume%20(as,trillion%2C%20%2B8.9%20Y%2FY.

[17] By contrast, we note that a person who ends every day, or most days, without economic exposure, would not necessarily qualify as a "dealer", notwithstanding the absence of overnight risk. Again, our view is that a review of the activities of the person must be evaluated at least in part against a functional definition.

IV. CONCLUSION

We appreciate the opportunity to provide comment on the Commission's proposed modifications to the definition of "dealer". Element Capital would be pleased to discuss any comments herein, or provide any additional assistance as the Commission proceeds with the rule proposal. Please do not hesitate to contact the undersigned at [redacted] if you have any questions.

Sincerely,



Richard Walz
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Element Capital Management LLC